LEGAL SERVICES BOARD

Thematic review of restrictions on choice of insurer

Analysis of the current arrangements

July 2016

This assessment will be of interest to:

Approved regulators

Providers of legal services

Legal representative bodies

Legal advisory organisations

Non-departmental public bodies

Consumer groups

Members of the legal profession

Accountancy bodies

Potential new entrants to the legal services market

Contents

Introduction

1. Professional indemnity insurance is important. It protects consumers' and practitioners' interests and supports and enhances public confidence in the purchase of legal services.

2. It is also likely to be in the interests of legal services practitioners to obtain some level of professional indemnity insurance (**PII**) cover given that its function is to cover claims associated with work related mistakes. Research indicates many practitioners would look to have PII cover in place regardless of any regulatory requirement to do so.[1] PII cover also offers a wider benefit to the profession in protecting its reputation as a whole. However, these incentives may not be sufficient to avoid harm to individual consumers and to sustain public confidence in the legal sector. Therefore, to deliver the regulatory objectives,[2] approved regulators (**ARs**) have intervened with regulatory arrangements[3] around PII.

3. Requirements imposed by ARs for PII will have implications for legal services. Previous LSB research has highlighted concerns among practitioners that it represents a significant operating cost (including outlay at the point of leaving the market).[4] This cost can act as a barrier to entry and exit[5] and to innovation.[6] Among other things, this may affect access to justice and quality of service.

4. Historically, there have been some regulatory controls in place on choice of PII provider. Typically these seem to have been put in place when regulation was the responsibility of the professions themselves and then 'passported' into AR regulatory arrangements by the Legal Services Act 2007 (**the Act**). In recent years there has been a general trend to allow the competitive supply of PII, although this position varies among the ARs. The solicitors' PII market in England and Wales, for example, has been 'open' since 2000. A common view among interested parties is that this market is experiencing a period of stability.[7] More recently, the Council for Licensed Conveyancers (**CLC**) has also moved to an open market (i.e. practitioners having choice of provider).[8]

5. In markets generally, restrictions on competition and choice can allow market power to be exercised, with potential to distort a market and introduce consumer detriment. In the absence of market failure, choice and competition between providers usually deliver better outcomes for consumers. In determining the best

---

[1] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2015/LSB_Cost_of_Regulation_Survey_Report.pdf
[2] Defined in section 1 of the Legal Services Act 2007.
[3] Defined in section 21 of the Act of the Legal Services Act 2007.
[4] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2015/LSB_Cost_of_Regulation_Survey_Report.pdf
[5] https://research.legalservicesboard.org.uk/wp-content/media/RPI-Final-Report-for-LSB-and-TLS-15-December-2013.pdf and https://research.legalservicesboard.org.uk/wp-content/media/2015-2016-FINAL-Market-Evaluation-OXECON-economic-advice-report.pdf
[6] https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf
[7] For example, see: http://www.lawgazette.co.uk/people/roundtable-pii/5055758.article
[8] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/CLC_PII_Decision_Notice_FINAL.PDF

arrangements for PII ARs should continue to observe and ensure that practising requirements keep pace with developments in the legal and PII markets.

6. The approach of any AR to exercising its functions, including on PII and restrictions on choice of insurer, should be informed by evidence-based assessment against the regulatory objectives in the Act and the principles of better regulation.[9] These will also underlie our assessment of any matter in discharging our oversight role.[10] In addition, ARs will need to determine if there are competition law considerations that apply to their arrangements.

7. Good regulation expects, then, that the need for intervention, including new proposals for regulatory obligations, should be take a first principles approach. In addition, existing obligations should be reviewed periodically with a view to justifying continued intervention, rather than having to justify their removal.

8. We therefore start from the position that these points should inform all regulatory arrangements, including those on PII.[11]

About this review

9. Our review has been conducted to help inform the work of the ARs, by providing an overview of what they need to consider in relation to choice of insurer. The review does not seek to provide definitive answers on all details of PII, nor is it intended to assert the 'right' answer for any particular AR. Rather, it aims to evaluate the different arrangements ARs have in place and to identify issues which they can reasonably be expected to consider. Although relevant to insurance, our conclusions have broader application to regulation generally.

10. As a mature market the legal sector in England and Wales is undoubtedly experiencing change, including through innovation in business structures and services. In seeking to facilitate this, among other things, ARs need to adequately understand PII.

11. This issue calls for stakeholder dialogue and collaboration among ARs. In this respect, we were pleased to note the willingness of stakeholders to engage. Our work has been aided by discussion with a small number of participants in legal sector PII markets. These include ARs, insurance providers to legal practitioners in England and Wales and beyond, and an insurance broker. We appreciate that these views are illustrative rather than representative. In addition, we have commissioned independent advice from the Regulatory Policy Institute (**RPI**) on economic principles that are relevant to choice of insurance provider. This offers

[9] Section 28 of the Legal Services Act 2007.
[10] Section 3 of the Legal Services Act 2007.
[11] Defined in section 21 of the Act as arrangements for the purpose of ensuring the indemnification of those who are or were regulated persons against losses arising from claims in relation to any description of civil liability incurred by them, or by employees or former employees of theirs, in connection with their activities as such regulated persons.

a very helpful and concise resource, which identifies further questions for ARs to consider and is published alongside this report.[12]

12. We encourage the ARs to make use of this report and RPI's advice. It is anticipated that it will serve as context for our oversight functions.

13. We would emphasise that the contents of this report are separate to any assessment by us of a request by an AR to alter its regulatory arrangements.[13]

Minimum terms and conditions

Minimum terms and conditions (**MTC**) set the scope of PII provided by insurers. Where these apply, we would expect them to be, and they generally are, set by the AR and can be part of their regulatory arrangements. Looking across the ARs, the Bar Standards Board (**BSB**) is to an extent an outlier, in only setting MTC for PII for its regulated entities (with those applying to self-employed barristers determined by the mandatory provider Bar Mutual Indemnity Fund (**BMIF**)). Broadly the content of the MTC is consistent across the ARs (which seems likely to reflect sectoral benchmarking being used to inform their development). We note that there continues to be representative body involvement in both BMIF and the BSB's MTC.[14]

While benchmarking is sensible, it may run the risk of mutual reinforcement, rather than requirements being based on an evidenced understanding of needs. This area is therefore one that could benefit from increased collaboration, including on what represents appropriate indemnification and compensation arrangements when taken in the round for any particular AR, and across ARs as a whole.[15]

[12] http://www.legalservicesboard.org.uk/news_publications/LSB_News/PDF/2016/20160715_RPI_Advice_To_LSB_On_PII.PDF

[13] The process for assessing such applications is set out in Schedule 4 to the Act.

[14] In both cases the Chairman of the Bar Council has a dispute resolution function in the event of disagreement between the insurer and insured: http://www.barmutual.co.uk/fileadmin/uploads/barmutual/2015_documents/Bar_Mutual_Terms_of_Cover_2015.pdf and https://www.barstandardsboard.org.uk/media/1657322/bar_standards_board_-_minimum_terms_of_entity_cover_-_spring_2015.pdf

[15] For example, run-off cover was the subject of some initial assessment by CILEx Regulation in 2015: http://www.cilexregulation.org.uk/~/media/documents/cilex-regulation/reports/report-to-lsb-restrictions-created-by-run-off-insurance.pdf?la=en

Current restrictions on choice of insurer

14. A requirement for practitioners to hold PII applies across all the ARs. The table at **Annex A** gives an overview of regulatory arrangements for PII.[16] We have not set out to comprehensively assess all of them. Rather, we have focussed on some particular regulatory approaches or 'models' associated with the extent of choice available to legal services practitioners in securing PII, and the rationales used to support them. The rationales are discussed in more detail at **Annex B**. Although there is no standardised approach, the broad categories are:

    - open market – practitioners seeking insurance are able to select their own PII provider. This may be subject to limitations set by the relevant AR, for example insurers having to sign up to specified MTC (with a view to consumer protection) or having a suitable credit rating. For example insurers have to sign the Solicitors Regulation Authority's (**SRA**) Participating Insurer's Agreement under which they agree to offer policies that meet its MTC. The SRA's arrangements are discussed in paragraphs 10 to 12 of Annex B

    - master policy – collective purchasing to deliver a policy that covers each member of a group. For example, a body (such as an AR) arranges the policy and then determines how its total cost is apportioned between those insured. Until 2011 the CLC required those it regulated to use a master policy scheme (**MPS**). It is still the case for the Law Society of Scotland (**TLSS**). These arrangements are discussed in paragraphs 7 to 9 and 14 to 16 of Annex B respectively

    - mutual fund – a profession becomes its own insurer, paying premiums into a common fund to cover claims. Members effectively own the insurance company (with the relationship between self-employed barristers and the BMIF being an example). The majority of practitioners, if not all, seek cover from the fund. Some ARs, like the BSB, have specified use of the insurer. Others, for example the Intellectual Property Regulation Board (**IPReg**), haven't. The BSB's arrangements, which include the BMIF, are discussed at paragraphs 2 to 6 of Annex B.

Approaches to choice of insurer

15. Moving towards an open market has been the general direction of travel among ARs in recent years. In the SRA's case it was as a result of a decision made by the profession in 1999. In 2010, a report prepared for the SRA endorsed the continued competitive provision of PII, stating that there was strong evidence the open market model should be retained.[17] Most of those we spoke to during the

[16] It is noted that, as this work has sought to draw on existing sources, some of the data in the table at Annex A is from historic sources and so may not be accurate at the time of writing.
[17] Charles River Associates (2010), Review of SRA client financial protection arrangements (prepared for the Solicitors Regulation Authority): http://www.sra.org.uk/documents/sra/cra-report-on-sra-financial-protection-arrangements.pdf

course of this review indicated that they consider that the findings largely remain valid.

16. Similarly, having allowed practitioners to opt out of its MPS since 2011, the CLC applied to move to an open market in 2016 with a view to competition facilitating lower PII premiums.[18] We granted the CLC's application in June 2016.[19] The BSB and CILEx Regulation also allowed entities to choose their insurer when they began authorising these new business models.

17. At present the BSB is the only AR that stipulates the use of a specific insurer – BMIF – by self-employed barristers (i.e. the vast majority of those it regulates). In its assessment this, "*has operated in the public interest by providing barristers with a stable source of primary layer cover*".[20] The restriction applies only up to a specified level of cover (with the amount decided by the BMIF). Above this the barrister must secure cover on the open market. The restriction does not apply to all business models that the BSB regulates. Entities are able to exercise choice.

18. The BSB has previously consulted on introducing a restriction for certain types of entities. This is on the basis that choice might have consequences for the viability of the BMIF and the availability and cost of PII for barristers as a whole.[21] To date, all but one of those entities authorised by the BSB are understood to have chosen to use the BMIF (which is not required to offer cover to them).

19. Beyond England and Wales other legal services regulators place restrictions on choice of insurer, for example, TLSS and the Law Society of New South Wales in Australia (through Lawcover). In both cases the remote geographic distribution of legal services practitioners, which potentially gives rise to concerns about access to justice if they experience problems obtaining PII, appears to have been identified as one rationale for restricting choice.[22]

Reasons for variation in approach between ARs

20. Commentators have suggested that MPS and mutual fund arrangements are more suited to circumstances where a low total premium value is associated with relatively few homogenous or uniform businesses.[23] We note that the RPI's advice associates these types of arrangement with emerging and declining

---

[18] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/20160525_Application.pdf

[19] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/CLC_PII_Decision_Notice_FINAL.PDF

[20] https://www.barstandardsboard.org.uk/media/1662760/consultation_paper_on_insurance_requirements_for_single_person_entities_-_pdf_-_final.pdf

[21] https://www.barstandardsboard.org.uk/media/1662760/consultation_paper_on_insurance_requirements_for_single_person_entities_-_pdf_-_final.pdf; https://www.barstandardsboard.org.uk/media/1681399/bsb_part_1_agenda_150723.pdf

[22] http://www.journalonline.co.uk/News/1001534.aspx#.VwfQzU1gkdV; and http://www.gov.scot/Publications/2006/04/12093822/6

[23] This may be reflected in the BMIF's cautious approach to insuring BSB regulated multi-person entities, because of the possibility that associated risks might not be compatible with those presented by the self-employed Bar: http://www.barmutual.co.uk/fileadmin/uploads/barmutual/2016_documents/BM_Chairmans_Report.pdf

markets,[24] that is, uniformity of business models is less likely to be seen in established markets.[25]

21. The solicitors' market in England and Wales is thought to have the largest global legal sector total PII premium. Here heterogeneity or variety has been put forward as one reason why the mutual Solicitors Indemnity Fund (**SIF**) closed in 2000.[26] The closure of SIF has also been attributed to poor risk assessment and pricing practices.

22. Stakeholders suggested that it is the size of the solicitor market premium that makes the competitive provision of PII feasible. If so, it is notable that CILEx Regulation's entity market is comparatively small and offers choice of PII insurer. It may be that that competition can be sustained for CILEx Regulation entities' PII requirements because (as discussed in the RPI's advice)[27] insurers perceive it as part of a larger market for PII for legal services.

[24] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 5).
[25] Heterogeneity or variety among barristers' practices might theoretically be one explanation for the finding in the 2015 joint LSB and SRA Innovation in legal services report, that barristers view regulatory requirements on PII as particularly problematic with regard to innovation when compared to solicitors: https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf
[26] The solicitors' profession effectively self-insured between 1987-2000. Concerns about (among other things) cross-subsidisation, potential challenge to SIF on competition law grounds, and a significant shortfall that the profession had to meet, led to a vote to open the PII market and SIF closing.
[27] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 2).

Impacts of restricting choice of insurer, and impacts of relaxing regulatory restrictions

23. Restricting choice of PII provider has consequences for practitioners, consumers and regulators. Throughout the course of this review we have seen a number of arguments made in favour of each of the approaches to restricting choice of insurer. These are often characterised as providing a relative advantage or disadvantage when compared to alternatives. We summarise below the arguments. In certain cases such arguments had limited supporting data and evidence. In particular, not all made explicit reference to the regulatory objectives and better regulation principles. Under the Act these should guide how ARs set their regulatory arrangements. In the next section we set out our thinking on what these aspects of the legislative framework would mean for the question of choice of insurer.

Impacts of restricting choice of insurer

Costs for practitioners

24. A regulatory restriction on choice is said to be able to reduce the cost of PII for legal services practitioners, with this saving potentially seen in a number of ways. For example the increased negotiating power that is available through collectively purchasing PII on behalf of a profession can deliver savings on the total premium cost. In turn, average individual policy cost is reduced. In practice, though, such savings would need to be evidenced.[28] There does not, for example, seem to be recent data available that allows for a comparison of costs under different regulatory models.

25. The design of any model for delivering PII will obviously have implications for costs. The BMIF for example defers a portion of individual policy holders' annual cost, i.e. the full amount may not have to be paid up front. This deferred amount is said to have been around £2 million per annum in recent years, with the right to call on those amounts having been waived for years up to and including the 2009-2010 policy year. Members are said to have saved approximately £17 million in waived premium.[29] In any assessment it would be important to evidence what saving, if any, is made compared to the cost of a policy in an open market (including when the impact of any additional top-up cover is taken into account).

26. In practice, the probability and cost implications of practitioners having to buy top-up cover from the commercial insurance market seem unclear. Some data from the solicitors' market may be available, although other intervening factors (for example how MTC attach to top-up policies) might need to be taken into consideration.

---

[28] A possible comparison here is a perceived benefit of 'bulk-buying' power associated with a single PII renewal date, whereas some firms report securing savings through longer 18-month policies: http://www.lawgazette.co.uk/people/roundtable-pii/5055758.article

[29] http://www.barmutual.co.uk/fileadmin/uploads/barmutual/2016_documents/BM_Chairmans_Report.pdf

27. The experience of the SIF (discussed at paragraph 11 of Annex B) shows that lower cost when restricting choice of insurer is not a given. Among other things, that example highlights the impact that administration of an insurance model can have on cost. The shortfall of around £180 million, which is said to be the result of poor policy pricing, had to be met by the profession.[30] More recently, Lawcover (the profession owned compulsory PII provider to law firms in New South Wales, Australia) has worked to address concerns about its costs,[31] which arguably could reflect the lack of competitive pressure on them.[32] As the RPI observes, this may reflect potential loss of economies of scope in PII provision.[33]

28. By comparison, the SRA has reported that the average cost of competitive insurance has been around 1.4% of gross fees compared to 2.2% under the MPS and 3% under the SIF, with respective cost savings of around £1.1bn and £2.1bn from 2000/01 to 2008/09.[34, 35] Although it has been suggested that premiums are typically lower, and then increase a few years after a market opens, this does not necessarily appear to be borne out by experience,[36] with pricing seemingly influenced by a variety of factors.

29. Cost savings are also said to be available with practitioners avoiding brokers' fees, which are said to cost up to 20% of premiums for small solicitor firms (although less for larger firms). These fees may still be incurred where top-up is required above the level of cover provided by a scheme or mutual fund.

30. Certainty that cover will be available is known to be attractive to practitioners.[37] Equally, we understand that the process of obtaining cover may require less information, for example the BMIF's process for calculating individual policy costs uses only fee income by area of practice and not individual claims history. It is possible that the certainty of cover or simplicity delivers administrative cost savings to practitioners or both.

31. By comparison most other models that are associated with a restriction on choice of insurer appear to take into account individual claims history or risk

---

[30] Charles River Associates (2010), Review of SRA client financial protection arrangements discusses problems associated with SIF at pages 50-51 (referencing SIF Annual Reports for 1996 and 1997). These included that after the early 1990s recession, increases in claims led to the identification in 1997 of a shortfall related to deficits for years back to 1989/90. An initial estimate of around £250 million was revised to £450 million, which was collected from the profession. Actual shortfall was then lower at £180 million, which saw the over-recovery returned to the profession.

[31] http://lawcover.com.au/lawcovenotes/august-2015-lawcovernotes/

[32] http://insurancenews.com.au/analysis/lawyers-pi-is-one-slice-enough

[33] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 5).

[34] The Charles River Associates (2010) review indicated that although care is needed on these figures (for example, while SIF offered a lower level of cover, run-off is no longer provided and instead involves the payment of a separate premium), the difference in costs more than overcomes concerns about run-off cover and brokers' fees in the open market.

[35] https://www.lawsociety.org.uk/support-services/documents/pii-faqs

[36] For example, the reported average premium for solicitors is 8% lower in 2016 and mean premium costs dropped for all firm sizes: http://www.lawsociety.org.uk/news/press-releases/law-society-annual-professional-indemnity-insurance-survey-confirms-favourable-market--for-firms/

[37] For example: http://www.lawgazette.co.uk/practice/solicitor-slashes-insurance-costs-through-bar-regulation/5056191.article

management or both. Requiring more information may impact on administration costs for the PII provider and for practitioners. The extent to which this differs from the process associated with open markets is unclear, but we observe that the process was the subject of criticism from respondents in recent research we published on the cost of regulation.[38] Dispensing with a single annual renewal date for PII may mitigate this criticism to some degree,[39] with longer policies in open markets able to reduce the frequency of completing a proposal form.

32. A separate question is whether a restriction is actually needed to secure any cost savings. One argument is that a model may not be sustainable otherwise. The CLC recently indicated that firms opting out of its MPS has resulted in the need to close it.[40] In contrast, PAMIA (a mutual not-for-profit PII provider to patent and trade mark attorneys in the UK and Ireland) has operated successfully without compulsion. However, PAMIA is not required to offer PII to all those firms regulated by the IPReg and appears to take claims history into account when calculating individual premiums.[41, 42]

Consumer choice

33. As observed in the RPI's advice, it is possible that an AR directing the use of a single PII provider may help to maintain a broader range of practitioner options for consumers to choose from.[43] This is because it may be possible to keep (through cross-subsidisation) certain practitioners in the market by managing pressures on sections of a profession. This may mitigate against under-served areas of law. For example, invested mutual funds[44] may be used to subsidise areas of practice that attract more claims, valid or not, whose premiums would be higher in an open market.[45] Similarly, funds may be available to smooth 'bad' years of high claims (although this is not said to be the case for the SIF).[46] This allows a longer-term view on risk ratings for areas of practice and increases to some or all policy prices delayed. However, practice may instead be to seek an additional financial contribution from members in 'bad' years. For example, the SIF is said to have had a greater degree of variation in the value of premiums

[38] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2015/LSB_Cost_of_Regulation_Survey_Report.pdf
[39] The Charles River Associates (2010) review indicated that by helping small firms, this would indirectly benefit diversity.
[40] http://www.conveyancer.org.uk/Latest-news/2016/May/CLC-applies-to-Legal-Services-Board-for-approval-o.aspx
[41] http://www.pamia.co.uk/insurance-cover/
[42] http://www.pamia.co.uk/fileadmin/uploads/pamia/PAMIA_2014_Renewal_Form.pdf
[43] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 2).
[44] For example, capital reserves placed into an investment portfolio with the intention of generating a return. Those of the BMIF are discussed in its Chairman's Report for 2015: http://www.barmutual.co.uk/fileadmin/uploads/barmutual/Reports___Acounts/Bar_Mutual_Chairman_s_Report_June_15.pdf
[45] https://www.barstandardsboard.org.uk/media/1681399/bsb_part_1_agenda_150723.pdf
[46] Charles River Associates (2010), Review of SRA client financial protection arrangements.

compared to other models.[47] Equally, there is said to be no evidence that TLSS's MPS has been more stable than the open market in England and Wales.[48]

34. The above points, however, potentially present challenges around over-supply. One question for an AR may therefore be whether it is appropriate and possible for it to identify the 'right' number of practitioners.

35. Where present, cross-subsidisation may impact on the ability of practitioners to compete effectively on price (although the extent of any impact might be influenced by the design of the PII model in question). Cross-subsidisation is suggested to flow from large to small firms, and particularly from some low risk to high risk firms.[49] Given this, restriction on choice may prevent a practitioner benefiting from cover at a lower cost where it might otherwise be available.[50]

36. Cross-subsidisation also has the potential to impact on innovation, for example with practitioners unable to use cost savings to develop their service offering. Research in 2015 indicated that barristers view regulatory requirements around insurance as particularly problematic with regard to innovation when compared to solicitors.[51] Reported differences in average cost of insurance under models in the solicitors' market are discussed at paragraph 28.

Client protection

37. Uncoupling of premium price from individual firm risk (which may lead to cross-subsidisation) may have implications for service quality (and for the strength and effectiveness of the legal profession).[52] Higher risk practitioners who may otherwise have to improve their risk management or leave the market may be sustained because cover is guaranteed, potentially posing a risk to consumers. Open markets are generally considered to be more efficient in applying incentives in this area.

38. MPS and mutual funds may, though, be able to avoid the 'turmoil' that has been said to arise through insurers entering and exiting markets (including during a policy period) and difficulties experienced by solicitors in securing cover in recent years.[53] This may avoid undue impact on clients if practitioners leave the market as a result of an insurer's exit. The solicitors' PII market, which is now said to be

[47] Charles River Associates (2010), Review of SRA client financial protection arrangements.
[48] Charles River Associates (2010), Review of SRA client financial protection arrangements.
[49] For example, the under the SIF one and two partner firms paid around 22% of contributions but represented 34% of the value of claims, but firms with 11 partners or more paid 35% of contributions and represented 27% of the value of claims: Charles River Associates (2010), Review of SRA client financial protection arrangements.
[50] A further risk is also that potential new entrants who, due to cross-subsidies, face higher premiums than they would on the open market may also be deterred from entering and competing in the market.
[51] https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf
[52] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 6).
[53] http://www.solicitorsjournal.com/regulation/indemnity/sra-pii-consultation-flawed-rushed-and-dangerous; http://www.lawgazette.co.uk/people/roundtable-pii-market/5049268.article

'soft' or favourable for those obtaining cover,[54] may offer help in exploring the causes of past problems and how these may be mitigated.[55]

39. It has been suggested that claims are more likely to be met by mutual funds than in open markets as discussed in the RPI's advice.[56] For example a practitioner's excess may be waived or steps taken to mitigate consumer detriment. On the other hand, a mutual fund might be more willing to dispute a consumer's claim, with a view to avoiding an unfavourable precedent being set. This is done on the basis that these actions are in the interests of members as a whole, by protecting the profession's reputation, as well as offering benefits for consumers.

Regulation

40. The certainty that cover will be available under particular models for PII provision, as discussed above at paragraph 30, may mean that the AR (rather than the insurer(s)) can decide who operates in a market.[57, 58] In 2010 it was reported that around 3 percent of solicitor firms would be at risk of the insurance sector refusing to insure them but the AR was otherwise willing to allow them to operate. Among other things, it is possible that this might assist diversity in the legal profession. The Assigned Risks Pool (**ARP**) in the solicitors' market that operated after the closure of the SIF for practitioners that could not secure cover on the open market contained a greater proportion of BME firms (28%) than in the profession as a whole (11%), which are disproportionately smaller firms.[59, 60]

41. It may also be administratively simpler for an AR to confirm that satisfactory cover is in place, and to be assured that claims will be met whether or not the individual policy premium is paid (this is also likely to be influenced by the content of MTC). This may reduce immediate pressure on an AR to intervene in a practice where cover has not been secured and also reduce overall regulatory costs. In addition, it is commonly agreed that more summary data will be available to the AR, for example on claims. We note, however, positive steps being taken by the SRA to overcome data issues with insurers,[61] which is in keeping with the RPI's advice.[62]

42. In theory, incentives may be greater for a single provider to report suspected fraud by policy holders (although this may also be dependent on the relevant

---

[54] https://www.lawsociety.org.uk/news/press-releases/law-society-annual-professional-indemnity-insurance-survey-confirms-favourable-market--for-firms/
[55] Among other things this might consider the implications of AR requirements on PII policy renewal dates and an insurer's credit rating.
[56] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 4).
[57] Discussed in the Charles River Associates (2010), Review of SRA client financial protection arrangements, in terms of "setting the regulatory boundary".
[58] https://www.barstandardsboard.org.uk/media/1681399/bsb_part_1_agenda_150723.pdf
[59] Charles River Associates (2010), Review of SRA client financial protection arrangements.
[60] There may, though, have been a correlation on this point with the strength of controls on lawyers with qualifications from overseas offering services in England and Wales, with BME firms mostly likely to fall into that category.
[61] https://sra.org.uk/sra/consultations/discussion-papers/protecting-clients-financial-interests.page#download
[62] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 2).

MTC). For example, a sole insurer bearing cost in any event may act to remove the practitioner from the market, whereas a commercial insurer might have an incentive to try to 'off-load' long-term risk to a competitor at the end of the insurance policy. Costs of around £3.7 million in 2008/09 were reported as arising due to misalignment of incentives on supplying information to the SRA about dishonest firms.[63, 64]

43. Finally, media reports indicate that some practitioners clearly find insurance via the BMIF attractive compared to alternatives.[65] This may be one explanation why most BSB regulated entities (who have a choice of provider) have continued to use the BMIF. For the BSB, this may be a reason why practitioners seek authorisation to practice from it, rather than another AR.

Impact of removing (or relaxing) regulatory restrictions

44. We share the view in the RPI's advice that one of the questions an AR should address is *"[h]ow might things develop if the restrictions were removed?"*[66] Some of the possible implications of relaxing a restriction on choice of insurer are discussed below. While this section takes into account the experiences of ARs, not all of the views that we have encountered on likely impacts appear to be validated by the available evidence.

45. The extent of any impact on practitioners, consumers and ARs seems likely to depend on how much actually changes as a result of removing a restriction and, just as importantly, how these changes are managed. We have looked at these points below, moving from low to high impact.

Low impact

46. A potential response to the removal of a regulatory restriction may be little or no change, with comparable impact. For example, the incumbent insurer may successfully continue providing cover to practitioners, resulting in limited market exit or need for transitional arrangements.

47. BSB regulated entities might in theory present an illustration of this, with all but one of those authorised to date insured by the BMIF, despite there being no regulatory requirements in place for them to use it. Of course, these are new, relatively simple business models, some of whom may have a cultural preference for the BMIF having been required to use it previously as self-employed barristers.

48. A relevant consideration here is the insurer's position on risk around its viability in the absence of regulatory compulsion, i.e. whether it will compete or elect to withdraw if the PII market opens. The discussion in the RPI's advice of adverse

[63] Charles River Associates (2010), Review of SRA client financial protection arrangements.
[64] Action taken by ARs on this topic is not covered in this paper.
[65] http://www.legalfutures.co.uk/latest-news/solicitor-who-is-not-an-advocate-sets-up-one-of-first-bsb-entities
[66] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 8).

selection may be relevant here, in terms of the insurer potentially being attractive to practitioners with higher than average risks, implying difficulty competing on price.[67] The CLC's PII market changed radically in 2015 when a third of CLC regulated practices chose to opt out of its MPS. Since then it has moved to an open market.[68] This transition can be expected to add to the evidence base available to other ARs.

49. The Society of Licensed Conveyancers[69] and also trademark and patent attorneys (through PAMIA) offer examples of practitioners responding to freedom of choice by establishing competitive MPS and mutual schemes respectively. PAMIA, for example, is reported to cover 95% of UK and Irish patent and trade mark attorneys in private practice.

50. These models may demonstrate the potential for viability without regulatory compulsion and although we note that PAMIA does not guarantee to offer cover and appears to take account of claims history in calculating individual premium cost, there does not appear to be a material problem of those who are unable to use it being prevented from entering the market.

Medium impact

51. Where removing a restriction is associated with migration to a more open market, there will be consequences for the AR and those it regulates. Although this may be influenced by the actions of the incumbent insurer, the extent to which other insurers compete to provide PII will be important for example in terms of adequate total capacity and distribution of risk. The AR should therefore assess whether appetite among insurers to enter the market needs to and can be stimulated. Steps were taken, for example, by the Law Society on opening the PII market for solicitors when the SIF closed.

52. Other impacts for practitioners may include potentially facing more complex processes for securing insurance and related search costs. We note that the SRA sought to respond to this by removing the single renewal date and working with brokers on the number of forms to be completed.

53. Moreover, some individuals or firms may exit a market as a result of being unable to secure cover at a feasible price for example where cross-subsidies are removed. How this happens, i.e. in an orderly or disorderly fashion, may have consequences for consumers, the AR and other practitioners. For example regulatory costs associated with intervention may be passed through to practitioners in practising certificate fees. As discussed above at paragraph 40, experience indicates that this may have a greater impact on smaller practitioners. In turn, there may be implications for diversity in the market. Conversely, of

[67] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 1).
[68] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/CLC_PII_Decision_Notice_FINAL.PDF
[69] http://www.conveyancers.org.uk/

course, it is possible some new firms may enter the market as a result of being able to get cheaper insurance.

54. Entry and exit of insurers can also be expected. The impact will vary according to the manner of exit. The solicitors' PII market in England and Wales offers a wealth of evidence, including on the perceived ability to get PII changing from a difficult to stable environment and explanations for this change. This is said to have been partly influenced by mortgage lenders encouraging legal services practitioners to choose rated insurers.[70]

55. Potential impacts may be addressed via transitional arrangements, for example the ARP in the solicitor market when the SIF closed. One risk associated with using an ARP to cushion the impact of change is that between 2000 and 2010 the loss ratio (total claims to total premium) averaged at 800%. However, this has not been the experience in the Institute of Chartered Accountants in England and Wales's (**ICAEW**) market where premiums are reported to be typically greater than claims.

56. Claims dumping is another risks felt by an incumbent insurer and the profession. For example, the closure of SIF saw high levels of claims notified by solicitors. This allowed practitioners to go into the open market with a clean record. This had administrative implications, even if actual payments were ultimately around normal levels.

High impact

57. The greatest impact of relaxed restrictions would be if a significant proportion of practitioners were unable to secure satisfactory PII on affordable or suitable terms, for example through unsuccessful change management or lack of insurance capacity. We are not aware of this occurring in the legal sector to date.

Conclusions

58. An argument for maintaining the status quo is the risk of damage if a PII market fails after a restriction on choice is removed. This is not a justification for doing nothing. Rather, an AR (as part of establishing whether a restriction is justified more broadly) will need to collect and analyse data (some of which it might already be expected to hold) to identify the likelihood and scale of risks, and mitigation and contingency plans.

59. However the magnitude of the impact of the solicitor PII market opening in 2000 is viewed, reports around that time suggest that lessons could be learned from the transition from SIF.[71] Events in other ARs' markets and the experience of other legal sector regulators are also of value to ARs in developing and maintaining arrangements. These may help to assess the likelihood and impact

[70] https://www.lawsociety.org.uk/support-services/documents/pii-faqs; http://www.legalfutures.co.uk/latest-news/building-society-tell-firms-use-rated-insurer-youre-off-panel

[71] http://www.lawgazette.co.uk/news/a-risky-business-from-this-week-the-solicitors-indemnity-fund-is-no-longer-but-the-open-market-is-struggling-to-take-its-place-as-excess-demand-and-inexperience-have-fuelled-the-confusion/21339.fullarticle

of events in an insurance market (i.e. ‘insurance-market-cycles’) on the availability of PII in ARs’ markets.

60. In assessing impact an AR may need to take account of factors beyond its own regulated market. As noted above, insurers may view the relevant market as legal services generally. If so, the total size of the PII premium for solicitors means it is possible that the SRA’s arrangements could influence insurers’ actions in relation to other parts of the legal profession. This highlights the benefits of joint working among ARs to look beyond regulatory boundaries to the experience of others in the legal services sector.

61. Consideration of the possible impacts on the sector of restricting choice of insurer and of removing such restrictions are not particularly conclusive as regards to whether such restrictions should be kept. The points and information we have discussed above would not be sufficient, and in any event it is not our aim to reach the ‘right’ answer for the entire sector, nor our expectation that an AR does this. The question of whether to restrict choice of insurer should, though, be answered by an AR with respect to its regulated community, since it is best positioned to access and analyse relevant information. The Act offers a framework to guide that assessment. We discuss this in more detail in the next section.

Restricting choice: consistency with legislation

62. Legislation for the purposes of this review means the regulatory objectives and better regulation principles as set out in the Act, and general competition law. These are discussed in the sections below.

Consistency with the regulatory objectives

63. Both we and the ARs have a duty in discharging our functions to, as far as is reasonably practicable, act in a way which is compatible with and is considered most appropriate for the purposes of meeting the regulatory objectives.

64. We previously published our view of what the regulatory objectives mean (i.e. how we will apply them to the ARs and ourselves).[72] This notes that each organisation is able to develop an appropriate response to challenges faced, but flexibility does not extend to what the regulatory objectives mean. Additionally, lack of hierarchy among the regulatory objectives means that no single objective has priority. They must be balanced in the particular circumstances of the issue under consideration because no single course of action is likely to deliver each objective.

65. We focus here on six of the eight regulatory objectives that are of most relevance to this thematic review. The remaining two (supporting the constitutional principle of the rule of law and increasing public understanding of the citizen's legal rights and duties) may of course still be relevant in developing regulatory policy, but are less directly relevant to this topic.

RO1 Protecting and promoting the public interest

66. MPS and mutual arrangements typically exist for the benefit of their members and are established by the profession, or by their representative body on their behalf. If such an arrangement is considered the least burdensome solution to an issue needing regulatory intervention, we would expect an AR is clear how this furthers the public interest.

67. Where provisions have been 'passported' into an AR's regulatory arrangements as a result of the Act (without dedicated assessment against the regulatory objectives or better regulation principles), the LSB said that this was to aid transition and regulatory certainty, rather than being intended as some form of perpetual blanket approval.[73] It is important for there to be a clearly articulated and evidence-based assessment of how the existing restrictions on choice of insurer promote this regulatory objective.

68. We also note that there would need to be a convincing justification for continued representative body involvement in AR PII arrangements, given the importance to

[72] http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf
[73] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2013/20130611_LSB_Sets_Out_Its_Approach_To_Overseeing_Regulation.pdf

the public interest of demonstrating separation of regulatory and representative functions.[74]

RO3 Improving access to justice

69. As a pre requisite to practising, PII is understood to form a large proportion of regulatory costs for legal services practitioners. Regulatory restrictions on choice of PII provider, for example where cross-subsidisation reduces the scope for cost savings for some practitioners, may affect market entry and innovation, and therefore access to justice. Potentially this also raises questions in relation to quality, as discussed above at paragraph 37.

70. Our research on innovation indicated that regulatory requirements around PII were viewed by barristers' chambers as particularly problematic when service innovations were considered.[75]

71. A restriction on choice of insurer might have the effect of helping to preserve numbers of legal services practitioners (for example through guaranteeing cover and/or cross-subsidisation), including in certain areas of practice. As discussed above at paragraph 35 and in the RPI's advice, though, it could also serve to keep some potential entrants out of the market.[76] Our expectation is that ARs actively seek to remove barriers to innovation. In balancing this with other regulatory objectives, we would expect them to engage with consumers to understand the impact of any reduction in numbers of practitioners through potential changes to arrangements – with this not automatically equating to a reduction in access to justice.

RO4 Protecting and promoting the interests of consumers

72. Restrictions on choice appear to be at odds with our general view that a competitive market will drive practitioners to better understand and meet the needs of their consumers. Further, competition among PII providers can benefit legal services practitioners and enhance competition between them through 'related markets' effects.[77]

73. The way in which restrictions are applied can have implications for consumer interests. For example, the basis on which PII is provided or declined may have implications for numbers of practitioners, and the costs of services. It may also influence service quality as competition can be expected to exert pressure on practitioners to reduce numbers of claims and guaranteed cover can mask quality issues. An AR will need to give thought to this in light of information asymmetries between consumers and practitioners of legal services. This includes absence of

[74] For example, both the BMIF and the BSB MTC afford a dispute resolution role to the Chairman of the Bar Council in the event of disagreement between the insurer and insured.
[75] See section 5.3 https://research.legalservicesboard.org.uk/news/innovation-in-legal-services-2015/
[76] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 11).
[77] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (pages 4 and 7).

data in a format that empowers consumers to counter potential detriment, for example on Legal Ombudsman and AR decisions.

RO5 Promoting competition in the provision of legal services

74. Our position is a strong presumption in favour of open competition and the need for compelling evidence to support the maintenance or imposition of any restriction rather than justifying its removal. Although competition in the insurance market falls beyond our and the ARs' remit, the points on 'related market' effects and on market investigations are relevant (see below at paragraph 106 and the advice from the RPI).[78]

75. Restrictions around choice of PII provider have the potential to adversely affect competition between practitioners. For example, the ability to compete on price may be impeded where a practitioner cannot negotiate with different insurers to secure cost savings.[79] The RPI's advice also discusses, however, that barriers to entry or expansion which increase prices or reduce competition could in theory be preferred by practitioners.[80]

76. While a restriction applied to any part of the market might have an adverse effect on competition, there are potential distortions of competition when such restrictions are only applied to some practitioners and not others. The burden of proof is therefore on an AR to justify a restriction on choice of PII provider, in the face of this proactive and positive duty toward competition. In this case, competition includes persons overseen by a particular regulator and between different types of legal services practitioners. Assuming a justification can be made for a restriction, the approach adopted must then be the least burdensome (and therefore least detrimental to competition) possible.

77. Some commonalities can be seen between the points discussed here and those on competition law at paragraphs 95 to 100 and in **Annex C**.

RO6 Encouraging an independent, strong, diverse and effective legal profession

78. A strong, diverse and effective profession are most relevant elements of this objective.

79. Depending on the manner in which it is applied, experience from the solicitors' market suggests that a restriction on choice may potentially serve to assist diversity in guaranteeing access to insurance.[81] Whether this is actually the case would need to be investigated by an AR. This assessment should include

[78] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 6, 7 and 9).
[79] Such negotiations may be assisted by the use of brokerage services. While these are likely to have associated costs, they may facilitate competition between practitioners on the basis of legal service quality and cost, through promoting improvements in business practices, which in turn may see a reduction in PII premium price.
[80] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 11).
[81] For example, see paragraph 40 on the proportion of BME solicitors in the ARP before they closed relative to the solicitors' profession as a whole.

exploring reasons why certain practitioners may otherwise have difficulty securing PII and whether other less burdensome means of addressing these difficulties exist. Thought would also need to be given to the impact on diversity of those potential entrants deterred from entering the market by the restrictions on choice, as discussed above at paragraph 71.

80. Even so, this point would need to be balanced against other considerations. These include the risk of a regulatory restriction weakening incentives around innovation and service quality, as discussed above at paragraphs 37 and 73, and associated implications for the strength and competence of the profession (including those who might otherwise have to improve their performance or exit the market). It is reasonable to assume that the AR could obtain data to assess and to seek to balance these different considerations.

RO8 Promoting and maintaining adherence to the professional principles

81. The discussion above touches on points relevant to this regulatory objective, for example around standards of work by practitioners and acting in the best interests of their clients.

Consistency with the better regulation principles

82. Sections 3 and 28 of the Act also impose requirements in relation to principles of better regulation. These require us and the ARs respectively to have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed,
- and any other principle appearing to represent the best regulatory practice.

83. These principles were referred to by the Better Regulation Task Force as "*a useful toolkit for measuring and improving the quality of regulation and its enforcement…*" that "*…should be applied to the full range of alternatives for achieving policy objectives…*" and "*Government departments and independent regulators alike should use them when considering new proposals and evaluating existing regulations*".

Transparent

84. Transparency in this context means using effective consultation to meaningfully inform the development of policy on choice of insurer. This includes sufficiently early engagement to identify relevant evidence and continuing dialogue on its application. To the extent possible, such evidence and how it has been interpreted (which we would expect as part of any application to alter regulatory arrangements) should be published.

85. By means of contrast, examples identified as poor practice include evidence being sought to justify chosen policy solutions, the selective use of evidence and inadequate consultation relative to policy formulation.

86. Once determined, an AR's requirements for insurance providers (i.e. the basis or MTC on which they must issue insurance) and for practitioners should be set out clearly.

Accountable

87. Accountability concerns ARs coherently explaining the rationale for their policies. ARs must then put in place measures to deliver them successfully. In the case of PII, this includes putting in place arrangements so that ARs can have an appropriate relationship with insurers. For example, we note the steps being taken by the SRA to obtain necessary information to inform its regulation of PII. Among others, a consideration for an AR imposing a restriction on choice that would give rise to monopoly provider of PII would be the necessary level of scrutiny of those arrangements, and whether the AR would be appropriately resourced to secure this.

Proportionate

88. Proportionality presumes a regulator's decision on the need for intervention is based on the assessment of relevant evidence, including on risk posed. The AR should then seek to similarly evaluate possible solutions and to adopt the least burdensome response from among them.[82] That said, both we and the ARs enjoy a discretion in this area and a measure does not become disproportionate merely because some other measure could have been adopted.[83]

89. The economic advice prepared by the RPI and published alongside this report identifies questions and information that are intended to inform the assessment of restrictions on PII provider. In our view, the approach discussed by the RPI in its advice has wider relevance to the development of regulatory policy and we recommend it to the ARs.

Consistent

90. In the absence of a cogent rationale for a different approach, broad consistency would be expected in an AR's requirements of those it oversees. As noted above, restricting the choice of insurer for only some types of practitioner might otherwise distort competition between different types of legal services practitioners and challenge the delivery of the regulatory objective around competition (RO5). The same point might reasonably also apply across different ARs. If an AR finds itself to be an outlier compared to other ARs this suggests the AR concerned should scrutinise its approach carefully.

91. We note, of course, that the above would need more assessment and is one of many different considerations that an AR would need to balance in imposing requirements. PII is undoubtedly one of many areas that could benefit from greater collaboration between ARs. This extends beyond the immediate issue to

[82] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 6).
[83] See for example paragraphs 102 and 103: https://www.judiciary.gov.uk/wp-content/uploads/2014/10/lumsdon71014-2.pdf

areas such as MTC for PII. This could include striking an appropriate balance between delivering consumer protection and the associated cost implications for practitioners (which potentially have implications for access to justice).

Targeted

92. As above, restricting choice also challenges our expectation that effective regulation includes targeting intervention at those presenting greatest risk. This is a further reason that the requirement is on an AR to establish that there is a market failure which makes intervention necessary.

93. In the case of choice of PII provider, the ARs have reached different conclusions on the need for regulatory intervention. This appears to be on the basis of very different levels of analysis. Better regulation generally advocates the use of impact assessments to understand policy intervention,[84] which would anticipate ARs obtaining and analysing relevant data.

94. Based on such examination, it is possible that a restriction on choice of PII provider may be a valid decision, with a variety of ways in which this can be imposed, in keeping with the better regulation principles. This is a question that an AR with an outlying policy will no doubt wish to challenge itself to determine if consistency may be appropriate or if its regulated community is so different from those of other ARs as to require a restriction on choice.

Consistency with competition law

95. Our oversight role and the roles of the frontline regulators are clearly different to the duties of a competition authority. However, competition legislation still presents valid considerations for us in carrying out our duties under the Act. So while this review is not intended to offer any view on whether particular regulatory restrictions are or are not permissible, it identifies points that in our view ARs could prudently give thought to in developing and maintaining regulatory policy. Other provisions relevant to this review can be found at Annex C.

96. An AR will want to consider compatibility with competition law and the impact of both new and existing regulatory arrangements. The assessment should, as the RPI notes, encompass both legal services ('downstream') and PII ('upstream') markets.[85] This includes considering whether to proceed with arrangements that might potentially be found to have an adverse effect on competition, regardless of whether the risk of challenge (for example from private litigation) is perceived to be low. An AR's consideration might be informed by the fact that, in addition to welcoming moves by the CLC to allow choice of PII provider,[86] competition authorities have investigated comparable legal sector PII arrangements, for

[84] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468831/bis-13-1038-Better-regulation-framework-manual.pdf
[85] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 6).
[86] The Office of Fair Trading's advice (as a mandatory consultee under Schedule 10 to the Act) to the LSB on the CLC's application for designation as a licensing authority welcomed entities being allowed to opt out of the MPS: http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/oft_advice.pdf

example those of TLSS. A consideration might also be the potential for rules imposed by a regulator to be found to have an impact on competition, with the current investigation of the Office of Gas and Electricity Markets' (**Ofgem**) actions in the energy markets an example.[87]

The Competition Act 1998

97. All undertakings, which can potentially include ARs, are required to make their own assessment of compliance with the Competition Act 1998 (**the Competition Act**). Despite this being a complex area of law, it is appropriate for ARs to remain mindful of the prohibitions in the Competition Act in their day to day work. This relates both to an AR's actions and those of associated parties, including possible wider implications or inferences that may be drawn from them. While ARs may not have competition enforcement powers, they still have the ability to question and influence behaviours.

98. The position in this case is not straightforward, and seems likely to be influenced by whether an AR is undertaking an economic activity in relation to PII. This reflects that generally speaking, legislation is not targeted at activities that are intrinsically regulatory, but rather those that are economic.

99. Useful insights on market definition, findings or conclusions as to why investigations have not proceeded may be found in comparable cases. Equally, thought could be given to whether an exclusion or exemption from a prohibition might apply. A significant volume of reference material is also readily available, for example on the Competition and Markets Authority (**CMA**) website.[88]

The Enterprise Act 2002 – market investigation

100. In addition to the Competition Act provisions, a market investigation under the Enterprise Act 2002 can explore the impact of regulatory actions, which can be found to have an adverse effect on competition (without this meaning that the law has been infringed).[89] Potential remedies arising from an investigation include removing regulatory restrictions that have been imposed.

Conclusions

101. An AR's decision on the appropriateness of restrictions on choice of insurer should start from a first principles assessment of the issues outlined in this chapter, namely the regulatory objectives, better regulation principles and other relevant statutory requirements that set the framework for legal services regulation. Given the changing legal services market and changes in the market for PII, the AR's decision will need to undergo regular review to ensure that it remains fit for purpose.

---

[87] https://www.gov.uk/cma-cases/energy-market-investigation
[88] https://www.gov.uk/government/collections/cma-ca98-and-cartels-guidance
[89] See, for example, the CMA's current investigation of the energy market: https://www.gov.uk/government/news/cma-publishes-energy-proposals-in-full

What we think ARs should consider

102. Fundamentally, we and every AR must give thought to what good regulation means and what it requires. The Act is clear that in satisfying our duties with respect to the regulatory objectives, we must all have regard to best regulatory practice. The burden is wider than sector specific legislation though. Competition law, for example, raises considerations that need to be understood and put into practice.

103. It is right that we look at PII. It overlaps boundaries between regulators and concerns have been highlighted.

104. The starting point for analysis should be that restrictions on choice in the form of regulatory requirements need to be justified. This means considering the need for regulatory intervention from first principles. This requires evidence based decisions on whether there is a market failure that necessitates action and, if so, adopting the least burdensome response from among those possible. This applies equally to new and existing arrangements.

105. Clearly this is not always easy in the face of difficult and evolving issues, some of which overlap ARs. For this reason, we believe that ARs can and should do more collaborative working on PII. This would build on their common objectives, help to realise the benefits of shared learning and mitigate the risk of insular practices. Although we have seen some good examples of collaborative working, much more is possible.

106. As an issue, PII is undoubtedly complex. Competition in the upstream insurance market is not immediately the responsibility of an AR under the Act. However, as the RPI observes, issues in the upstream market (including those potentially resulting from regulatory arrangements) can affect competition between legal services practitioners through 'related market' effects, and have implications for the protection of consumers individually and at large.[90] This means that ARs need to carefully consider their regulatory arrangements relating to PII. Encouragingly resources are readily available to help them.

107. ARs need to monitor their regulatory requirements in this area, to ensure that they evolve in tandem with the legal sector and PII markets. This may include taking into account the implications of other ARs' proposals and decisions, and the reasons for them.

108. The RPI advice reviews the questions and associated data expected to inform an AR's assessment of its regulatory arrangements for PII,[91] but that advice applies to regulatory policy development more broadly. While some questions will undoubtedly be easier than others to address, it is possible for ARs to obtain

[90] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 4, 6 and 7).
[91] Regulatory Policy Institute (2016), Regulatory issues surrounding PII arrangements in legal services provision (page 7 to 11).

relevant data to inform policy making and it is reasonable to expect them to do so.

109. Beyond the specific issue of choice of insurer, it seems likely that work is needed on the subject of PII more generally. This includes the content of MTC, including run-off cover (which may be required on exiting a market). It would seem appropriate for an AR to give thought to financial protections in the round, with a view to securing an appropriate overall level of protection for consumers.

Annex A – Overview of current restrictions on choice

Market	**BSB** Self-employed barristers	**CILEx Reg** Entities	**CLC**	**CLSB**	**ICAEW**	**IPReg**	**MoF**	**SRA**	**TLSS**[92]
Cover type	Mandatory mutual / then open market	Qualifying insurers / open market	Participating insurers / open market[93]	Open market[94]	Participating insurers / open market	Participating insurers (PAMIA majority provider)[95]	Open market	Participating insurers / open market[96]	Mandatory MPS
Minimum cover	BMIF primary layer - £0.5 up to £2.5m[97] per claim by practice area / revenue	Qualifying insurers - £2m any one claim[98]	£2m per claim	£100k per claim	Participating insurers - £100k-£1.5m total by firm size (£0.5m probate firms)	£250k in the aggregate	£1m in the aggregate	Participating insurers - £2m / £3m (by firm type) each claim	£2m per claim
Top-up (above min.) cover	Open market above £2.5m	Open market[99]	Open market	Open market	Open market	N/A[100]	Open market	Open market	MPS
Value of premiums	£14.7m	TBD	£4.3m[101]	£250k	£30m	£3m	£0.5 - £1m	£246.6m	£15 - £20m
Premium basis	Insurer directed (fixed rating schedule)	Insurer directed	Insurer directed	Insurer directed	Insurer directed	N/A	Insurer directed	Insurer directed	Insurer directed (rating factors)

[92] https://www.lawscot.org.uk/rules-and-guidance/section-b/rule-b7-professional-indemnity-insurance/rules/b71-master-policy/
[93] In June 2016 the LSB granted an application by the CLC to move to this arrangement: http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/CLC_PII_Decision_Notice_FINAL.PDF
[94] Open market here and in the remainder of the table means that cover is not subject to AR MTC or rules.
[95] http://ipreg.org.uk/pro/rules-and-regulations/code-of-conduct/
[96] http://www.sra.org.uk/solicitors/handbook/indemnityins/content.page
[97] Limits of cover applied by BMIF: http://www.barmutual.co.uk/insurance-cover/premiums-rates-limits/
[98] http://www.cilexregulation.org.uk/~/media/pdf_documents/cilex-regulation/resources/pii-minimum-wording.pdf?la=en
[99] http://www.cilexregulation.org.uk/entity-regulation/professional-indemnity-insurance
[100] http://ipreg.org.uk/wp-content/files/2016/06/Minimum-Terms-and-Conditions-2016.pdf
[101] Figure provided by the CLC in July 2016

Market	BSB Self-employed barristers	CILEx Reg Entities	CLC	CLSB	ICAEW	IPReg	MoF	SRA	TLSS[92]
Size of regulated community	15.2k individuals, 44 entities[102]	6.8k individuals, 4 entities[103]	1.3k individuals, 179 entities[104, 105]	598 individuals[106]	92 individuals, 150 entities[107]	2.3k individuals, 242 entities[108]	800	145k individuals, 10.8k entities[109]	10.4k
Excess	£350 for professional misconduct / wasted costs applications	£3k per partner with a 15 partner cap	Max £3.5k or % of fees. Firms with fees >£1m can apply to increase excess	None specified	Not more than £30k x no of principals but no restriction for firms with more than 50 principals	£500 - £7.5k per claim. Exceptions apply	None specified	None specified	£3,000 per partner (max. 15 partners)
Significant policy exclusions	Yes	Yes	Yes	No MTC in force	Yes	Yes	No MTC in force	Yes	None
Fraud	Limitations apply	Limitations apply	Limitations apply	No MTC in force	Limitations apply	Limitations apply	Separate fidelity insurance	Person involved not covered	Covered (bar all principal fraud)
Run-off	£0.5m. Option to increase for up to 6 years to previous level of cover if higher	6 years conditional on payment of premium	6 years	6 years recommended	2 years, but 'best endeavours' applies to secure 6 years cover	No guidance	No guidance	6 years	Unlimited cover (premium in limited circumstances)
ARP	N/A	None	N/A	N/A	Insurers must subscribe	N/A	N/A	Closed 2013	N/A

Except where footnotes indicate otherwise the information in this table is drawn from the SRA July 2015 discussion paper

[102] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_BSB_PERFORMANCE_REPORT.pdf
[103] http://www.cilexregulation.org.uk/~/media/pdf_documents/cilex-regulation/resources/cilex_authorised_entity_directory_13_june_2016.pdf
[104] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_CLC_PERFORMANCE_REPORT.pdf
[105] 230 entities as at July 2016 (source: CLC).
[106] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_CLSB_PERFORMANCE_REPORT.pdf
[107] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_ICAEW_PERFORMANCE_REPORT.pdf
[108] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_IPREG_PERFORMANCE_REPORT.pdf
[109] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/pdf/1605_SRA_PERFORMANCE_REPORT.pdf

Annex B – Legal sector regulatory arrangements

AR requirements

1. The PII market for the regulated legal sector has seen change recently, particularly for solicitors and, to a lesser extent, for licensed conveyancers. Their arrangements are looked at below, along with those of the BSB, which is an outlier among ARs in imposing a restriction on choice. These cover the three models discussed above at paragraph 14 for delivering PII.

Bar Standards Board

2. The BSB requires all self-employed barristers to use the BMIF for their first layer of PII, in return the BMIF guarantees to provide them with cover. The minimum amount of cover is £500k, with the BMIF prepared to go up to £2.5m. The effect of the BSB's rules may mean that a self-employed barrister has to obtain top-up insurance in excess of £2.5m.[110] Top-up cover can be bought on the open market and the BMIF provides information on two brokers on its website.[111]

3. The BMIF is a not for profit company run for the benefit of its members. It is managed by its Board, with executive functions outsourced to Thomas Miller (Bar Mutual Management Company). The BMIF sets the MTC that apply to the self-employed bar. The mutual scheme was set up by the Bar in 1988, following a report that was prepared for the Bar Council as a result of concerns about securing PII cover, clients not receiving payments and perceptions around costs. The Bar Council arrangements were then 'passported' into the regulatory arrangements of the BSB (which was established in 2006). Bar Council involvement in the BMIF has declined, although its Chairman still has a dispute resolution function.

4. The introduction of entity regulation prompted the BSB to introduce MTC for them that essentially mirror the BMIF's (and will determine those for alternative business structures if our recommendation to the Lord Chancellor that the BSB is designated as a licensing authority is accepted). It has said that although there is no formal protocol for review of regulatory arrangements, any significant changes by the BMIF would be likely to prompt action by the BSB.

5. The BMIF determines cover by applying a rating schedule. This applies a percentage rate to income declared for different areas of practice, to determine a member's basic contribution/limit of cover. Members can pay additional amounts to increase their cover up to the upper limit. Its approach appears to differ from other insurance arrangements in not taking account of individual claims history or risk management.

[110] The effect of the cab rank rule is that a barrister must accept instructions if potential liability for professional negligence in respect of the particular matter is unlikely to exceed the level of PII which is reasonably likely to be available in the market.
[111] One of which, LONMAR, is a Bar Council service partner.

6. On leaving the market a member may have to pay a cessation contribution set by the BMIF[112] in respect of future claims (which may be nothing).

Council for Licensed Conveyancers

7. The CLC's MPS was in place between 1988 and 2016. Until 2011 firms were required to buy their first layer of cover from the MPS, which could either be topped up with MPS or from the open market. MPS provided cover, but subject to limitations around significant claims history. The base rate for policy premiums was negotiated by an appointed broker and agreed by the CLC. Individual policy cost was based on firm turnover, along with claims history and the level of the policy excess. It is possible a small number of firms got cover under the MPS that would not otherwise have done so.

8. Historically, the CLC balanced concerns about restrictions on choice against risk of small firms being unable to get cover in an open market. It recognised that the MPS involved a degree of cross-subsidy. However, members were concerned about costs of servicing PII claims being high relative to their total value.

9. A drive to secure lower premiums led to the ability to opt out of the MPS in 2011. The OFT's advice to the LSB on the CLC's application to become a licensing authority welcomed this option.[113] Alongside this, the Society of Licensed Conveyancers introduced a similar rival product.[114] More recently, after around a third of its regulated firms decided to opt-out of the MPS, the CLC made an application to the LSB to move to an open market.[115] In doing this, the CLC did not consider transitional arrangements to be necessary. We granted the CLC's application in June 2016.[116]

Solicitors Regulation Authority

10. The SRA is of interest because the solicitors' market has tried different approaches to PII. These have been the subject of detailed analysis in the Charles River Associates report. A MPS was in place between 1976-1987, with the Law Society apportioning the overall policy premium among the profession. This came under pressure during the 1980s recession, with claims payments exceeding premium income.

11. To counter falling numbers of insurers and increasing premiums, the profession effectively became its own insurer between 1987-2000, through the SIF. Concerns about cross-subsidisation and a significant fund shortfall that the profession had to meet (through poor policy pricing and claims being

---

[112] Practitioners are typically required to purchase cover on exiting the market. The length of cover varies by AR, for example the SRA requires it to be in place for 6 years unless there is a successor practice assuming liabilities. This has been highlighted as a significant cost, for example around three times an annual PII policy.

[113] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/oft_advice.pdf

[114] http://www.conveyancers.org.uk/2015/12/23/slc-announces-strong-interest-in-alternative-pi-policy/

[115] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/20160525_Application.pdf

[116] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/CLC_PII_Decision_Notice_FINAL.PDF

underestimated), led to a vote to open the PII market to competition. The Law Society had stated that this would mean SIF closing and transitional arrangements (the ARP) that effectively acted as insurer of last resort) were used to generate interest among insurers and to manage the impact on firms that could not secure cover.

12. Today, the SRA develops MTC that participating insurers' policies must meet. It does not impose a credit rating requirement on them, in comparison to CILEx Regulation for example. Insurers determine policy pricing with minimum cover of £2m per claim for sole practitioners and partnerships and £3m for limited companies and LLP. The SRA does not take a view on whether firms that cannot secure cover are otherwise 'viable'.

Other comparable regulatory requirements

13. Looking further afield, TLSS and the Law Society of New South Wales (Australia) have offered interesting comparisons. Their selection for analysis in part reflect the relative availability of information via desk based analysis.

The Law Society of Scotland

14. TLSS has had a MPS in place since 1978. The MPS uses a broker and lead underwriter, with other insurers taking a proportion of all the premiums and claims. The overall premium is agreed between TLSS and the insurers, with premiums and underwriters reviewed annually. Individual premiums apply discounts and loadings, reflecting different types of risk or changes in the level of the policy excess. TLSS is informed by the insurers of emerging trends about claims as a whole, but not at a granular level.

15. Between 2003–05 the Office of Fair Trading (**OFT**) investigated if the MPS restricted or distorted competition in the market for solicitors' services. Full details of the investigation are not available, but the OFT's case summary concluded that there was insufficient evidence to show the MPS appreciably restricted competition between individual solicitor firms by denying freedom of choice of insurer.[117] However, it stressed that it was not necessarily fully satisfied.

16. Considerations in the OFT's decision to close its case included that policy premiums took account of claims history. Whether apparent benefits of the solicitors' market in England and Wales, in terms of greater freedoms to seek insurance directly from approved insurers, could be achieved for the much smaller Scottish legal profession (who play a wider role in the conveyancing market) also appears to have been an element in the decision. A contributing factor might also have been that Scottish solicitors were believed to be more uniform businesses compared to England and Wales, with a lower total value of PII premium.

[117] http://webarchive.nationalarchives.gov.uk/20140402142426/http:/www.oft.gov.uk/shared_oft/ca98_case_closures/2005.pdf;jsessionid=3096200B1A596BBD84AF4E686084B1F5; http://www.gov.scot/Publications/2006/04/12093822/6

The Law Society of New South Wales (Australia) – Lawcover

17. Although owned by the New South Wales Law Society, Lawcover is operated separately. It was a mutual scheme between 1987-2004, until financial sector regulatory requirements meant it became an insurer.[118]

18. It covers over 16k solicitors in around 5.5k practices, the majority of which are said to be small and geographically spread out. It provides cover of up to $2m (AUS), but also top-up of up to $20m (AUS) via an endorsement to the existing policy. Fees apply by area of practice, but with discounts and loading factors applied.[119] It believes there is limited cross-subsidy in the model.

19. Lawcover also runs an education program that is intended to reduce claims, and is said to demonstrate clear return on investment leading to lower premiums and a policyholder rebate. This makes use of 20 years of claims and causation data.[120]

20. There have been concerns about the viability of an open market, but also about the cost of premiums (which have perhaps reflected the absence of competitive pressures),[121] which Lawcover has sought to address.[122] Its cover is expensive compared to other arrangements in Australia, but New South Wales is also noted as having high claims.[123]

[118] http://www.lawcover.com.au/wp-content/uploads/2015/10/TCP3437_LawcoverAR_vFA_e.pdf
[119] http://www.lawcover.com.au/how-we-calculate-your-premium/
[120] http://www.lawcover.com.au/wp-content/uploads/2015/02/LSJ-DEC-2013-Lawcover.pdf
[121] http://insurancenews.com.au/analysis/lawyers-pi-is-one-slice-enough
[122] http://lawcover.com.au/lawcovenotes/august-2015-lawcovernotes/
[123] http://lawcover.com.au/lawcovenotes/august-2015-lawcovernotes/

Annex C – Overview of competition law

The objective of competition law

1. Competition law seeks to promote, among other things, innovation, consumer choice and lower prices for consumers and other customers, by restricting practices that prevent or reduce competitive pressures applying in different markets.

Enforcement (UK)

2. Neither we nor ARs have enforcement powers in respect of competition law (as distinct from the Act's regulatory objective on promoting competition in the provision of legal services). The CMA is primarily responsible for enforcement of UK competition law and corresponding EU law, although certain sectoral regulators have concurrent jurisdiction to enforce the prohibitions within their respective regulated sectors (for example Ofgem for the energy markets).

3. The Competition Act may also be invoked in private litigation before UK courts. From October 2015 a new regime for competition claims was introduced (via the Consumer Rights Act 2015) to provide, among other things, for collective actions, settlements and voluntary redress schemes. This will allow any representative consumer group or trade association to take forward an action.

Sources of competition law

4. UK competition law is derived from legislation and extensive case law. The main sources of legislation are described below. However, recognising the constraints noted above we have not sought to identify or review applicable case law.

5. The Competition Act is the main piece of UK legislation. Its prohibitions are closely modelled on Articles in the Treaty on the Functioning of the European Union 2007 (**TFEU**). The Competition Act incorporates requirements to minimise divergence in the application of UK and EU prohibitions. The implications of the UK EU referendum for this area are not clear at this point.

6. UK competition rules can be considered under four broad headings, although for the purposes of this thematic review the first three are most relevant and so are discussed in more detail below:

    a) anti-competitive agreements and cartels

    b) abuse of market power

    c) market investigations

    d) merger control.

Anti-competitive agreements and cartels

7. Chapter I of the Competition Act prohibits any agreement or concerted practice that may affect trade between Member States and which have the object or effect of preventing, restricting or distorting competition unless an exclusion or

exemption from the prohibition applies. Chapter I is based on Article 101 of the TFEU. Where the agreement or concerted practice affects trade between EU Member States, it may also be prohibited by Article 101. Companies and individuals found to have breached the Chapter I prohibition are liable to penalties.

8. Chapter I comprises several elements, each of which must be satisfied in order for the prohibition to be infringed. There must be:

    - *an agreement, decision* (including those of trade associations which constitute agreements between members) *or concerted practice* (i.e. this includes formal and informal arrangements);
    - *between undertakings* (although mainly those with significant combined market share). This is broadly interpreted to include natural or legal persons engaged in economic activity (i.e. commercially offering or supplying a good or service), irrespective of legal status and means of finance. Public sector bodies engaging in economic activities can be undertakings for these purposes;
    - *which may affect trade within the UK (or part of it)*; and
    - *which has as its object or effect (which must be appreciable), the prevention, restriction or distortion of competition within the UK*.

9. Guidance exists on the implications of competition law for public bodies.[124] This highlights that they must assess on a case-by-case basis if, in carrying out any of their functions, they are acting as undertakings (with focus on the nature of the activity being conducted).[125] Case law has set out certain broad principles that should be taken into account, with public bodies asking themselves a) am I offering/supplying a good/service, as opposed to, for example, exercising a public power?, and b) if so, is the offer/supply 'commercial' in nature – rather than exclusively 'social' in nature? This reflects, generally speaking, that legislation is not targeted at activities that are intrinsically regulatory, but rather those that are economic.

10. Competition law may apply to agreements and conduct relating to a public body's purchasing activities (individually or jointly with others). Whether an activity is economic in nature depends on the end use the public body puts the goods or services to. If they are related to a subsequent offer or supply of goods or services on a market, then, if the downstream supply is considered to be an economic activity, the purchasing activity is also likely to be economic. By contrast, if the public body doesn't directly offer or supply goods or services in that (or a related) market, it will not typically be acting as an undertaking.

11. Where public bodies offer or supply goods or services, it is necessary to consider if downstream supply is of a commercial or exclusively social (non-economic)

[124] OFT 404 (CMA powers of investigation). https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284398/oft404.pdf
[125] A diagram on the application of competition law to public bodies is at page 7 of the OFT guidance.

nature. The clearest example of commercial activity is that undertaken for profit in direct competition with private sector companies. However, an activity need not generate a profit – or even have a profit-making motive.

12. Whether an activity is exclusively social in nature is highly fact specific, taking account of all its aspects as a package. These have previously been characterised as activities that by their very nature could not – even in principle – be carried out for profit without State support. Importantly, though, the fact that private sector companies currently do not carry out activities in a market does not preclude the possibility of an activity being economic. Past cases, including on State controlled compulsory insurance schemes, have involved provision to members regardless of financial status, which did not take account of contributions in paying out benefits and were non-profit-making.

13. Examples of the types of agreements previously considered to have breached the prohibition include price fixing; anti-competitive trade association rules and recommendations; and rules of sporting bodies governing entry criteria.

14. The Competition Act includes a non-exhaustive list of agreements that will generally be considered to have the object of preventing, restricting or distorting competition, in which case no analysis of their effect is needed. Appreciable effect for other agreements takes account of combined share of the relevant market, and factors such as the structure and characteristics of that market, including the state of competition in it in the absence of the agreement in question.

15. In order to analyse the economic context of an agreement, it is necessary to identify the relevant product and geographic markets affected by it. This requires structured analysis, taking account of different tests and considerations, which is flexible enough to take individual circumstances into account. In practice, it involves balancing various types of evidence and the exercise of judgement.

16. Some exclusions from the Chapter I prohibition apply, with the Competition Act enabling the Secretary of State to add to or remove them. This includes agreements made to comply with a legal requirement, including (among other things) one imposed by any enactment in force in the UK. Exclusions relating to public bodies acting as undertakings are interpreted strictly, and will generally be applicable only in very limited circumstances. Agreements that an undertaking must enter into, or conduct it must engage in, may be excluded if a ‘legal requirement’ (i.e. explicitly in legislation or other legal instrument) applies, but again this is expected to be applicable only in very limited circumstances.

17. Individual exemption from the prohibition may apply if an agreement satisfies (and continues to do so) certain criteria – broadly, that the competitive disadvantages to which the agreement gives rise are outweighed by other economic benefits. Such benefits should accrue to customers and the agreement should contain the least restrictive means of achieving the relevant benefits. No prior decision on exemption is needed. Block and parallel exemptions may also apply in specified circumstances. For example an EU block exemption exists in

relation to certain agreements in the insurance sector (related to specific forms of cooperation considered indispensable to carrying on insurance business).

18. Agreements that infringe the Chapter I prohibition are void and unenforceable (if the anti-competitive restrictions can be severed from the rest of the agreement, then only those restrictions will be void and unenforceable).

Abuse of market power

19. Chapter II of the Competition Act prohibits the abuse of a dominant market position in the UK. Such an abuse may also breach Article 102 TFEU to the extent that it affects trade between EU Member States. Civil sanctions for breaching the Chapter II prohibition are as for Chapter I, but there are no criminal sanctions for purely unilateral conduct.

20. Chapter II has several elements:

    - *any conduct;*
    - *by one or more (sufficiently linked) undertakings which, either singly or collectively, hold a dominant position in a market* (with that including public bodies engaging in economic activity (with the same considerations here as for Chapter I) and dominance normally meaning a market share of 40% or more, but with other factors taken into account including the number and size of competitors and customers, and whether new businesses can easily set up in competition)*;*
    - *which amounts to the abuse of a dominant position in a market; and*
    - *which may affect trade within the UK (or any part of it)* (with no requirement for the abuse to occur in a UK market, so long as the undertaking committing abuse is dominant in relation to a UK market, and that the conduct complained of produces effects in the UK or part of it)*.*

21. Most cases investigated (by the Office of Fair Trading (**OFT**) and sectoral regulators) have related to conduct alleged to have excluded competitors from a market. Forms of conduct that have been reviewed for potential exclusionary effects include the conclusion of exclusive purchasing, supply or distribution agreements so as to create a barrier to entry, and pricing with exclusionary effects. Cases in which conduct has been alleged to exploit customers have been fewer in number and most have related to excessive pricing. However, concerns were raised by OFT previously on conduct that discriminated between customers.

22. Whether an undertaking enjoys sufficient economic strength to be considered dominant may depend on how the relevant market is defined. Again, this requires careful assessment of the goods or services involved and the geographic extent of the market.

23. The Chapter II prohibition does not define abuse, but sets out a non-exhaustive list of specific conduct that may constitute it. In practice, Article 102 cases have

included pricing abuses, such as predatory pricing (undercutting a rival with a view to eliminating him from the market).

24. There is limited immunity from fines in the case of 'conduct of minor significance', which is defined as conduct by a firm with turnover in the preceding financial year not exceeding £50 million, but the CMA can decide to withdraw it following an investigation. There is no protection against third party actions for damages. The Competition Act sets out exclusions from the prohibition. General exclusions include conduct engaged in to comply with a legal requirement. There is no possibility of exemption from the Chapter II prohibition.

Market investigations

25. The Competition Act prohibitions operate alongside market investigation powers in the Enterprise Act 2002 (**the Enterprise Act**).[126] The CMA has wide powers to investigate markets (as a whole or in part) where there are concerns that competition may not be operating effectively. A market study can lead to an investigation, thus serving as the first phase in a two-phase process. In investigating, the CMA is required to decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom.[127]

26. An investigation is able to tackle adverse effects on competition from any source, including structural aspects of the relevant market. The Enterprise Act does not specify a theoretical benchmark against which to measure an adverse effect on competition. Market investigation reports have used the term, "a well-functioning market" in the sense, generally, of a market without the features causing the adverse effect on competition, rather than to denote an idealised, perfectly competitive market.[128]

27. The CMA has published guidelines for conducting market investigations.[129] The guidelines describe ways in which competition in a market can be impeded, including through the existence of significant market power, with incumbent firms potentially given an advantage by barriers to entry and expansion, including as a result of regulatory requirements. They go on to state that, among others, regulators have an important role to play in making sure competition is as effective as possible.[130]

---

[126] Amended by the Enterprise and Regulatory Reform Act 2013.
[127] Section 134(1) of the Enterprise Act.
[128] Although there has been recent commentary on this point in the context of the energy market investigation, Stephen Littlechild, February 2016: https://assets.digital.cabinet-office.gov.uk/media/56b9d951e5274a0369000015/Mr_Stephen_Littlechild_submission_February_2016.pdf
[129] Guidelines for market investigations: Their role, procedures, assessment and remedies, April 2013 (published under s171(3) of the Enterprise Act: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284390/cc3_revised.pdf
[130] CMA guidelines, paragraph 16.

28. In assessing whether or not an adverse effect on competition has arisen the CMA looks at three basic issues:

    - the main characteristics of the market (for example market share data, relevant legal and regulatory framework and history of the market) and the outcomes (for example prices and profitability, levels of innovation, product range and quality) of the competitive process
    - the composition of the relevant market within which competition may be harmed (market definition)
    - the features, if any, which are harming competition in the relevant market (the competitive assessment – which the CMA frames using, 'theories of harm')[131], considering also possible countervailing factors, such as efficiencies, which may remove or mitigate the competitive harm of the features (for example benefit competition and operate to the benefit of customers).

29. Specific structural features identified in past investigations to be harming competition include aspects of the planning system, government policy and the regulatory system. 'Conduct' of a market participant includes any failure to act, whether intentional or not, and any other unintentional conduct.[132] Positive effects of barriers to entry may include incentives to innovate or delivery of important social goals outside the scope of competition policy.

30. In the event of an adverse report a wide range of legally enforceable remedial steps (which will have regard to proportionality) may be taken. The identification of anticompetitive features in a market investigation or the imposition of remedies does not equate to a finding that the law has been infringed. Remedies typically focus on making the market more competitive in the future and make recommendations for remedial action by other public bodies. In making an assessment of proportionality, the CMA is guided by principles that the remedy is one that:

    - is effective in achieving its legitimate aim
    - is no more onerous than needed to achieve its aim
    - is the least onerous if there is a choice between several effective measures
    - does not produce disadvantages which are disproportionate to the aim.

31. Where the CMA is considering whether to modify licence conditions in a regulated sector would be proportionate it will have regard to the relevant statutory functions of the regulator concerned.[133] The potential effects – positive and negative – of a particular remedy on those persons most likely to be effected

[131] Hypothesis of how harmful competitive effects may arise in a market and adversely affect customers (without any prejudgement of there being an adverse effect on competition).
[132] Section 131(2) of the Enterprise Act.
[133] Section 168 of the Enterprise Act.

by it will be considered. This includes customers, businesses, government and regulatory bodies.

32. The decision whether to implement remedies by means of accepting undertakings or making an order is determined case by case, primarily based on practical issues and whether the proposed remedy falls within the scope of order-making powers in the Enterprise Act.[134] In contrast, the subject of an undertaking is not limited.[135]

[134] Schedule 8 sets out the types of provisions that could be included in an order and Part 1 of Schedule 9 enables the CMA to modify, by order licence conditions in various regulated markets.
[135] Section 164(1) of the Enterprise Act.

Annex D – Glossary of terms

Term	Definition
AR or approved regulator	Defined in section 20 of the Act as a body which is designated as an approved regulator by Part 1 or under Part 2 (or both) of schedule 4 to the Act and whose regulatory arrangements are approved for the purposes of the Act.
ARP	Assigned Risks Pool(s). Employed by some ARs as part of indemnification arrangements. These may provide insurance for firms that do not get cover on the commercial market. The premium level(s) may be set to discourage firms from entering and there may be restrictions on their use of it.
Bar Council	The Bar Council. The approved regulator (representative body) for barristers in England and Wales according to the Act.
BMIF	Bar Mutual Indemnity Fund is a not for profit company run for the benefit of its members. Self-employed barristers practising in England & Wales are required to obtain their primary or first layer of PII from BMIF and it undertakes to provide cover to them in return. It may, but is not required to provide cover to BSB regulated entities.
BME	Black and Minority Ethnicity.
BSB	Bar Standards Board. The independent regulatory arm of the Bar Council. The BSB regulates barristers called to the Bar in England and Wales and (non-alternative business structure) entities.
Charles River Associates report	Commissioned by the SRA, a report in 2010 on a, "root and branch" review of client financial protection arrangements, considering (among other things) the different structural models that could be used to deliver PII.
CILEx Regulation	The independent regulatory arm of the Chartered Institute of Legal Executives (CILEx). It regulates chartered legal executives, other CILEx members and non-members with practice rights in the legal sector (including associate prosecutors).
Competition Act	The Competition Act 1998.
CLC	Council for Licensed Conveyancers. The AR for licensed conveyancers, licensed conveyancing practices and probate practitioners working throughout England and Wales. It has no representative function.
CLSB	Costs Lawyer Standards Board. The independent regulatory arm of the Association of Costs Lawyers. It regulates costs lawyers who hold a practising certificate to practice in England and in Wales.
CMA	Competition and Markets Authority.

Term	Definition
Consumer- i.e. clients and potential consumers	Defined in section 207(1) of the Act as persons who use, have used or are or may be contemplating using any services within section 207(2) of the Act, which provides for any service provided by a person who is an authorised person in relation to an activity which is a reserved legal activity and any other services which consist of or include a legal activity carried on by, or on behalf of, that person. The person providing those services may or may not be authorised to conduct a reserved legal activity.
Enterprise Act	The Enterprise Act 2002.
First principles approach	A first principles approach in legal services regulation is an approach that first considers whether there is a risk to the regulatory objectives that demands regulatory intervention. If so, costs and benefits of possible options should be assessed and the least restrictive way of resolving the issue adopted.
Indemnification arrangements	For the purposes of regulatory arrangements, defined in section 21 of the Act, in relation to a body, as arrangements for the purpose of ensuring the indemnification of those who are or were regulated persons against losses arising from claims in relation to any description of civil liability incurrent by them, or by employees or former employees of theirs, in connection with their activities as such regulated persons.
ICAEW	Institute of Chartered Accountants in England and Wales. The regulator and professional membership body for the accountancy profession in England and Wales. There is no separate regulatory body and all decisions relating to legal activities are delegated to the independently chaired Probate Committee.
IPREG	Intellectual Property Regulation Board. The independent regulatory body for individual Trade Mark and Patent Attorneys and entities (ABS and non-ABS). It is a joint Regulation Board set up by the Chartered institute of Patent Attorneys (CIPA) and the institute of Trade Mark Attorneys (ITMA), which are approved regulators under the Act.
Lawcover	Owned by the Law Society of New South Wales (NSW), Lawcover provides approved PII to legal services practitioners in NSW and the Australian Capital Territory.
Law Society	The approved regulator (representative body) for solicitors in England and Wales according to the Act.
LSB	The Legal Services Board is the Independent body responsible, in accordance with the terms of the Act, for overseeing the regulation of the legal services sector in England and Wales.
MOF	The Master of the Faculties is the regulator of the profession of notaries in England and in Wales, and the Faculty Office (led by the Registrar) assists the Master in his functions.

Term	Definition
MPS	Master Policy Scheme**.** Collective purchasing of PII to deliver a policy that covers each member of a group, for example with a body (such as an AR) arranging the policy and then determining how its total cost is apportioned between those insured.
MTC	Minimum terms and conditions define the scope of PII cover for practitioners.
Mutual fund	A profession becomes its own insurer, paying premiums into a common fund to cover claims. Members effectively own the insurance company.
Ofgem	The Office of Gas and Electricity Markets.
Open market	Those seeking insurance are able to select their own PII provider, although this may be subject to limitations set by the relevant AR, for example insurers having to sign up to specified MTC (with a view to consumer protection) or having a suitable credit rating.
OFT	The Office of Fair Trading. Its responsibilities have been passed to a number of different organisations.
PAMIA	Professional Indemnity Insurance for Patent and Trademark Attorneys. It is a mutual not-for-profit provider of PII to patent and trade mark attorneys in the UK and Ireland.
PII	Professional Indemnity Insurance. Employed by ARs as indemnification arrangements.
Regulatory arrangements	Defined in section 21 of the Act; includes indemnification arrangements.
Regulatory objectives	The LSB and the approved regulators have a duty to promote eight regulatory objectives set out in section 1 of the Act: • Protecting and promoting the public interest • Supporting the constitutional principle of the rule of law • Improving access to justice • Protecting and promoting the interests of consumers • Promoting competition in the provision of services in the legal sector • Encouraging an independent, strong, diverse and effective legal profession. • Increasing public understanding of citizens legal rights and duties • Promoting and maintaining adherence to the professional principles of independence and integrity; proper standards of work; observing the best interests of clients; complying with the duty to the court to act with independence in the interests of justice; and maintain client confidentiality.
RPI	The Regulatory Policy Institute.
Reserved legal activities	Defined in section 12 of the Act as: the exercise of a right of audience; the conduct of litigation; reserved instrument

Term	Definition
	activities; probate activities; notarial activities; and the administration of oaths. These activities may only be carried out by those authorised by an AR (or those who are exempt). Their scope is set out in Schedule 2 to the Act.
SIF	Solicitors Indemnity Fund. A mutual fund established by the Law Society to provide compulsory indemnity insurance to the solicitors' profession, which operated between 1987-2000.
SRA	Solicitors Regulation Authority is the independent regulatory arm of the Law Society. The SRA regulates solicitors and entities (ABS and non-ABS) in England and Wales.
The Act	The Legal Services Act 2007.
TFEU	Treaty on the Functioning of the European Union 2007.
TLSS	The Law Society of Scotland is the regulator and professional membership body for solicitors in Scotland. There is no separate regulatory body.