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Regulatory issues surrounding PII arrangements in legal services provision

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This advice has been prepared by George Yarrow, Chair of the Regulatory Policy Institute (RPI) at the request of the Legal Services Board to help inform its thematic review of regulatory restrictions on choice of insurer.

It sequentially addresses: general features and issues in insurance markets, including more specific features/issues relating to PII insurance and to mutual insurance; competition and regulatory principles relevant to assessment of PII arrangements in legal services; questions that should be asked by the LSB and by ARs when assessing such arrangements; and types of data and information that would be relevant in seeking to answer those questions. It ends with some very brief comments on preventing unwanted divergences in approach between the LSB and ARs when considering PII requirements.

Features of insurance markets

Insurance markets have distinctive features deriving from the limited information available to insurers about the risks attributable to different clients. Risk assessment is a costly and far from exact activity.

The problem is more straightforward to address when the population of clients is large and the events to be insured against are easily definable and general to the population, life insurance being the most obvious example. Insurance can then be priced against reasonably ‘objective’ statistical distributions, e.g. of mortality rates.

Even in these large-population/easily-definable-events cases, however, there are difficulties, including *adverse selection*: an insurance contract with given terms will be more attractive to those who believe they face higher than average risks than to those who believe they face lower than average risks. Those with low risks may choose not to participate in the insurance market (i.e. choose to ‘self insure’). This leads to a client base with higher average risks than the population as a whole, implying higher prices. In some contexts this might provide a rationale for compulsory insurance. Examples of compulsion include vehicle insurance and health insurance in publicly-organised, insurance-based health services.

In cases where those with higher risks do nevertheless participate in the market, if insurance is priced similarly for a group of insurees comprising a mix of higher and lower risk customers, the former will benefit more than the latter from the arrangements. In some circumstances this can imply a degree of cross-subsidisation among insurees, i.e. a situation in which some customers actually pay less than the economic costs of providing their insurance, with the associated losses being recouped from other customers who pay more.

Where, as is usually the case, the insured party has some degree of influence or control over the risks, there is also the problem of *moral hazard*: the existence of insurance can attenuate the incentives for, and hence resources or effort devoted to, risk reduction. In this case compulsion is not in itself a full solution to the problem. Example: legal requirements for cars to have air-bags and for drivers and passengers to wear seat belts may lead vehicle drivers to exercise less caution.

Both moral hazard and adverse selection problems can be alleviated if there exists information that allows for a finer classification of clients into smaller groups with differing risk characteristics. No-claims discounts for auto-insurance are an example. In the limit,

there can be bespoke tailoring of insurance arrangements with premia based on individual claims records (effectively an automatic updating of risk-assessment based on recorded events that are implicitly assumed to provide additional information about levels of risk).

This last point emphases the centrality of *information conditions* when considering relevant issues: *who knows what about the relevant risks, and how easy/costly is it to collect additional information about the risks to be insured?* Thus, tailored pricing may only be economically viable for large contracts.

Features of PII insurance

In general PII insurance for legal services providers (LSPs) typically involves relatively small numbers of clients for insurers, at least when compared with categories such as life insurance, vehicle insurance and home insurance. However, *whether or not the characteristics of PII for LSPs are significantly differentiated from PII for other professional groups is a matter for empirical assessment*: it cannot simply be assumed that supply of PII to LSPs comprises a distinct market or market segment. The same point applies to possible differentiation among sub-categories of LSPs, for example among the group of providers regulated by different ARs.

The relevant focus when considering PII is on harm caused by *fraud* and *negligence*, but the conduct that might lead to or be classified as fraud and/or negligence is not straightforward to define and categorise with great precision. At root these are again information problems and is appropriate to recognise that providers of insurance to legal services firms operate in a difficult market, a point that was stressed by insurance providers in the course of the RPI's LSB/Law Society study of barriers to entry, exit and mobility in the market for solicitors' services (consistent with evidence on the exit of insurance providers from the supply of PII to solicitors).[2]

Subject to inevitable information constraints and resulting imprecisions, ARs might nevertheless be reasonably be expected to have informed views on questions such as: *What counts as fraud or negligence (e.g. how are such patterns of conduct to be distinguished from, say, inefficiency)? What types of business arrangements give rise to risks of their occurrence? How prevalent are these types of conduct? How frequently does harm eventuate? What is the profile/distribution of the magnitude of harms?*

Since these are questions that insurers can be expected to ask in specifying and/or pricing PII contracts, insurance providers should be a rich source of information on the relevant matters. It is therefore advisable for ARs to engage in dialogue with actual and potential insurers to establish a good and regular flow of information about current and potentially upcoming issues.

At the same time, care needs to be taken not to take the views of insurance providers as normative (rather than simply as sources of information). This follows from the underlying informational problems of insurance markets: put at its most basic, it cannot be assumed that competitive insurance markets are necessarily the most efficient alternative. That would beg a number of regulatory questions. Example: a profit-seeking insurer might choose not to

[2] https://research.legalservicesboard.org.uk/wp-content/media/RPI-Final-Report-for-LSB-and-TLS-15-December-2013.pdf

insure a particular professional service provider and consequently prevent that provider from operating in circumstances where, from a wider perspective encompassing consumer and competition considerations, its operation would be advantageous.

It is always a good idea to ask who benefits from the relevant insurance since this can differ from market to market. In the case of PII for LSPs there appear to be three types of beneficiary:

1. The legal services business against which any claim is made, whether a sole trader or a larger business. In the case of a larger business, the insurance affords financial protection against the consequences of negligence by some of its members. In the sole-trader case, the financial protection is enjoyed by the individual. In both cases there may also tend to be a reputation effect. If customers are informed about the existence of PII and are comforted by that information (because they have better prospects of making a successful claim in the event of harm), it will tend to increase demand for the services offered by the provider.

2. Other providers of similar legal services. In this case the negligence of some LSPs is liable to cause damage to the reputation of LSPs more generally, and hence to the latter's own net incomes. This can occur when customers lack full information about the PII positions of different providers. If clients/customers are inadequately indemnified for the harms caused (because of lack of insurance), it will tend to have a chilling effect on the relevant *market* demand. This is another information effect – the inadequacy of indemnification from one (offending) provider leads to a downgrading in expectations about the protection available from other providers – usually expressed in terms of the 'reputation' of the profession. In economic terminology, the effect can be characterised as an *inter-supplier externality*.

3. Clients or customers of legal service providers who (a) would otherwise be inadequately indemnified for the harm caused by the offending conduct and/or (b) whose downgrading of expectations (see the previous point) might cause them not to engage in what would, in fact, be beneficial market activity.

Categories (1) and (3b) account for the propensity of professionals or professional service businesses to take out PII across all professional services markets (not just in legal services markets).

Categories (2) and (3b) provide a rationale for self-regulation in professional services with respect to insurance.

Category (3a) is a concern of higher-level public policy.

There is, however, a major question about whether (2) and (3b) are sufficiently strong as to provide adequate incentives to self-regulatory bodies. Since the issue is closely connected with competition effects, its consideration is deferred until later.

Mutual insurance

As noted, markets for the provision of professional indemnity insurance for legal services can be difficult markets for insurers to operate in and one of the issues is the extent to which there

is vigorous competition among insurers. Since PII can be a non-trivial cost component for LSPs, problems in the ('upstream') insurance markets (due, say, to limited competition, adverse selection and moral hazard) can lead to higher costs in the ('downstream') legal services markets. If this happens, it is obviously to the disadvantage of clients/customers of LSPs.

One adaptation to such difficult conditions in other parts of the economy is mutual insurance (as an alternative to 'for-profit' provision). It is advisable, therefore, that ARs be familiar with the pros and cons of mutual insurance when they engage in rule-making or rule-assessment in relation to PII issues.

In effect, mutual provision of insurance is a form of vertical integration. The legal service providers (who supply the downstream market) collectively undertake to engage in insurance activities (the upstream market) to meet their own insurance requirements. An initial understanding of the pros and cons of this type of arrangement can therefore be aided by considering the advantages and disadvantages of vertical integration more generally.

Perhaps the most relevant of the advantages derive from:

a. The informational complexity of the buyer/seller interface, including the amount of detailed information involved and the extent of asymmetries in information between buyers and sellers of insurance. This varies across different types of insurance market, but, in general, the greater the degree of complexity the more difficult it is to write contracts that define contractual obligations with any great precision in the range of contingencies that may be relevant.[3]

b. The resulting conflicts of interest that can occur when contractual obligations are not clear. Thus, in the event that a claim is triggered, a for-profit provider has a commercial interest in interpretations of contractual provisions that would reduce its payments[4], whereas the insured party has precisely the opposite interest. This can lead to disputes and resulting costs of dispute resolution, including delay in payments. Such disputes are a familiar feature of insurance markets.

Under mutual insurance arrangements, those involved in assessment of claims sit 'across both sides of the market'. There is still a tension between the collective interest of the LSPs (in seeking to keep PII costs down) and the interest of the particular claimant, but the divergence of interests is lessened since lower or slower payment of claims will itself have some negative effect on the collective interest (recall that each legal service provider benefits from the protection afforded to other providers, via collective reputational effects). The reduction in conflict of interests may also help to make insurance provisions easier to specify *ex ante*, since interpretation can be expected to be more flexible *ex post* in response to particular contingencies (the possibility and consequences of which might in other circumstances need more careful thought and consideration *ex ante*, which in turn tends to raise costs).

[3] To the extent that more and better information is discovered, there can be consequential benefits for a supervising regulator. On the other hand, if the effect of mutual provision of PII is to reduce the number of insurance providers (in the limit to just one), it can reduce the variety/diversity of sources of information available to a regulator. This then is another trade-off to be considered.

[4] This is mitigated to some extent by reputational effects in markets for insurance, and the degree of mitigation can be expected to be a function of the particular characteristics of the relevant insurance market.

Against these potential advantages, and assuming that the mutual insurance provision is focused only on the relevant group of users (i.e. a mutual provider does not seek to provide PII insurance to other types of professionals), is to be set a potential loss of any economies of scope in PII provision. For example, for-profit providers may be able to obtain efficiencies in risk-assessment capabilities and in administrative costs if they provide services to a wider range of professional clients. They may also be able to achieve scale economies. Much will depend here on the distinctiveness of the businesses of the relevant professionals (*how similar is the risk assessment exercise to that for other groups of professionals?*) and the collective magnitude of their insurance requirements.

These points are closely related to general arguments developed in a (mini-classic) article of Professor George Stigler, itself based on the second chapter of Adam Smith's *Wealth of Nations*, which explicitly covers vertical integration issues.[5] Briefly, Stigler argued that, other things equal, the benefits of vertical integration tended to be greatest when the sizes of both output (here legal services) and input markets (here PII) are relatively small, which tends to be the case when an industry or market is in the very early or very late stages of its life-cycle. Hence, vertical integration might be expected to be observed more frequently be observed in these early and late stages. The 'small market size' points appears to be reflected in the OFT's analysis of Scottish LSP arrangements (2004).

More generally still, it is commonplace to find differences in business arrangements that are driven by differences in commercial contexts. 'One size fits all' approaches are not to be found in many regulatory structures, the most obvious type of example being the frequently observed (across economic sectors) linkage of regulatory requirements to some or other measure of the size of business. That is, smaller businesses are frequently subject to less stringent regulatory requirements. *The most important question when considering such 'calibrated' regulation is simply whether or not any differences in the rule-books are appropriately/proportionately adjusted to clearly identified variations in the relevant business or market contexts, bearing in mind the underlying regulatory purposes or objectives that are in play.*

A good case study of the trade-offs between mutual and for-profit insurance is to be found in the shipping sector, since the relevant issues have been considered and debated since the 18th century and mutual insurance arrangements in the form of 'Protection and Indemnity clubs' (P&I clubs) have featured in relatively recent EU competition law investigations.[6]

Competition and regulatory principles

The Legal Services Act sets out a series of regulatory objectives, some of which are related to the distinct characteristics of legal services markets – e.g. *promoting and maintaining adherence (by authorised persons) to the professional principles* – and others that are to be found more generally in public supervision of economic activities (e.g.s. the competition and consumer protection objectives).

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[5] G. Stigler, "The Division of Labour is Limited by the Extent of the Market", *Journal of Political Economy,* 1951.

[6] See http://europa.eu/rapid/press-release_IP-12-873_en.htm and D. Semark, *P&I Clubs: Law and Practice*, 4th edition, London: Informa Law, 2010.

Professional rules (including in regard to PII) are clearly a form of regulation: they exist to influence or govern the conduct of service providers. As such, it is appropriate that rule-making and enforcement satisfy general principles of regulation. In particular, rules should serve a clearly identified purpose and be proportionate. They should not, for example, have significant effects that go beyond the identified, transparent purpose, as could happen for example if they have avoidable, adverse effects on competition.

As noted above, a particular set of regulatory arrangements that is effective in addressing the issue of maintaining the collective reputation of a particular type of LSP will not necessarily be effective in achieving competition and consumer objectives. The latter objectives are made explicit in the legislation precisely for this type of reason.

To the extent that they impose obligations on LSPs, professional rules relating to PII arrangements clearly have effects on both legal services (downstream) and PII (upstream) markets, Standard regulatory and/or competition principles are therefore clearly relevant to their assessment, and assessment should, equally clearly, encompass both sets of markets (a point of significance when considering the regulatory objective of the Legal Services Act 2007 concerning competition among legal services providers, as discussed below).

In relation to legal services markets, most of the major competition issues surrounding PII have been covered in relation to solicitors in previous reports by CRA[7] and by the RPI.[8] Similar considerations apply in other legal service areas although, as always, adjustments to the analysis are appropriate to reflect specific differences in economic contexts, the existence of mutual insurance arrangements being a case in point.

Being less focused on profit-seeking, mutual arrangements can lead to a greater proclivity for 'price averaging' across varying levels of risk and a greater potential for cross-subsidisation among insurees. Such a tendency can in turn can have mixed implications for competition among LSPs: on the one hand it may facilitate new entry and help sustain a larger number of competitors in the relevant legal services market, on the other hand it can dull incentives to compete on quality of service (because a lower risk of performance failures may be less well reflected in PII costs). This kind of trade-off between different aspects of competition is familiar in the application of competition law to vertical agreements.

Given that the supply of most legal services is characterised by significant or large numbers of competing providers, the competition issues are chiefly centred on potential effects of PII requirements on barriers to entry, exit and mobility.[9] That is, supplier concentration issues tend to be less central than in, say, the types of cases that typically come before the Competition and Markets Authority. Once more, however, there is a requirement to pay close attention to the specifics of a particular context: as the comments on mutual arrangement indicate, competition can be *distorted* even when there is a large number of competing suppliers.

The effects of professional rules on (upstream) PII markets are less well examined, perhaps because the LSB and ARs have no explicit objectives/duties in relation to these markets. The

[7] http://www.sra.org.uk/sra/how-we-work/reports/cra-financial-protection-arrangements.page
[8] *Op cit.*
[9] Mobility refers to the ability of providers to move from one type of business model or structure to a significantly different business model or structure.

operation of PII markets does, however, have potential competition effects downstream including implications for clients/customers of LSPs: if, for example, PII markets work inefficiently, PII costs for legal firms will be higher and that in turn will tend to imply that LSP clients/consumers will end up paying more.

Professional rules can be expected to have economic effects on insurance markets that are similar to effects to those that would eventuate if the relevant firms had simply come together and entered into a horizontal agreement on the relevant points. Indeed this is precisely how the aforementioned P&I clubs in shipping operate. It is unsurprising therefore that the P&I arrangements have attracted the interest of the Competition Directorate of the European Commission. Given this, it can often be helpful to 'remove the veil of regulation' and ask *how might we look at the effects of these arrangements if they had arisen as a result of a multi-party agreement among businesses?*

More generally, collective buying arrangements have always been a matter of interest in antitrust and competition law because of their potential implications in downstream markets, particularly when the arrangements cover a significant fraction of downstream firms' costs. The issue is that they can cause a significant reduction in competition among downstream providers in the procurement of their major inputs and this is a dimension of competition that can have bearing on downstream firms' own costs and quality of service (e.g. in PII the level of protection they provide to clients/customers of LSPs). It is this 'related market effect' that is of relevance to legal services regulators.

Thus, even though such procurement arrangements relate directly to business conduct in an insurance market, not directly to business conduct in legal services markets, they can have consequences for competition in legal services markets, i.e. for competition between authorised persons which is set out as a regulatory objective in the Legal Services Act 2007. Approved regulators should, therefore, take account of these potential consequences of PII arrangements in the course of seeking to achieve their statutory objectives.

The fact that there are potential competition problems in relation to PII arrangements does not, of course, imply that there is, or is likely to be, an actual problem. This is recognised in the EU insurance block exemption. In general, competition policy tends to be more concerned about inter-firm agreements among suppliers (here the insurance companies) than among their customers (here the professional service businesses seeking PII), but, in recognition of some of the specific features of insurance markets, competition law practice even takes a relatively benign view of certain types of co-operative behaviour among *suppliers* of insurance, for example in sharing information that would allow for more effective risk assessments. Nevertheless, those who would seek to benefit from such exemptions need to be clear that the necessary conditions are satisfied. There is therefore a compliance obligation to be discharged.

Questions that should be addressed by the LSB and ARs

The LSB wishes to understand the relevant economic considerations for its work in reviewing regulatory restrictions imposed by approved regulators (AR) on authorised persons' choice of professional indemnity insurance (PII) provider. At the most basic level, assessment of an existing set of arrangements must involve assessment of a hypothetical, alternative set of arrangements (a 'counterfactual').

The most obvious alternative set of arrangements (counterfactual) is a situation in which the relevant restrictions did not exist, and hence the most obvious question is:

How might things develop if the restrictions were removed?

This is a good question to ask in that it tends to stimulate thinking at a fairly fundamental level, provided, of course, that easy answers – "there would obviously be terrible consequences, so it is not worth thinking very much about them" – are resisted. The point is that it is worth thinking through this issue, irrespective of whether simple 'deregulation' is considered, *ex ante*, to be a likely prospect. Call this the 'zero option'.

In reality, there will be a number, possibly a large number, of other potential counterfactuals, one for every possible, alternative formulation of regulatory requirements in relation to PII. For practical purposes, the number of alternatives to be considered will need to be very substantially reduced relative to the possibilities. Two useful criteria for doing this are embodied in the following questions which might be asked of a candidate option:

Is it (the option) likely to be sufficiently differentiated in its effects from both the status quo and the zero option to be worth considering in detail, given the constraints on regulatory/assessment resources?

Is it a realistically feasible option?

The second of these questions is important because there can be tendencies in regulatory assessments towards undue focus on idealised notions of what a 'well-functioning markets' might look like, often based on speculative assumptions. This in turn can lead to disproportionality in regulation.

In considering realistic options current, *observable* practices provide an obvious first guide. Thus it might be asked:

What types of alternative approaches have been adopted for different types of legal service provider in England and Wales and in other jurisdictions?

This will not be enough on its own, however: if alternatives were always restricted to things that have been tried already, there would be no innovation. A further question is:

Are there other possible regulatory arrangements beyond those that have been adopted to date?

Greater care to test for realism will be necessary at this point, since the hypothetical options will not yet have been 'market tested', and there may well be greater uncertainty about effects.

In practice, counterfactual analysis tends to be an iterative process: it is not usually a matter of writing down a comprehensive list, at the outset, of all options to be considered. There are no hard and fast rules here, but a common sequence is to start with possibilities that are most easily evaluated, e.g. because there is readily available experience from other contexts on which to draw, and then to use accumulating knowledge to inform the development and assessment of further possibilities.

In respect of any particular counterfactual, substantial disaggregation will be necessary. For example, in the light of the earlier discussion, it can be asked:

What are the likely implications for PII markets?

What are the likely implications for the relevant legal services provision?

In relation to the first of these, it is desirable that all regulators have a good understanding of the workings of and issues in the PII markets, both in general and, for a particular AR, of any specific issue raised for those LSPs with which it is specifically concerned. The requirement for a general understanding of PII markets arises from the linkages between the sub-segments of the wider PII markets. For example:

Are there significant economies of scale and scope that have implications for the effectiveness of PII suppliers to meet the requirements of any particular type of legal services provider?

Much of the assessment exercise here is common across the ARs, so there should be scope for information/burden sharing and the LSB's role might be particularly important.

More generally in relation to PII markets, questions will need to be asked about the likely effectiveness of these markets, bearing in mind the type of problems raised by insurance provision. For example:

How effective is competition in the PII market?

How significant are the risks of default or of exit from the market by suppliers of PII?

Are these risks particularly sensitive to changes in PII trading conditions, e.g. such when circumstances give rise to a significant uptick in claims?

Does the PII market work better for some types of legal services provider than others? For example, does it work better for legal businesses that serve larger corporate clients than for businesses that serve individuals and small businesses?

Is the PII market characterised by an unwillingness or inability to take on certain types of risks (because of informational/risk assessment challenges)? Put another way, is the scope of the coverage that is on offer unduly narrow?

To repeat, the interest of a legal services regulator in these matters does not derive from any delegated responsibility in relation to PII markets. Such responsibility is confined to legal services markets. However, precisely because of this, there might be a tendency to under-weight the significance of the above types of question, which are relevant because of the implications for LSPs and their customers/clients, i.e. the because of the 'related market effects' explained above. For example, weaknesses in the performance of PII markets can raise barriers to entry for LSPs.

More generally, rule-making and enforcement for LSPs does affect the demand-side of PII markets, and hence the performance of those markets. Assessing the resulting effects on PII market performance, which in turn can affect the functioning of (the downstream, related) legal services markets (which are the direct concern of legal services regulators), will depend

on developing at least some understanding of the operation of PII markets. Hence the questions above.

By way of illustration of the significance of this general point and of the complexities involved in assessment, consider the following question:

Do PII premia that are invariant or relatively insensitive to claims history signal a problem of competition in legal services market (because, for example, they constrain the ability of higher-performance providers to benefit from lower insurance costs and, by reducing their own charges, to win business from lower-performance competitors)?

The answer should depend in part on the answer to another question: *how closely related are (i) expected, future claims and (ii) past claims histories?* If, for example, performance lapses are relatively random in nature, the absence of any close link between premia and claims histories is not in itself indicative of any competition problem.

Turning to legal services markets themselves, the two major areas for exploration are defined by the general questions:

How do alternative sets of insurance arrangements affect the net benefits of (a) clients/customers/consumers and (b) the relevant LSPs, and by how much?

Do the net benefits of the relevant parties vary significantly among different sizes and types of (a) clients/customers/consumers and (b) of LSPs?

What are the implications of alternative arrangements for competition in legal services markets?

There are many detailed questions that can flow from these generic questions, the relevance of each of which will vary from regulatory option to regulatory option and from one type of LSP to another. It is, therefore, probably more helpful to illustrate with a specific example than to simply set down a long laundry list of questions.

Consider, therefore, an existing arrangement in which regulation specifies a requirement for at least some prescribed level and scope of PII coverage, leaving legal service providers free both to choose their PII supplier and to seek additional PII as they want, and ask *how will net benefits and competition be affected by incremental variations in this basic arrangement?*

The underlying regulatory 'policy' in this (hypothetical) case likely reflects a view that large, commercial customers of LSPs can safely look after their own interests. If the prescribed level and scope of protection of a particular LSP is inadequate, they have enough skin in the game to incentivise them to discover that fact for themselves and to act accordingly, i.e. turn to an alternative provider who provides them with more comfort.

But is the scope and level of prescribed protection set at an appropriate level?

If coverage is set low or narrow, there is increased risk that some (mid-range) customers could end up with an inadequate level of protection. If coverage is set too high or broad, there is risk of gold-plating for mid-range customers, i.e. costs could be too high.

Would gold plating tend to lead to a barrier to entry or expansion?

The question is important because, if it did, it would provide a rationale for it to be a preferred option for providers, via the establishment of an economic externality: customers would pay more, providers would benefit from reduced competition. The issue was addressed in the RPI report for the LSB and Law Society.

Does the prescribed scope of the coverage provide appropriate protection to consumers in the event of cessation of trading and does it give rise to any barriers to exit?

Cessation of trading is a problematic area because it breaks the normal incentive for an individual or business to maintain reputation. This is therefore a particularly sensitive aspect of PII provision in relation to the consumer protection objective. There is also a competition dimension in that 'run-off' insurance arrangements have implications for the cessation/exit decision itself, and hence, potentially, for the structure and effectiveness of the competitive process.

What are the differences in the implications/effects of arrangements in which, for the prescribed requirements, (a) legal service providers choose their PII supplier and (b) PII is supplied by a single provider selected via a competitive tender for the business as a whole (a 'single buyer' model)?

The relevant trade-offs between cost and competition effects have been noted in the earlier discussion of mutual arrangements.

Information/data collection for assessment purposes

As emphasised, assessment involves comparisons of the implications of alternative types of (realistically possible) regulatory arrangements. The most obvious source of information on realistic possibilities comes from *comparative experience* of legal services regulation *in different segments of the wider legal services market and in other jurisdictions*. Such comparative-information-collection exercises are also likely to be helpful when it comes to assessing implications of the identified alternatives.

Background information/data on the PII market should, where feasibly available, include:

- *Indicators of the total magnitude of the PII business, preferably broken down by segment of the legal services sector* (solicitors, barristers, specialist conveyancers, etc.)
- *Statistics on the level of claims (numbers, values) and on changes over time.*
- *Claims ratios, i.e. ratio of claims paid to premium income, including information on: changes over time and differences between different segments of the wider market for legal services.* (A performance indicator that might be helpful in comparing 'for profit' and mutual insurance arrangements or single-buyer versus individual buyer alternatives).
- *Any information on numbers of disputes, the value at stake and on costs of dispute resolution, including delays.*
- *Indicators of the number of PII suppliers who are active and of supplier (market) concentration, including changes in concentration over time.*
- *Information on entry and exit from the supply of PII to legal services providers.*
- *Market research studies on the PII market, particularly anything containing assessments of prospects.*

Similarly, in relation to LSP markets, relevant data on the following would be helpful[10]:

- *Expenditures on PII relative to (a) total costs and (b) total administrative costs.* (Relevant for assessment of the likely sizes of economic effects.)
- *Statistics on any changes on these proportions over time.*
- *Any evidence on the transactions costs of PII.* E.g. time taken, costs and difficulties in obtaining quotations/offers. (A potential insurer might confront an LSP with a rather extensive 'information request', which the insurer in turn will need to process and assess.)
- *Whether LSPs are active in seeking to obtain competitive quotations.* E.g. do they use brokers?
- *Proportions of LSPs who rely only on prescribed (minimum) levels and scope of PII.*
- *Where it is purchased, estimates of the magnitude of additional PII cover.*
- *Collated information from the RPI barriers-to-entry study, including from the anonymised interview notes.*
- *Evidence on consumer information about and perceptions of the level of protection that is afforded to them by PII.* Have any consumer surveys been undertaken and, if not, would this be within the scope of the LSB's work?

LSB and AR perspectives

The LSB and the ARs share the same regulatory objectives and should, in principle, approach PII issues in similar ways. There are however two, related practical matters that it may be worth keeping in mind since they are possible sources of (unintended) divergence in approaches.

First, as is typically the case in relation to the specification of regulatory objectives, the legislation sets matters down in terms of a 'flat list'. Thus, when the pursuit of different objectives comes into conflict – as it sometimes will – regulators are not given explicit guidance or instructions as to how different objectives should be weighted when seeking to resolve the trade-offs. This suggests that the LSB should, as an oversight regulator, recognise that it has a special responsibility to help ensure that there is a broad consistency in the way that ARs evaluate issues, particularly cross-cutting issues such as PII arrangements.

It is to be stressed that such consistency carries no implication that the regulatory arrangements that are settled upon should be uniform among ARs: pursuit of the same objectives, similarly weighted, can appropriately lead to different outcomes on account of relevant differences in the individual contexts.

Second, the principal 'field of view' of an AR is almost inevitably narrower than that of the LSB. In assessing PII arrangements in its own domain, an AR should properly also look at PII issues in a broader context, including not only arrangements in other segments of the legal services sector but also PII insurance for other types of professional services business and the performance of PII markets more generally. However, an AR's primary 'field of view' can easily lead to an underweighting of evidence from other market segments and sectors, a form

[10] Some of this data will already likely be available, for example from the LSB's cost of regulation survey and from other like exercises. No attempt is made here to distinguish between information that is or is not already available.

of cognitive bias in judgment that is much studied in contemporary psychological and economic research. In this case, any such bias is also liable to be reinforced by simple cost-benefit trade-offs: if all ARs duplicate information gathering from wider sources, the result may be an inefficient assessment system.

The LSB might therefore consider whether it has particular roles to play in (a) preventing the emergence of AR biases consequential on overly narrow assessment exercises and (b) itself facilitating the efficient collection and assessment of information that is relevant to the work of multiple ARs.