An indicative cost benefit analysis of the future regulation of authorised professional firms

A report for the Solicitors Regulation Authority

May 2012

© Economic Insight Ltd 2012

Contents

1 Introduction 4
2 Background and context 5
2.1 The current regulatory framework 5
2.2 The issues the SRA is seeking to address 5
2.3 The SRA's proposals 6
2.4 The scope of our work 7
3 Cost benefit analysis 9
3.1 Background to cost benefit analysis 9
3.1.1 Identifying and assessing costs and benefits 9
3.1.2 A proportionate approach 10
3.1.3 Dealing with risks and uncertainties 10
3.2 Our analysis of the SRA's options 11
3.2.1 Identifying relevant stakeholders 12
3.2.2 Identifying the counterfactual 12
3.2.3 Key impacts of the SRA's proposed options 13
3.2.4 Analysing costs 18
3.2.5 Analysing benefits 22
4 Conclusions and findings 26

1 Introduction

The Solicitors Regulation Authority (SRA) asked Economic Insight to undertake an indicative cost benefit analysis (CBA) of its proposals relating to the future regulatory treatment of authorised professional firms – particularly in relation to the regulation of certain financial activities undertaken by them. This report sets out the findings of our analysis and is structured as follows:

- Section 2 provides some background and context to our report; and describes the future regulatory options proposed by the SRA and the scope of our work.

- Section 3 sets out the analysis we have undertaken, including details of the methodology we employed.

- Section 4 summarises our findings and conclusions.

2 Background and context

In this section we provide some background and context to our analysis, addressing in turn:

- the current regulatory framework;
- the issues the SRA is seeking to address;
- the SRA's proposals for addressing the issues; and
- the scope of our work for the SRA.

2.1 The current regulatory framework

The SRA's proposals, which we have been asked to assess, relate to the future regulation of the financial activities undertaken by a subset of law firms that are *'authorised professional firms'*. In order to consider the impact of the SRA's proposals therefore, it is first necessary to understand the prevailing regulatory framework that exists in relation to the financial activities undertaken by law firms.

Under the Financial Services and Markets Act 2000 (FSMA), no one in the United Kingdom can carry out financial services activities (known as regulated activities) unless they are authorised by the Financial Services Authority (FSA) to do so, or they are exempt.

The majority of law firms do not provide mainstream financial services, but do provide certain 'non-mainstream' services to clients in the course of providing legal advice. These firms are subject to an exemption in Part XX of the FSMA, which allows them to undertake 'exempt regulated activities' relating to these non-mainstream financial services under regulation by the SRA.

A small number of law firms provide mainstream financial services to their clients; and so are not subject to the exemption. They are authorised by the FSA to conduct these regulated activities and are described as authorised professional firms (APFs); they are also regulated by the SRA. Because they are dually regulated, APFs benefit from certain 'carve-outs' from compliance with the FSA Handbook of rules and regulations. These APFs can also undertake non-mainstream regulated financial activities. When undertaking such activities they are required to comply with the SRA Financial Services (Conduct of Business) Rules 2011, in the same way as exempt professional firms, plus a limited number of FSA regulations, which are only relevant to authorised firms when they carry out non mainstream regulated activities.

2.2 The issues the SRA is seeking to address

The Legal Services Act (2007) enabled new forms of legal practice to develop, including Alternative Business Structures (ABSs) which allowed - for the first time - non-lawyers to be either managers of, or have an ownership interest in, law firms. The SRA granted its first licenses to ABSs on March 28th 2012.

In the context of the prevailing regulatory framework relating to financial services provided by law firms, the licensing of ABSs raises two issues, which are described in the SRA's main consultation document:

- whether the scope of the SRA's regulation of ABSs should include the regulation of mainstream financial services provided by those firms (ABS APFs); and
- whether and how the SRA should regulate the financial services provided by traditional APFs (i.e. non-ABS APFs) - and how this fits with the SRA's approach to regulating ABS APFs.

In relation to the first of the above issues, the SRA has stated that it believes the scope of its regulation of ABSs should not extend to any activities that are not legal services. Consequently, the SRA will not be authorising the mainstream financial activities of ABS APFs. This approach would have created a 'regulatory gap' in that the financial activities of ABS APFs would fall outside of the scope of both SRA and FSA regulation. To address this matter the FSA published a Policy Statement, which removed the exemptions (the carve-out) in its rules that applied to professional firms (including ABSs) which are APFs.[1]

The second issue arises because, given the SRA's view that its regulatory scope in relation to ABSs should not include mainstream financial activities, there is an inconsistency in the treatment of ABS APFs and traditional APFs (because traditional APFs at present continue to benefit from the FSA carve-out). Consequently, the options developed by the SRA (summarised in the following) provide alternative ways of addressing this inconsistency.

2.3 The SRA's proposals

The SRA has identified three options for removing the inconsistency set out above. These are described within the SRA's consultation document, but are summarised in Table 1 (shown overleaf).

[1] See 'Policy Statement PS11/17: Authorised professional firms and legal services reform, feedback to CP11/13 and final rules.' The FSA (December 2011).

Table 1 Summary of the SRA's options

	Option 1	**Option 2**	**Option 3**
Headline description.	Bring ABS APFs into the regulatory model that currently applies to other APFs.	Extend the current ABS approach to all APFs.	Apply SRA regulatory requirements only to the conduct of non-mainstream regulated (financial) activities of all APFs.
Key features.	The SRA licence would include conditions enabling ABS APFs to undertake regulated (financial) activities.	The SRA's licence would not include any right to conduct regulated (financial) activities for ABSs. It would also switch off its rules and regulations in respect of traditional APFs.	The SRA's license would not include any right for APFs to conduct regulated *mainstream* financial activities (but would cover non-mainstream financial activities).
Implications for regulatory scope.	The SRA would be responsible for overseeing certain mainstream (where FSA carve outs apply) and non-mainstream financial activities of ABS APFs as well as for existing 'traditional' APFs.	The SRA would not be responsible for the regulation of either mainstream or non-mainstream financial activities. APFs would, therefore, no longer have the benefit of the carve outs from the FSA Handbook (and would also have to comply with FSA requirements with regards to activities that were previously classified as being "non-mainstream").[2]	The SRA would only be responsible for the regulation of non-mainstream regulated (financial) activities; and so this option would enable all APFs authorised by the SRA to undertake such activities in much the same way as exempt professional firms currently do.

Source: SRA consultation document

The SRA has indicated that Option 1 is its 'least preferred' option, as it places the regulator in a position where: *"its regulatory coverage will extend to an area of work in which it has little experience or expertise. This option also places the Compensation Fund at risk of being used to remedy breaches over which the SRA has no control."*[3]

2.4 The scope of our work

In the above context, the SRA asked Economic Insight to undertake an indicative CBA of the three options it has developed. In reviewing this report, it is important that we are clear as to the scope of our work for the SRA. In particular:

- We were not asked to address the issue of the underlying rationale for regulatory intervention in the first instance. That is to say, the SRA's interpretation of the Legal Services Act (which is a question of law and a matter for the SRA) has been assumed to be a 'given' for the purpose of our analysis.

---

[2] Under Option 2, whereby the SRA did not have regulatory responsibility for the financial activities of APFs, the distinction between mainstream and non-mainstream activities would no longer exist. However, the point is that, under this option, all financial activities (including those that were *formally* classified as being non-mainstream) would fall under the FSA's jurisdiction.

[3] As stated in the SRA's consultation document.

- We were not involved in the development of the three options that the SRA asked us to appraise.

- Within the available timescales for competing the work, is was not possible to undertake raw data and evidence collection (for example, to commission new surveys relating to the incremental impact on costs and benefits of the options). As a consequence, we have had to rely on existing data and evidence provided to us "as is". In areas where existing evidence did not exist, we have - where appropriate - made what we consider to be reasonable assumptions regarding the likely scale of costs and benefits. As a result, the CBA presented here should be treated as high level and indicative. We therefore believe that there is scope to further refine and improve the robustness of this initial CBA, should the SRA wish to do so in future. To assist in this matter we have, within this report, indicated where additional evidence and data would be of most importance.

3 Cost benefit analysis

In this section we describe the CBA we have undertaken for the SRA. This is made up of two parts. Firstly, we provide some background to CBA, and summarise the best practice approach to undertaking such analysis, as described in existing regulatory guidance. Secondly, we set out the details of the approach and methodology we have adopted in completing the present study.

3.1 Background to cost benefit analysis

CBA is an analysis which seeks to quantify, in monetary terms, as many of the costs and benefits of a proposal as possible; including items where markets do not provide a direct measure of economic value.

There is an extensive literature regarding the best practice approach to undertaking CBA; and the HM Treasury Green Book provides guidance as to the key stages of developing such an analysis.[4] In particular, The Green Book states that the first goal is to create a 'base case' for the costs and benefits of the options under consideration, which involves the following steps:

- Identify and value the costs of each option
- Identify and value the benefits of each option.
- If required, adjust the valued costs and benefits for distributional impacts and/or relative price movements.
- Adjust for the timing of the incidence of costs and benefits by discounting them, to obtain their present values.
- If necessary, adjust for material differences in tax between options.
- Adjust for risk and optimism to provide the base case, and consider the impacts of changes in key variables and of different future scenarios on the base case.
- Consider unvalued impacts (both costs and benefits), using weighting and scoring techniques if appropriate.

3.1.1 Identifying and assessing costs and benefits

In identifying relevant costs and benefits, we are interested in assessing the *incremental* impact on all costs/benefits that could be affected by the proposals being evaluated. That is to say, we are interested in understanding the costs and benefits that arise from the proposal over and above those that would have occurred in any event.

[4] 'The Green Book: Appraisal and Evaluation in Central Government.' HM Treasury (2003).

3.1.2 A proportionate approach

In practice, the level of detail within a CBA can vary considerably and is largely determined by a combination of: (i) the availability of evidence and data; and (ii) the proportionality of undertaking detailed analysis relative to the likely impact of the policy in question. In broad terms, there are three 'levels' at which CBA can be undertaken:

1. **Qualitative analysis:** in which the relevant costs and benefits are identified and described; and their likely consequences considered as part of the policy evaluation process.

2. **High level quantitative analysis**: in which the indicative scale of key cost and benefit items is assessed in order to provide a sense of the 'order of magnitude' of the likely net benefit of the policy.

3. **Detailed quantitative analysis:** in which a very granular quantification of most/all relevant costs and benefits is undertaken, often supported by fresh data collection and research, in order to provide the most robust possible view of the net benefit of the policy.

The need to ensure that CBA is applied in a proportionate manner is well understood both within the relevant literature and government guidance. For example, BIS' wider guidance on impact assessments states: *"The effort applied at each step of completing an Impact Assessment, in particular the estimation of cost and benefits, should be proportionate to the scale of the costs and benefits, outcomes at stake, sensitivity of the proposal and the time available. A less detailed Impact Assessment may be adequate where a regulatory proposal is likely to affect only a few firms or organisations, or many firms or organisations but only to a negligible degree, where the costs and benefits are likely to be negligible and can be captured within a lighter touch evidence base. By the same token, more data and analysis is required where the impact is expected to be substantial."*[5]

In our view, it is therefore important to ensure that any CBA is developed in a pragmatic manner, reflecting both the availability of data and evidence, but also the proportionality of the analysis to the issue under consideration.

3.1.3 Dealing with risks and uncertainties

CBA analysis is inherently uncertain because: (i) one can never know, ex ante, exactly what impacts the issue under consideration will have; and (ii) because it not possible to precisely quantify the cost and benefit implications of the identified impacts. Therefore, in all cases there is a need for CBA to explicitly take into consideration relevant risks and uncertainties (and when presenting results to make clear the implications of those risks and uncertainties).

There are a range of analytical techniques that can be used to address risk and uncertainty – and the appropriateness of each technique again depends on both data availability and the proportionality of the analysis. The key techniques of relevance are:

- **Qualitative assessment of uncertainties:** Identify and describe the key uncertainties (even if they cannot be quantified) and set out the potential implications for the conclusions.

---

[5] 'Impact Assessment Guidance: When to do an impact assessment.' BIS (2011), para 17.

- **Sensitivity analysis:** Showing how conclusions may vary depending on variations in key inputs or assumptions (i.e. if cost X was Y times bigger, would the answer change?)
- **Scenario analysis:** Identifying specific scenarios, designed to reflect key uncertainties upon which the conclusions depend, and reporting the results relative to the base case.
- **Monte Carlo analysis:** A statistical technique that shows the combined impact of various risks by using probability distributions for key input variables that are subject to uncertainty.

In our view, as a minimum a robust CBA should ensure that relevant risks and uncertainties are identified and described – so that the audience understands these risks and the implications for the results. In addition, where the CBA is itself quantitative in nature, in most cases it would be appropriate to also provide some quantification of the impact of risk and uncertainty. For example, at the very least, a range of cost/benefit measures should be provided, as indicated by BIS's guidance: *"In order to reflect the inherent uncertainty of costs and benefits estimates, you may need to provide a range for your costs and benefits estimates. Highlight the factors determining the outcome within any range and how any risks will be mitigated."*[6]

The above is also consistent with HM Treasury's Green Book, which states explicitly that the results of sensitivity (and other analysis addressing risk and uncertainty) should be included in the presentation of results and summary reports – rather than simply presenting single point estimates of expected net benefits. This is because it is important that the audience is able to understand that there is a range of possible outcomes, and the implications of these.[7]

3.2 Our analysis of the SRA's options

In the following we set out a description of the CBA we have undertaken in order to evaluate the three options proposed by the SRA. In turn we address:

- the stakeholders we have identified as being relevant (as their incremental costs/benefits may be affected by the SRA's proposed options);
- the counterfactual we have assumed;
- the key potential impacts of the SRA's proposed options;
- the costs we have identified and evaluated associated with the options; and
- the benefits we have identified and evaluated associated with the options.

[6] 'Impact Assessment Guidance: How to do an Impact Assessment.' BIS (2011), para 107.
[7] 'The Green Book: Appraisal and Evaluation in Central Government.' Para 2.15. HM Treasury (2003).

3.2.1 Identifying relevant stakeholders

For the purpose of our analysis we consider that the most relevant stakeholders (i.e. those most likely to face an incremental cost or benefit arising from the SRA's proposed options) are: law firms; end consumers of legal and financial services; and the SRA itself.

In addition to these, there may be other stakeholders who are indirectly affected by the proposals to a degree. However, based on the materials we have reviewed, we do not consider it likely that additional stakeholders would be materially impacted by the options (and further, it was not possible to consider additional stakeholders within the scope of our work).

3.2.2 Identifying the counterfactual

As described previously, the purpose of a CBA is to evaluate the incremental costs and benefits of the issue under consideration. Therefore, in this instance we are concerned with identifying and assessing the costs and benefits arising from the SRA's three options that are 'over and above' those that would have occurred in any event. In our view, as the options proposed by the SRA primarily relate to whether SRA or FSA regulatory requirements apply to different categories of law firms, one of the key direct impacts (discussed subsequently) will be the change in the regulatory requirements arising from the options. Given this, the most important part of the counterfactual is the regulatory requirements (both SRA and FSA) that currently apply to law firms in relation to their financial activities. There are a number of different categories of law firms that one might need to consider separately when defining the counterfactual (because the impact of the SRA's proposals may vary across these different categories of firm). These are:

- **Traditional APFs.** These are law firms that provide mainstream financial services to their clients (and so are not subject to the exemptions that apply to exempt professional firms – see below). They are authorised by the FSA to conduct these regulated activities but are also regulated by the SRA. Their dual regulated status means that (at present – i.e. under our counterfactual) these firms benefit from a number of 'carve-outs' from compliance with the FSA Handbook on rules and regulations. These APFs can also undertake non-mainstream regulated financial activities. When undertaking such activities they are required to comply with the SRA Financial Services (Conduct of Business) Rules 2011, in the same way as exempt professional firms, plus a limited number of FSA regulations, which are only relevant to authorised firms when they carry out non mainstream regulated activities. There are 64 law firms in this category.[8]

- **ABS APFs.** These are law firms that (in accordance with the Legal Services Act 2007) have non-lawyers as either managers or owners. ABSs that also provide mainstream financial services are authorised to do so by the FSA (and so are ABS APFs). However, unlike the status quo in relation to traditional APFs, the SRA does not intend to license the activities of ABSs that are not legal services. Consequently, under current arrangements (and therefore our counterfactual) ABS APFs will not benefit from the 'carve-out' that applies to traditional APFs.

---

[8] As advised by the SRA.

- **Exempt professional firms.** These are firms that do not undertake mainstream financial activities; but rather, only undertake certain exempt regulated financial activities under the regulation of the SRA. The majority of law firms fall into this category.

3.2.3 Key impacts of the SRA's proposed options

Below we describe the key impacts of the SRA's proposed options on each of the main stakeholder groups: law firms, consumers and the SRA itself.

The impact on law firms

As described previously, the SRA's three options would change the regulatory scope and requirements relating to the financial activities undertaken by law firms. Consequently, the main direct impact of the three options will be on the activities law firms need to undertake in order to comply with the revised regulatory framework; and the costs they incur in doing so. Of the three categories of law firm under consideration, it is likely that the direct impact of the changes to regulatory requirements will be most pronounced for traditional APFs. Our understanding[9] of the potential direct impacts on law firms is as follows:

- **Traditional APFs.** Under Option 1 (which brings the ABS APFs into the existing APF regulatory framework) there would be no direct change to the regulatory requirements made of traditional APFs, and therefore no direct change to their regulatory compliance costs. Under Option 2 (which would extend the SRA's approach to ABSs to traditional APFs), the traditional APFs would lose all of their FSA 'carve-outs' and would further need to comply with all FSA requirements with respect to their activities that were previously classified as being "non-mainstream regulated activities".[10] Consequently, there would clearly be a direct impact on the requirements of traditional APFs (and their associated compliance costs) under this option. Under Option 3, whilst the traditional APFs would lose elements of the FSA 'carve-out', they would remain authorised by the SRA and so would be able to continue providing non-mainstream regulated activities subject to compliance with the SRA. Under this option therefore, whilst there would be some impact on the requirements made of traditional APFs (and therefore the compliance costs they incur) these would be less than for Option 2.

- **ABS APFs.** Under Option 1 there would, most likely, be little direct impact on the activities undertaken by ABS APFs (and therefore on their regulatory compliance costs). Further, because this represents a relaxation of regulatory requirements relative to the counterfactual, to the extent that there was an impact, it would be to reduce the scope of activities undertaken (and costs incurred). Under Option 2 there would be no change to the regulatory requirements made of ABS APFs relative to the status quo. Under Option 3, there would be a modest relaxation of regulatory requirements - and consequently, potentially a modest reduction in compliance costs. However, to the extent that ABSs may

[9] We have relied upon the SRA for an understanding of what the options would imply for law firms with respect to changes in regulatory requirements.

[10] Under Option 2, whereby the SRA did not have regulatory responsibility for the financial activities of APFs, the distinction between mainstream and non-mainstream activities would no longer exist. However, the point is that, under this option, all financial activities (including those that were *formally* classified as being non-mainstream) would fall under the FSA's jurisdiction.

already be large financial organisations, for whom the provision of financial services is a core part of their offer, it is perhaps less likely that any of the SRA's proposed options would lead to any incremental change in compliance related activities (and, accordingly, costs).

- **Exempt professional firms.** None of the SRA's options imply any direct change to the regulatory requirements made of exempt professional firms (which are the majority of law firms). Consequently, there can be no direct impact on these firms in terms of the activities they undertake to comply with regulation (or therefore, the costs they incur in doing so).

Given the above, when assessing the potential incremental costs and benefits to law firms associated with the SRA's options, we consider that it would be appropriate to focus on quantifying the incremental compliance costs incurred by traditional APFs under the three options. This is because the incremental compliance cost impact on ABS APFs is likely to be negligible (and positive). By definition there would be no direct incremental compliance cost incurred by exempt professional firms.

The direct impacts on law firms described above may have wider consequences if they are sufficient to affect their incentives with respect to: the services they choose to provide, the prices they charge and their competitive strategies in the markets in which they operate. This is discussed further below in our consideration of the impact on consumers.

The impact on consumers

None of the SRA's three options directly impact end consumers of legal or financial services, as they relate to the scope and requirements of the regulation of financial activities undertaken by law firms. However, it is clear that the options *could* affect consumers indirectly in a number of ways. In the present case, indirect impacts could include:

- If the impact of the change in regulatory requirements resulted in law firms incurring higher or lower regulatory compliance costs, these might ultimately be passed onto consumers in the form or higher or lower prices (for legal or financial services). In practice there is no need to separately consider/quantify this impact, so long as one includes the initial assessment of the incremental cost impact on law firms within the CBA.[11]

- Whether the change in regulatory requirements has any effect on competitive intensity within the market(s) for the supply of legal and/or financial services, resulting in either an increase or decrease in consumer welfare. In principle this could occur for one of two reasons: (i) the options result in there being increased/decreased barriers to entry and/or consumer switching within markets; or (ii) the options impact certain types of firms more than others, either reducing or enhancing their competitive position to the detriment or

[11] This is because under a CBA one would already have captured the incremental compliance costs to the law firms arising from the SRA's options. There is therefore no need to additionally assess or quantify the subsequent consumer price impact, as do to so would be "double counting".

benefit of consumers. In practice however, we do not consider it likely that this issue would be material under any of the SRA's three options.[12]

- Whether the change in regulatory framework (under any of the three options) increases or decreases the scope for economically efficient pricing, such that industry prices more or less accurately reflect their true economic costs. Here the most relevant consideration is that the SRA considers itself to be less expert than the FSA with regard to assessing the risks associated with the provision of financial services. This may have implications for the end prices paid by consumers and the economic efficiency of those prices under the SRA's three options. We explore this issue further below.

Considering the impact on the economic efficiency of prices

In relation to Option 1 (whereby the SRA would be responsible for the regulation of certain mainstream financial activities of both traditional APFs and ABS APFs) the SRA has expressed the following concern: *"[The SRA's regulatory coverage will extend to an area of work in which it has little experience or expertise. This option also places the Compensation Fund at risk of being used to remedy breaches over which the SRA has no control."*[13] Under Options 2 and 3, the mainstream regulated (financial) activities of APFs would not fall within the scope of the SRA's compensation scheme but, rather, would be subject to the FSA's compensation arrangements. Therefore, under these two options, the SRA's concern would be addressed.

The SRA Compensation Fund is a means of "last resort" protection for consumers, against which they can make claims in the event that a solicitor behaves improperly, leading to a loss. The Fund is financed from contributions paid by law firms and licensed individuals (solicitors). It is managed by the SRA, which sets the level of contributions and oversees claims payments. In essence, it can be thought of as similar to an insurance fund, whereby the prices charged (in this case the contributions from law firms and individuals) are set based on taking a forward view as to the risk exposure with respect to both the frequency, size and distribution of claims that will need to be paid out by the SRA.

Given the above, both in the insurance industry – and in relation to the management of compensation funds – firms invest in developing expertise in order to forecast and manage risk. Consistent with this, it is widely accepted in the economics literature that the pricing of insurance is more economically efficient the more reflective of risk it is.[14] This point is highly relevant to the SRA's concerns as expressed in relation to Option 1. In particular, the SRA is concerned that it is less well placed than the FSA to understand and manage the risks associated with regulated financial activities. In other words, due to its lack of experience in relation to financial services, the SRA would be less able to forecast the *frequency, size and distribution* of claims relating the financial

[12] Whilst in principle the SRA's options could affect the incentives of law firms in a way that impacted competition in either the supply of legal or financial services, in practice we consider that the scope for this is likely to be limited. This is primarily because we have been advised by the SRA that it is only the costs of traditional APFs that will be directly affected by their proposals. Because there are currently only 64 of these firms (out of a total of over 11,000 law firms) it is unlikely that any change to their costs, no matter how large, could materially impact consumer welfare.

[13] As stated in the SRA's consultation document.

[14] For example, OXERA state: *"There is a large body of literature demonstrating that, in a competitive insurance market, prices reflect costs in each risk pool (ie, pricing is risk-based), and that such risk-based pricing is economically efficient."* 'The use of gender in insurance pricing: Analysing the impact of a potential ban on the use of gender as a rating factor: A report by OXERA.' ABI Research Paper No 24 (2010). Page 12.

activities undertaken by law firms than the FSA would be. Whilst there is no observable evidence that could be used to objectively assess whether the SRA is less able to manage and quantify risk relating to financial services than the FSA, it would intuitively seem to be a fairly non-contentious point, given the FSA's role, experience and expertise.

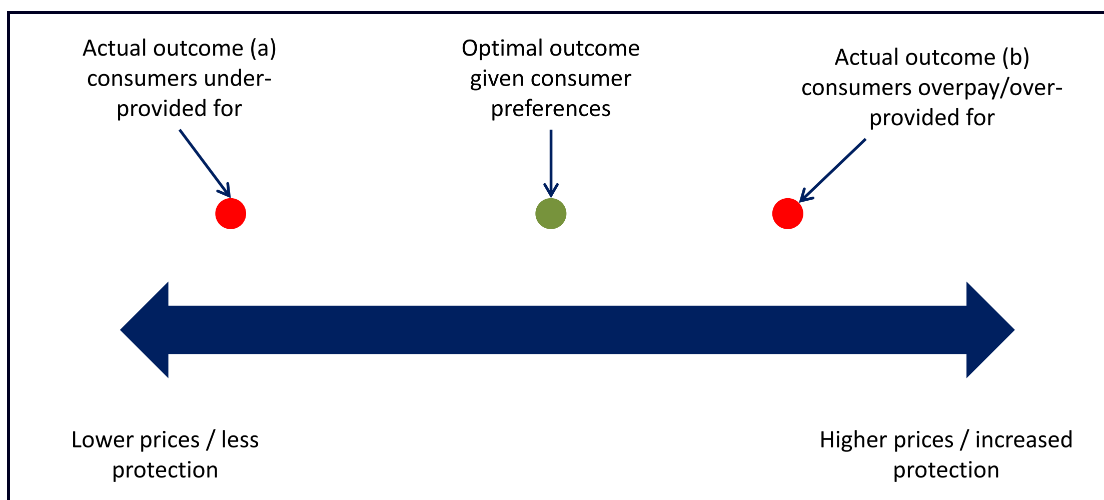
If it were the case that the SRA was less able to forecast and manage risk than the FSA, this could ultimately result in the pricing of contributions to the Compensation Fund being "less economically efficient" than would be the case if the FSA had regulatory responsibility. This inefficiency in pricing by the SRA could lead to one of two outcomes:

- The SRA could be overly cautious with respect to the risks associated with financial services and so would set the compensation contribution payments required from law firms "too high" relative to their efficient level going forward. This could ultimately result in consumers paying more than they should for legal and financial services; or

- Conversely, the SRA might under-estimate risk, such that consumers are more exposed to risk than they would be willing to pay for.[15]

Figure 1 illustrates the potential outcomes that could arise.

Figure 1 Illustration of potential adverse consumer outcomes



Source: Economic Insight

Given the above, our view is that both Options 2 and 3 as proposed by the SRA are likely to lead to a benefit to consumers, insomuch that the end prices they pay for legal and financial services are likely to more accurately reflect their true economic costs than would be the case under Option 1 (under which the Compensation Fund attached to financial activities would be managed by the SRA).[16] We subsequently consider how this potential benefit might be quantified.

[15] Ultimately the impact will be on end consumers, as the Compensation Fund is a form of insurance for those consumers and the costs of providing it will be reflected in the charges law firms set to their clients.

[16] Note, for clarification, it is not the case that the FSA - nor any regulator - would be able to perfectly forecast the nature, frequency and size of claims relating to financial activities. Rather, it is just that they are likely to be able to forecast these parameters more accurately than the SRA, and so are less likely to misprice risk. In addition, even if the SRA were equally able to assess these risks as was the FSA, the potential for mispricing would still arise by virtue of the fact that the FSA would in all eventualities be the

The impact on the SRA

With regard to the potential impact of the three options on the regulator itself, we asked the SRA to provide an initial view as to what those options might imply with respect to:

- the resources it requires;
- its capability requirements;
- SRA policy development; and
- the development of SRA guidance.

The following table (see overleaf) sets out the SRA's initial view of the potential impact on the organisation in the above categories. We should emphasise that this represents a 'high level' assessment of the potential impact of the options. In order to reach a more robust view, the SRA would need to undertake a detailed internal evaluation of what the options would imply, considering the resource implications for the organisation based on a bottom up assessment of its requirements.

body that determined the regulatory framework. Consequently, the SRA would not itself be able to directly manage the risks for which it was responsible.

Table 2 Indicative impact of options on the SRA

SRA activity category	Option 1	Option 2	Option 3
Summary of SRA's regulatory jurisdiction in respect of financial services of APFs.	SRA regulates the mainstream and non-mainstream financial services of APFs.	SRA does not regulate the mainstream or non-mainstream financial services (as previously classified) undertaken by APFs.[17]	SRA regulates only the non-mainstream financial services of APFs.
Impact on SRA resources.	Additional staff time required to allow for full monitoring, evaluation and supervision of financial services of ABS APFs. Increase in staff minor at first - in long term would require recruiting a specialist financial regulatory team.	No staff time to be allocated to financial services of APFs. Demand on SRA resources will decrease. Free up staff hours currently allocated to financial regulation of APFs.	Staff time currently allocated to supervision of mainstream financial services of traditional law firm APFs will be freed up. Some staff time will be required to supervise the non-mainstream activities of ABS APFs. Currently (as the number of ABS APFs is low) this represents a net reduction in demand on SRA resources - in the long run probably no net change in staffing.
Impact on SRA capability requirements.	SRA will need to develop the capability to provide full financial regulation of a wide range of financial services provided by firms of various types. The additional specialist staff (as per above) would require regular training with respect to financial regulation.	SRA will no longer regulate mainstream financial services - capability requirements will be reduced in this area. No additional training requirements.	SRA will no longer regulate mainstream financial services - capability requirements will be reduced in this area. No additional training requirements.
Impact on SRA policy development.	SRA must respond to changes in the political and financial landscape to ensure its policy is maintained and fit for purpose in respect of full regulation of financial services. A policy specialist may be required.	SRA policy development will be limited to the requirement to define and regulate non-mainstream financial services. Policy development resourcing remains stable.	SRA policy development will be limited to the requirement to define and regulate non-mainstream financial services. Policy development resourcing remains stable.
Impact on guidance (help line, response to queries).	Call centre facilities to handle queries arising from mainstream financial services. Would need to recruit new call centre staff to handle long term increase in demand for guidance.	Reduced demand associated with providing of mainstream financial services. Small reduction in demand on call centre.	Additional demand on call centre provision associated with non-mainstream financial services offered by ABS APFs. Reduced demand associated with providing of mainstream financial services. On balance a reduction in demand on call centre resources.

Source: SRA

3.2.4 Analysing costs

Consistent with our description of the potential impacts of the SRA's options (see previous), for the purpose of this CBA we are focusing on two key categories of cost: (i) the incremental compliance costs incurred by traditional APFs; and (ii) the incremental administrative costs incurred by the SRA. Our assessment of these costs follows.

[17] Under Option 2, whereby the SRA did not have regulatory responsibility for the financial activities of APFs, the distinction between mainstream and non-mainstream activities would no longer exist. However, the point is that, under this option, all financial activities (including those that were *formally* classified as being non-mainstream) would fall under the FSA's jurisdiction.

The incremental regulatory compliance costs incurred by traditional APFs

As set out in our discussion of 'impacts', with regard to law firms it is the traditional APFs whom are most likely to face an impact on incremental compliance costs under the SRA's options. Consequently, for the purpose of seeking to quantify relevant costs, we have focused on these firms. With respect to the SRA's three options, we understand:

- There will no change in the regulatory requirements of traditional APFs under Option 1 (which brings the ABS APFs into the existing APF regulatory framework).
- Under Option 2 (which would extend the SRA's approach to ABSs to traditional APFs), the traditional APFs would lose all of their FSA 'carve-outs' and would further need to comply with all FSA requirements with respect to their activities that were previously classified as being "non-mainstream regulated activities."[18]
- Under Option 3, whilst the traditional APFs would lose elements of the FSA 'carve-out', they would remain authorised by the SRA and so would be able to continue providing non-mainstream regulated activities subject to compliance with the SRA. Under this option therefore, whilst there would be some direct impact on the requirements made of traditional APFs, these would be less than for Option 2.

We are therefore concerned with assessing the potential incremental compliance costs relating to Options 2 and 3. With regard to considering how to quantify these costs, there are a number of issues to consider. Firstly, it is widely understood that isolating the incremental cost of compliance is challenging. This is because it requires one to identify the activities firms undertake as a result of regulation that they would not undertake in any event. As some of the activities required by the SRA's and FSA's regulations might be considered 'normal good business practice', it may be that even if certain regulations did not apply, firms would continue to undertake those activities. Secondly, because the incremental compliance costs we are interested in quantifying relate to the additional costs incurred by traditional APFs in moving elements of their activities from SRA to FSA oversight, the SRA is not well placed to evaluate the details of what APFs would have to do in order to comply with regulations under its proposed options. Given this, we have relied on public domain data and information to provide an indication of the potential incremental compliance costs the traditional APFs could incur under the SRA's Options 2 and 3.

Our indicative analysis of incremental compliance costs

In 2006 Deloitte undertook a study for the FSA that estimated the incremental compliance costs associated with the totality of the Financial Services and Markets Act (FSMA). Deloitte's approach was to survey firms to ascertain which activities they undertook in order to comply with the requirements of the Act were incremental. The study focused on three categories of firms: (i) corporate finance providers; (ii) institutional fund managers; and (iii) investment and pension advice providers. For each category of firm, Deloitte reported incremental compliance costs as a percentage of operating costs. We have used the results reported by Deloitte as a start point for our

[18] Under Option 2, whereby the SRA did not have regulatory responsibility for the financial activities of APFs, the distinction between mainstream and non-mainstream activities would no longer exist. However, the point is that, under this option, all financial activities (including those that were formally classified as being non-mainstream) would fall under the FSA's jurisdiction.

indicative analysis. In particular, we assumed that the category of 'investment and pension advice providers' was likely to be most relevant to the financial activities undertaken by law firms. For this category, Deloitte reported incremental compliance costs of 4.3% of firms' operating costs.[19]

Were we to apply the 4.3% figure to law firms unadjusted, we would significantly over-state the true incremental compliance costs associated with the SRA's Options 2 and 3; this is for two reasons. Firstly, because the firms in the Deloitte sample were financial services firms, by definition the majority of their activities are financial activities. For APF law firms however, clearly this would not be the case; and so the compliance costs associated with the FSMA would naturally be a smaller percentage of their overall operating cost base. Secondly, the 4.3% relates to the total incremental costs associated with complying with the Act. However, in this case we are interested in assessing the incremental costs of moving from one regulatory framework (under which APFs already have to comply with a number of elements of the Act under FSA supervision) to one where they will be directly subject to *more* elements of the Act under FSA supervision. Whilst there is no data that we can meaningfully use to identify a precise adjustment factor, we have assumed that for APFs the incremental compliance cost as a percentage of operating costs would be one third of that reported for financial services firms (i.e. it would be 1.4%).[20] This is akin to assuming that their operating cost base is two thirds less driven by financial activities than financial services firms. This may still be a somewhat conservative assumption (i.e. it may still over-state incremental compliance costs in relation to Options 2 and 3).

Taking the assumption from the Deloitte study, we calculated the average incremental compliance costs "per law firm" associated with complying with the FSMA to be £7,885 per annum.[21] As we have been advised by the SRA that there are 64 traditional APFs, this would imply that the total incremental compliance costs are in the region of £504,619 pa. As described above, the likely incremental compliance costs will be lower for Option 3 (as non-mainstream activities would remain within SRA scope). However, given the indicative nature of the analysis, we do not consider there to be a meaningful adjustment that we could make to the calculation in order to estimate this.

The above approach is subjective and therefore, the results should be regarded as illustrative. Going forward, there are a number of alternative analytical methodologies that could be deployed in order to generate more robust results. In particular, the SRA could consider undertaking a survey of the affected APF law firms in order to ascertain what incremental activities they would undertake in order to comply with the revised regulatory frameworks implied by Options 2 and 3 (and the associated costs of these activities, and what proportion of their actual operating costs they

[19] 4.3% figure was calculated from the sum of incremental costs for individual elements of the FSMA reported by Deloitte.

[20] Figures rounded to 1dp.

[21] To calculate this figure we estimated the operating cost base of law firms using the ONS Annual Business Survey, which reports a number of variables relating to the characteristics of firms by industry; such as the number of firms and details of certain costs, categorised by Standard Industry Classification (SIC) code. We took the 'legal activities' SIC code to identify law firms. The Survey reported total employment costs of £8,610m and costs of purchases of goods/materials of £6,194m, giving a total operating cost for the year of £14,804m (for all firms). The number of firms was 29,387 (all figures are for 2010). This implies an annual average operating cost base of £503,760 per law firm, which inflated to 2012 gives a figure of £553,958 per firm. By multiplying this figure by the % incremental cost assumption we made from the Deloitte study (1.4%), the implied incremental compliance costs to APFs of moving fully within the scope of FSA supervision (i.e. consistent with the SRA's Option 2) would be £7,885 per firm per annum. Because our calculation is based on an *average* incremental compliance cost (as Deloitte reported averages) it does not take account of whether incremental compliance costs would vary by firm size (which may or may not be the case). Therefore, our calculated "cost per law firm" could be over or under stated if both: (i) the 64 APFs were of a smaller or larger size than the overall average; and (ii) compliance costs varied with firm size. However (as noted in the main body) our assumption regarding compliance costs as a percentage of operating cost is, in any case, likely to be conservative.

represent). Additionally, the SRA could examine the changes in regulatory requirements under its proposed options "line by line", so that a bottom up incremental compliance costing could be undertaken.

In principle, it is also possible that the costs of professional indemnity insurance could be affected by the SRA's proposed options. In this regard we note that, as part of its *Indemnity Insurance Rules*, the SRA sets *'Minimum Terms and Conditions of Professional Indemnity Insurance'*[22], which stipulate both the scope and amount of cover firms are required to hold. However, the SRA's options do not directly imply any change in the actual activities undertaken by the traditional APFs. Rather, they merely relate to whether it is the SRA or FSA that has responsibility for their regulation. There are two implications that follow from this. Firstly, it is unlikely that there would be any material impact on the premiums charged to these firms under any option – as for this to be the case insurers would have to believe that the change in regulatory responsibility *alone* has an appreciable impact on risk, even if the activities of firms remained unchanged. Secondly, even if there was an impact, it would most likely be to *reduce* premiums under options 2 and 3 (where regulatory responsibility for financial activities moved to the FSA) relative to option 1 and the counterfactual. In our view therefore, this issue is likely to be sufficiently immaterial that no quantification should be considered.

The incremental administrative costs incurred by the SRA

As set out in our description of 'impacts' the SRA provided us with an initial (high-level) view as to the potential internal resourcing implications of its three options. For options 2 and 3, the SRA believed that the resourcing implications would be negligible; and consequently, there are no costs to be quantified with respect to these. With respect to Option 1, the SRA identified the need for:

- Additional specialists in financial regulation and monitoring in order to manage the increased work flow from ABS APFs being within regulatory scope.
- A policy specialist to manage the implications for SRA policy development.
- Additional call centre staff to cope with increased demand / queries.

As the SRA has not undertaken a detailed assessment of its resourcing requirements relating to the above, it has not been possible to quantify the implied cost impact on the SRA within the present study. Broadly, however, the information provided by the SRA indicates that Option 1 would have an impact on its administrative costs, but in relative terms this impact is likely to be low. In addition (and as noted in the discussion of impacts) under Option 1 the SRA would not necessarily need additional resource with immediate effect. Rather, the increase in resource would most likely be phased in over time. To quantify this impact the SRA would need to determine in more detail exactly what its resourcing requirements would be under Option 1. Once this had been done, appropriate data on likely recruitment and salary costs could be analysed to provide a bottom up costing.[23]

[22] Minimum SRA indemnity requirements published at: http://www.sra.org.uk/solicitors/handbook/indemnityins/appendix-1/content.page

[23] For example, the Annual Survey of Hours and Earnings provides detailed data on earnings broken down by profession and role.

In addition to the above resourcing issues, the SRA also identified some potential implications for internal training under Option 1. However, we regarded these to be sufficiently small that there was no need for any further consideration in the context of the present analysis.

3.2.5 Analysing benefits

As described in the 'impacts' section of this report, the key potential benefit we are concerned with is the impact on end consumers arising from the change in responsibility from the SRA to the FSA with regards to managing compensation relating to financial activities. The key issue here is whether the SRA is less able to assess and manage risk than the FSA in relation to these activities. If this were the case then, if responsibility of managing the compensation arrangements relating to financial activities rested with the SRA, this could result in:

- the SRA setting prices (i.e. the contributions from law firms and individuals) with respect to the Compensation Fund above the economically efficient level (ultimately resulting in consumers over-paying for protection); or

- the SRA might set prices below their economically efficient level, leaving consumers more exposed to risk than they would wish.

Consequently, if the preceding is true, there is a benefit to consumers associated with the SRA's Option 2 and Option 3, where Compensation Fund responsibility for financial activities is fully owned by the FSA. The economic rationale for this benefit is unaffected by the SRA's planned review of Compensation Fund arrangements.[24]

To quantify the benefit to consumers of increased pricing efficiency under Options 2 and 3, one must reach a view as to what outcomes would occur if the SRA retained responsibility for the Compensation Fund, as under Option 1. However, this is not straightforward. For example, with respect to the possibility that pricing inefficiency would result in the SRA over-charging for contributions, one would need to determine:

- **The absolute level of the contributions the SRA would set in future with respect to both law firms and licensed individuals.** This is critical because, the bigger the size of the contributions (and accordingly the Fund) the bigger the potential end benefit to consumers of those contributions being priced more efficiently. Over time the key driver of the contribution payments would be the risk profile of the Fund (i.e. the activities undertaken by law firms and whether the overall mix of activities became more or less risky). If the SRA retained responsibility for financial activities – and if the scope of these increased (say due to increased presence of ABSs) then one might expect the overall risk profile of the Fund – and therefore the contributions to it – to increase. However, clearly this is highly uncertain. For example, the Legal Services Board has stated that: *"there is uncertainty as to how ABS will impact on different groups in the market;"* and accordingly is planning to

[24] We understand that the SRA is planning to undertake a detailed review of Compensation Fund arrangements starting in the first half of 2013, with a view to moving to a more "risk based" approach. Regardless of whatever changes might ultimately be implemented, the underlying rationale driving the benefit we are seeking to address is that the FSA is better placed to assess and manage risk relating to financial activities than the SRA. This is, therefore, unaffected by the review.

undertake a full Impact Assessment in 2014.[25] In addition, the SRA does not hold data that specifically shows the relative risk profile of the financial activities we are considering here (i.e. the existing financial activities of APFs currently covered by the Compensation Fund). Further, by definition no such data yet exists in relation to ABS APFs.[26]

- **The amount by which the SRA would "overcharge" in setting the contribution relative to the FSA (i.e. "how big" the pricing inefficiency might be).** Again this is highly uncertain and there is no available data that can be used to inform a view on this. This ultimately depends on how big the capability gap is between the FSA and SRA with respect to their ability to assess and manage the risks associated with financial activities.

- **The number of law firms and individuals contributing to the Fund.** This is a driver of the overall size of the Fund and therefore, the absolute size of the potential benefit of contributions being priced more efficiently.

As there is no available data that we can directly use with regard to the above issues, we have conducted an illustrative scenario analysis, based on high, middle and low cases – where under each we show the potential over-charge to end consumers (or rather, the benefit associated with Options 2 and 3). The purpose of this is to illustrate the potential 'order of magnitude' of the consumer benefit that would arise were one to believe that certain factors held true. Rather than being a precise quantification of the benefit therefore, this can be thought of as a "what if" analysis. The following table sets out the input assumptions we have made under each scenario.

Table 3 Input parameters used to estimate consumer benefits

Input parameter	Low case	Middle case	High case
Fund contribution levels.	Start at prevailing levels and increase only in line with long term inflation, which is 3.3%. This implicitly assumes no change in the risk profile of the Fund.	Start at prevailing levels and increase by 5% pa. This assumes a modest increase in the risk profile of the Fund.	Start at prevailing levels and increase by 10% pa. This assumes a more significant increase in the risk profile of the Fund.
SRA risk premium.	Contributions are 5% higher than they would be under FSA supervision.	Contributions are 7% higher than they would be under FSA supervision.	Contributions are 10% higher than they would be under FSA supervision.
Number of contributing law firms and individuals.	Constant at prevailing levels.	Constant at prevailing levels.	Constant at prevailing levels.

Source: Assumptions as stated within table

[25] See 'Research Note: the legal services market.' Legal Services Board (August 2011).

[26] The SRA has advised us that its view is that the mainstream financial activities of relevance to this study would carry greater risk than legal activities. Consequently, if the overall mix of activities covered by the Fund was to change over time (such that financial activities accounted for a higher proportion of the total) so the overall risk exposure would increase. We have therefore assumed that this is the case for the purpose of our analysis. If this was not the case, the question as to whether the SRA was less well equipped to manage risk than the FSA would still arise. Consequently, there would still be a consumer benefit associated with the responsibility for managing compensation associated with financial activities moving within the FSA's remit. However, the overall size of that benefit would be reduced.

Given the above assumptions, we calculated the annual benefit that consumers would receive if the SRA were not responsible for the Compensation Fund in relation to financial activities (or conversely, the additional costs consumers would incur were the SRA to remain responsible). The results of this are shown below in Figure 2.

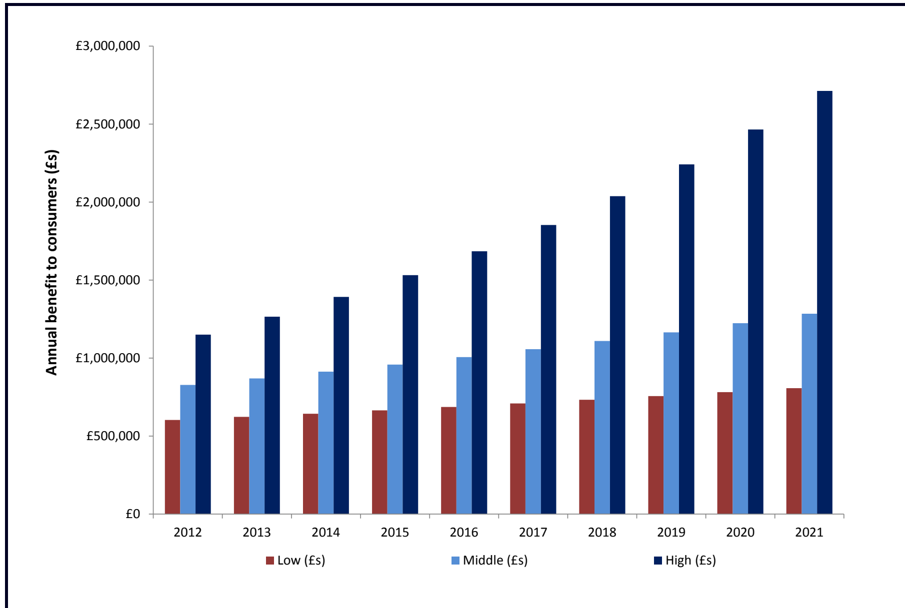


Figure 2 Illustrative analysis of the potential annual benefit to consumers of the SRA not retaining Compensation Fund responsibility for financial activities

Source: Economic Insight

The above results can be thought of as the implied benefit to consumers associated with either Option 2 or Option 3 of the SRA's proposals. This illustrative analysis shows that, under the "low case" annual consumer benefits would raise from £603,000 pa to £807,000 pa over a period of 10 years. Under the "high case" however, the annual consumer benefit would rise from £1.2m to £2.7m over the same period.[27] It is important to stress, however, that because the above results are driven by parameters that are highly uncertain (and for which we have not been able to review any data) we cannot comment on how likely they are to reflect the actual benefit to consumers under Options 2 and 3 as proposed by the SRA.

With regard to the possibility that the SRA could "under-price" and so leave consumers less protected than they would wish (i.e. would be willing to pay for) the potential benefit of avoiding this possibility could be substantial. This is because, in addition to the detriment associated with being "under-protected" relative to their preferences, consumers may also face an increased probability of more extreme adverse outcomes. In particular, if the SRA was specifically less able than the FSA to anticipate and manage the possibility of very large single claims arising from financial activities, this could lead to the Fund being more exposed to the risk of being made insolvent. In such a case, the impact on consumers could be that they lose a valuable source of protection (at least in the short run, until either alternative arrangements could be made, or until the liquidity of the Fund was restored).

As per the potential for over-pricing, it is not possible to precisely quantify the benefit to consumers of reducing the likelihood of the SRA under-pricing contributions relative to their efficient level. However, we can provide some illustrative evidence to help scale the overall size of the issue. SRA

[27] Figures rounded to 1dp.

data shows that the total claims paid out of the Fund for the last three years have averaged £18.5m pa. Consequently, if we use this as a proxy for consumers' valuation of the Fund, it is clear that, if the chances of insolvency were higher under the SRA than the FSA, the implied benefit to consumers of having the Compensation Fund within FSA scope could be worth several million. However, we do not consider it meaningful to attempt to quantify this precisely, as there is no evidential basis that would allow us to do so.

Conceptually to properly measure the total benefit to consumers of reducing the prospect for inefficient pricing, one would need to capture *both* the possibility of the SRA over or under-charging (as described above) for the contributions to its Compensation Fund. Put simply, if the benefit of avoiding the over-charge was X and the benefit of avoiding the under-charge was Y, we would need to take an average of both, probability adjusting to reflect the fact that one might be more likely than the other.

In summary, with the available data it is not possible to accurately quantify the potential benefit to consumers of responsibility for the management of compensation relating to financial activities to sit with the FSA rather than the SRA (as would be the case under the SRA's Options 2 and 3). We can, however, suggest that there are strong economic grounds to suppose that such a benefit is likely to exist; and that, given the size of the Compensation Fund, it could be substantial. In order to reach a more robust view on this issue, the SRA could consider undertaking analysis as to how the risk profile of the Fund might change over time, depending on the mix of financial activities included within its scope. This would help provide a more evidenced view as to the likely size of future contributions (and the overall size of the Fund) were the SRA to remain responsible for financial activities. However, other key parameters (such as the extent to which the SRA might over or under charge relative to the efficient level) would remain subject to considerable uncertainty.

4 Conclusions and findings

Due to the indicative nature of the analysis we have undertaken, we do not consider it appropriate to present our findings in terms of: (i) discounted costs and benefits (i.e. the net present value of costs and benefits) over time; or (ii) formal cost benefit ratios. Notwithstanding this, our analysis has allowed us to identify and parameterise the most significant costs and benefits associated with the SRA's three options. The results of this are summarised below in Table 4.

Table 4 Summary of key costs and benefits identified

Key cost / benefit	Option 1	Option 2	Option 3
Summary of SRA's regulatory jurisdiction in respect of financial services of APFs.	SRA regulates the mainstream and non-mainstream financial services of APFs.	SRA does not regulate the mainstream or non-mainstream financial services (as previously classified) undertaken by APFs.[28]	SRA regulates only the non-mainstream financial services of APFs.
Incremental compliance costs to traditional APFs.	None.	Medium (likely to be less than £500k pa in total for the industry).	Somewhat lower than for Option 2.
Incremental compliance costs to ABS APFs.[29]	Negligible (potential slight reduction in compliance costs).	None.	Negligible (potential slight reduction in compliance costs).
Incremental resource costs to the SRA.	Low.	Negligible impact.	Negligible impact.
Incremental benefits to consumers arising from more efficient pricing of the Compensation Fund.	None.	Potentially high (value could be in excess of £1m pa).	Potentially high (value could be in excess of £1m pa).

Source: Summarised from main report

In relation to our analysis, we consider the conclusions to be as follows:

- That the overall impact of any of the three options proposed by the SRA is, in relative terms, low because they only directly affect the regulatory framework for a small number (64) law firms out of a total of over 11,000.

- That within the overall relativity described above, although Option 1 saves compliance costs to traditional APFs relative to Options 2 and 3, it cannot deliver the consumer benefits implied by the other options (which arise from the Compensation Fund being

[28] Under Option 2, whereby the SRA did not have regulatory responsibility for the financial activities of APFs, the distinction between mainstream and non-mainstream activities would no longer exist. However, the point is that, under this option, all financial activities (including those that were *formally* classified as being non-mainstream) would fall under the FSA's jurisdiction.

[29] Based on the information we have reviewed, we do not consider that it would be appropriate to attempt to quantify incremental compliance costs relating to ABS APFs, as the impact is likely to negligible (or zero) under all three options.

more efficiently priced/managed under the FSA's jurisdiction). Given this, Option 1 is least likely to be net beneficial.

- As both Options 2 and 3 should in principle deliver the same consumer benefits, one should consider the proportionality of these two options in terms of costs. In this regard, whilst both would lead to increased compliance costs for traditional APFs, these are likely to be lower for Option 3 (as non-mainstream financial activities would remain within SRA scope under this option). Consequently, our indicative analysis is consistent with Option 3 being the most proportionate solution of those proposed by the SRA.

- However, the high level nature of the assessment presented here is such that there is considerable uncertainty regarding our findings. We have, within this report, set out a number of areas where further work could be undertaken in order to improve the robustness of the analysis.

Economic Insight Limited

90 Long Acre - Covent Garden - London - WC2E 9RZ | +44 (0) 207 849 3004
www.economic-insight.com