



## **Legal Services Board's Consultation Paper – Referral fees, referral arrangements and fee sharing**

### **Response from the Association of British Insurers**

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1. The Association of British Insurers (ABI) is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. Employing more than 300,000 people in the UK alone, it is an important contributor to the UK economy and manages investments of £1.5 trillion, over 20% of the UK's total net worth.

#### **Introduction**

2. This is the ABI response to the Legal Services Board's (LSB) consultation exercise in relation to the regulatory treatment of referral fees, referral arrangements and fee sharing.
3. The ABI's interest in referral arrangements stems from a number of perspectives. We have an interest, as users of the civil justice system, in ensuring that access to justice is achieved at proportionate cost. Some of our members are defendant compensators, who ultimately foot the bill for referral fees, whilst some (including those same defendant compensators) act as intermediaries and receive referral fee income.
4. More generally, the ABI believes that reform is urgently needed to limit unnecessary costs in the civil litigation system – excessive legal costs for both claimants and defendants and disproportionate litigation costs for the Government. We believe that the costs should be proportionate to the issues and sums involved. We fully support the recommendations of Lord Justice Jackson (as endorsed by Lord Young) and have always maintained the position that a positive outcome for claimants, defendants, and consumers would be the implementation of Jackson's recommendations as a package and in full.
5. The ABI's response is restricted to the issue of referral fees for personal injury claims. This response does not comment on the operation of referral fees for conveyancing transactions or criminal advocacy.

#### **Summary of the ABI's Response**

6. The Consumer Panel and LSB have suggested that there is no compelling case for banning referral fees. The ABI does not agree with this assessment.
7. The payment of referral fees comes at a disproportionately high cost to the insurance industry and ultimately consumers. The ABI believes that referral fees can be removed from the civil justice system without significantly affecting access to justice, with the added benefit of reducing legal costs. Referral fees contribute to excessive legal costs without adding any value to the services provided to the consumer. It is for this reason that we believe they should be banned, and it is with this context in mind that we answer the LSB's questions as set out below.

#### **Consultation questions**

## Conclusions – Personal injury

### **1. Do you agree with our analysis of the operation of referral fees and arrangements?**

8. No. The ABI believes that the LSB's consultation has focussed too heavily on the use of referral fees in isolation and not properly considered the use of referral fees in the context of the civil litigation system as a whole. We also challenge the conclusions of both the Vanilla and Charles River Associates (CRA) reports.
9. The Vanilla research report derived its conclusions in relation to personal injury claims from a pool of only 25 personal injury claimants. A sample of this size cannot be considered to be representative. In addition, of the 25 participants, only 15 took part in the group discussions and other 10 contributors were only interviewed over the telephone. Both the sample size and methodology used for this research report cannot be said to be reliable enough for the LSB to draw substantive policy conclusions from.
10. The CRA report also carried out some interviews in addition to its assessment of existing research. However, these were small in number too, comprising only 15 participants. Our concerns about the size of this pool are the same as outlined for the Vanilla research above. In addition, the CRA report draws upon the Vanilla report for its conclusions (for personal injury claims, at pages 83, 97 and 103).
11. The ABI believes that the payment of referral fees should be banned, and in tandem, legal fees must be reduced by a corresponding amount to ensure that supposed marketing or acquisition costs are adjusted to a more appropriate level. This will ensure that any transactional savings to lawyers that come from banning referral fees are passed on and directly reduce the end legal cost to consumers. Legal costs have become increasingly disproportionate over recent years – as much as 87p for every pound of compensation received (2009/2010 ABI research of over 50,000 motor personal injury claims under £5,000). The Transport Select Committee are currently considering the escalating costs of motor insurance pricing<sup>1</sup> - referral fees have been a contributory cause to this escalation.

### **2. Do you have additional evidence about the operation of referral fees and arrangements that should be considered by the LSB?**

#### Oxera

12. ABI commissioned research by Oxera<sup>2</sup> concluded that because the legal fees charged by claimant solicitors within the personal injury market are not subject to sufficient market constraints, the expenses incurred in marketing (e.g. referral fees) are not constrained by the claimant's willingness to pay. Within this structure, referral fees paid by solicitors represent the difference between the costs of actually processing the case and the costs that can be recovered from the defendant. Referral fees have, as shown by Figure 19 in the CRA report (page 93), increased over time, indicating that claimant solicitors have been able to drive efficiencies. This has not, however, resulted in any savings to consumers in the form of reduced legal costs, because the present costs structure has referral fees factored into the fixed costs and hourly rates. The costs system has in effect allowed solicitors to increase their referral fees/marketing spend. The result, as noted by Lord Justice Jackson in his Review of Civil Litigation Costs, is that there are too many 'middle men' involved, adding no value to the consumer. As Jackson says in his report:

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<sup>1</sup> <http://www.parliament.uk/business/committees/committees-a-z/commons-select/transport-committee/inquiries/cost-of-motor-insurance/>

<sup>2</sup> "Marketing Costs for Personal Injury Claims" carried out by Oxera Consulting Limited, ABI Research Paper No 15, 2009

*“the present level of referral fees has grossly distorted the costs of personal injuries litigation.”<sup>3</sup>*

13. Lord Justice Jackson’s report was a comprehensive, evidence-based and objective consideration of our compensation system as a whole, and takes a pragmatic approach to addressing issues for both claimants and defendants. It was undertaken by a senior and respected member of the judiciary, and its recommendations should, therefore, be given the weight that they deserve. The LSB’s dismissal of Lord Justice Jackson’s recommended ban on referral fees has not, we believe, been considered carefully enough.

#### Access to justice and claims frequency

14. The ABI believes that the LSB has understated the effect of referral fees on claims frequency. For example, the LSB states that the recoverability of CFA success fees and ATE premiums is another factor driving claims frequency. CFA uplifts and ATE premiums became recoverable in 2000 but the insurance industry has seen an increase in the volume of motor accident claims since 2004<sup>4</sup>. This happens to coincide with when referral fees were permitted.

15. The increased frequency of motor accident claims has not been mirrored in employers’ and public liability claims (EL and PL) which would be expected if success fees and ATE premiums were a major driver of claims frequency since these additional liabilities are much more prevalent in EL and PL claims. A review of the number of personal injury claims submitted in recent years shows that in 2000/2001, 219,183 EL claims were submitted<sup>5</sup>. By 2009/2010 that number had fallen to 78,744. In respect of PL claims, in 2000/2001 the number of claims presented was 95,583. By 2009/2010 that number had reduced to 91,025 – a 5% reduction. Whilst we accept that workplaces and public areas may have generally become safer over the last 10 years, the statistics would indicate that employees and the public have not been pursuing additional claims as a result of the additional cost liabilities. The same can be said for clinical negligence claims which have also reduced.

16. Given this, and despite the increase in motor claims (which can be attributed to a wide range of other competing factors), we would question whether there is any real evidence that referral fees have enhanced access to justice. Indeed, the Charles River Associates research (on page 83) acknowledged that despite a steady decline in road traffic accidents (RTAs) motor personal injury claims have been increasing from 400,000 in 2000/2001 to 625,000 in 2008/2009.

17. The cost of marketing through claims management companies by way of the payment of referral fees is very high. The ABI’s Oxera research found that, for personal injury claims, marketing costs in the form of referral fees were high when compared to other comparable markets. The research concluded that marketing activity for personal injury claims was around 23-40% of base legal costs. This was compared with other professional services, where the average spend on marketing as a proportion of turnover was around 15%. For other legal services, (e.g. wills and conveyancing) marketing spends were around 18% of base legal costs. The high marketing costs for personal injury work can be attributed to the lack of market constraints for claimant solicitor’s costs.

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<sup>3</sup>Para 3.10(ii) ( page 450) of Lord Justice Jackson’s Review of Civil Litigation Costs, December 2009

<sup>4</sup> Evidence from the Compensation Recovery Unit as shown in Figure 21 (page 96) of the CRA report.

<sup>5</sup> Data from the Department of Work and Pensions (Compensation Recovery Unit).

18. Oxera also concluded that it would be possible to reduce the marketing spend within the personal injury sector, without significantly impacting on access to justice. Therefore, it is possible that referral fees could be removed whilst maintaining access to justice.

#### Change to legislation

19. Since 2000, when changes to cost recovery took effect, coupled with a lifting of the ban on solicitors paying referral fees in 2004, intermediaries have been receiving referral fees to introduce people with a potential claim to solicitors. Intermediaries find potential claimants in a number of ways, including national advertising, local advertising, and as a result of their activity in another market (e.g. car hire companies). The most significant intermediaries are claims management companies. Over time, Oxera found that the level of referral fees being paid to intermediaries has increased significantly, and particularly for personal injury claims, have risen from £400 five years ago to up to £1000 now. The fees represent an increasing percentage of the costs they recover.

#### Quality of Claims

20. In insurers' experience, the impact of activities of intermediaries involved in referral arrangements impacts on the genuine claimant. The referral arrangements, particularly those involving claims management companies, present opportunities for dubious firms to take advantage of claimants, solicitors, insurers, and other service providers. For example, some referral arrangements work on the promise of a minimum volume of referrals. Given the variable frequency of genuine accidents, this practice represents a higher than average risk of producing spurious or even fraudulent claims to meet agreed volumes. This combination of factors means that there is a risk that those involved in claim management companies may engage in suspect practices. This impacts upon the genuine claimant accessing justice where a spurious or fraudulent claim takes precedence, and on a defendant who must seek to rebut the spurious or fraudulent claim, or unknowingly compensates a fraudulent claim.

#### Quality and independence of legal service provided

21. Under the current system, the claimant will generally be referred to a legal representative who has been chosen by the intermediary, rather than the claimant. Therefore, the level of quality will depend on the extent to which the intermediary has emphasised quality in the service level agreement or contract with the legal representative.
22. The CRA research acknowledges that it is clear that introducers refer clients to particular law firms on the basis of referral fees (page 91). The independence of the lawyer is governed by the professional duty of care they owe to the claimant as client and should not be compromised by the referral process. Moreover, as legal services can be considered to provide deferred value and the claimant may not be able to observe the quality of the service either before or after, it is difficult to measure the impact of referral arrangements has had on quality.

#### Fraudulent claims

23. Nowhere in the LSB document are fraudulent claims discussed. The Insurance Fraud Bureau (IFB) believes that there may have been as many as 30,000 fraudulent RTA claims made in 2009. Current estimates from the IFB indicate that undetected (i.e. the true cost of) fraud total almost £2bn a year, adding, on average, £44 per insurance policy premium. The existence of referral fees may have influenced this behaviour by encouraging claims management companies to induce solicitors to accept what may be spurious claims. Doctors agree that this is a problem; a recent survey by one of our

member companies found that 93% of GPs have seen a patient in the past two years who they thought was exaggerating their injuries in order to try to make a compensation claim, and 79% said they had seen someone they suspected was making the injury up entirely.

#### Recommendations for improving transparency and disclosure

##### **6. Will the proposals assist in improving disclosure to consumers?**

24. Yes, provided that the standards applied are consistent and provided that the CM Regulator and the FSA apply a joined up and consistent approach. Indeed, the first two objectives in respect of to whom the referral fee is paid to and the amount should already be provided to the consumer, under section 2A (4) of the Solicitors Introduction and Referral Fee Code 1990. If the LSB does not, as it indicates in its report, believe that this is presently the case, then the issue is one of enforcement. Any rules designed to improve disclosure must be supported by a robust enforcement process in order for the aim for improved disclosure to be achieved.

##### **7. Are there other options for disclosure that ARs should consider?**

25. If the LSB wishes to ensure that there is full transparency to the consumer, provision could be made to require that the written consent of the consumer be obtained before the payment of a referral fee is made.

##### **8. What are the issues relating to the disclosure of referral contracts by firms to approved regulators and their publication by approved regulators?**

26. The ABI is concerned that the publication of these arrangements will not necessarily protect the consumer. It is also likely to place commercially sensitive information in the public domain. Competition law or data protection issues must be carefully considered.

27. Currently, the SRA/FSA can require solicitors/insurers to provide such information on request. Maintaining this arrangement would, in our view, be adequate and proportionate.

##### **9. How should these issues be addressed?**

28. Notwithstanding the ABI's position that a ban on referral fees is most appropriate, we would suggest that to address the issue at question (8) above, the LSB should seek this information on a case by case basis as and when appropriate.

#### Recommendations for delivering active regulation

##### **10. Will the proposals assist in improving compliance and enforcement of referral fee rules?**

29. The ABI believes that the existing rules ensure transparency, provided they are properly enforced.

##### **11. What measures should be the subject of key performance indicators or targets?**

30. The aim here should be for the rules to be complied with in each and every referral case.

##### **12. What metrics should be used to measure consumer confidence?**

31. Strict measures such as the publication of details of enforcement action taken against firms who do not comply with the rules, and the possibility of fines for serious or persistent transgressors.

### **The ABI's Conclusions**

32. The ABI believes that referral fees should be removed altogether, as part of wider reform to ensure legal costs are re-set at proportionate levels. This would benefit consumers by reducing legal costs and reducing the undesirable associated activities such as persistent cold calling of potential claimants.
33. It is accepted that solicitors do need to undertake marketing and that claimants need to be aware of their rights to compensation, however, we believe that this can be done at a substantially lower cost to the consumer. For example, a centralised education campaign, supported by stakeholders, could be conducted at much lower cost than through referral arrangements, without significantly impacting the existing level of access to justice. It is argued that intermediaries such as CMCs fulfil an important social function in informing potential claimants about their rights in respect of any damages they might be entitled to. An alternative could therefore be a public campaign which fulfils the same role. Oxera's research showed that a public campaign could be conducted at significantly lower cost than through referral arrangements, without significantly impacting the existing level of access to justice. This may also increase awareness and access for some consumers who indicate that personal injury compensation advertising actually dissuades them from claiming.

Association of British Insurers  
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