



LMA response to Legal Services Board discussion document: *Referral fees, referral arrangements and fee sharing*

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This response is made on behalf of the LMA's members - 54 active Managing Agents with thousands of employees and millions of insureds. LMA members underwrite insurance business, in the UK and globally, including casualty, property, marine, aviation, reinsurance, motor, health, and financial lines.

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1. **Summary** (NB Our comments are limited to personal injury claims issues only)
 - 1.1 We appreciate that the LSB has formed a provisional view only, based on original research in this area. However, we disagree with the provisional conclusion that referral fees do not cause consumer harm.
 - 1.2 It is our view that referral fees are part of a highly inefficient and non-transparent market mechanism that supports a disproportionate spend on business acquisition when compared to other industries.
 - 1.3 Given the LSB's narrow (statutory) focus, the LSB is not able to consider the wider issue of reform of the compensation system of which referral fees form a small part. Accordingly treatment of this issue should be escalated to the Ministry of Justice.
 - 1.4 The consumer detriment of high insurance prices has been ignored in this paper.
 - 1.5 We also disagree with the LSB's conclusions, given their definition of consumers is far too narrow; it is solely focussed on users of claimant legal services. The implications of referral fees, and the other elements of the failing civil claims system, require a much wider consideration in the public interest; not least on behalf of the 20 million+ motor insurance consumers who are currently facing record premium increases, due in large part to increases in claims costs.
 - 1.6 The LSB proposal is to enforce disclosure of referral fee arrangements by lawyers, and ensure that this is well-policed by legal regulators. This would be a minor step forwards only, and we remain to be convinced that this will make a significant difference to the underlying problem of excessive costs of civil litigation.
 - 1.7 We are also concerned that the LSB stance is at odds with the position adopted by Lord Jackson - who has conducted an independent, holistic and authoritative study into the costs of civil litigation, and reached entirely different conclusions. We agree with Lord Jackson, and the Law Society, and Lord Young, that referral fees are contrary to the public interest.

1.8 Lord Jackson has recommended that referral fees should be either banned outright, or capped at a low level, perhaps £200. A cap would help solicitors reduce costs, which can be passed on to consumers via lower fixed fees in the RTA claims process. NB This would lead to downwards pressure on insurance premiums.

1.9 We found the paper to be unclear in its conclusion regarding whether or not referral fees negatively contribute to costs for consumers. The reality is that the fees are not directly relevant to claimants as they don't pay them. The fees are recovered by solicitors via costs, and funded ultimately by insurance customers in most cases, who are powerless to apply the efficiencies of a functional marketplace.

2. LSB Proposals

2.1 Regulatory treatment of referral fees in isolation is a false premise - they are part of a wider problem with the civil claims system, which is riddled with waste and inefficiency sustained by middlemen exploiting the system.

2.2 Re disclosure: generally the consumer-claimant does not pay the referral fee (or their own legal costs) directly, and so - even if the amount of the fee, and the terms attaching to it - were disclosed, the consumer is not in a position to apply normal market pressure to this cost. They have no interest in the level of the fee, as they don't pay it. This is a dysfunctional market mechanism. Referral fees are ultimately absorbed by claimants solicitors and/or paid for by defendant insurers via increased costs, which must ultimately be recovered via premiums.

2.3 The proposal to require disclosure by law firms is faulty, as it comes too late in the process - at the suggested point the referral would have already happened. Real, meaningful customer choice would involve disclosure *prior* to a referral, and the opportunity for the claimant to make an informed choice about whether to accept a referral or make alternative provisions of their own. This superior framework would likely fall outside the scope of LSB regulation, and would need joint action from LSB and the Claims Management regulator, if not intervention from the Ministry of Justice.

2.4 We would also question if further rules on disclosure are really an answer to this problem, given there already existing rules requiring disclosure which are seemingly neither complied with nor enforced.

2.5 The strengths and weaknesses of the referral fee system are described in the LSB paper as:

- o **Strength** = promotion of access to justice, and no deleterious effect on quality independence of service, legitimate marketing spend.
- o **Weakness** = insufficient disclosure by providers (despite rules requiring this), and lack of real choice for consumers.

2.6 To this we would add:

- o **Weakness** = Referral fees are a symptom of inefficiency and waste in the claims, and should be banned or capped in the public interest.
- o **Weakness** = access to justice is often used as a smokescreen for claims farming of unmeritorious claims, and contributes significantly to the compensation culture and has contributed to the increase in fraudulent claims.
- o **Weakness** = the current referral fee system fails to give claimants a financial stake in their claim.

- **Weakness** = referral fees have now escalated up to £800 per case in 2009, from £250 in 2004, a 320% increase in 6 years for small and fast track cases and anecdotally substantially more for significant multi track cases, forming an excessive cost for insurance customers.
- 2.7 The paper contains virtually no analysis of alternative models of business acquisition for solicitors. Thus it is inevitable that the proposals represent only minor adjustments to the status quo, and its attendant failings.
- 2.8 The implication, at 5.6, that claims payments have increased as a function of referral fees seems highly misleading, with no evidence of cause and effect provided. Many factors have contributed to an increase in claims frequency, compensation levels and costs. Some of these factors, including referral fees, are the product of a dysfunctional market and will likely require statutory intervention to correct them.
- 3. Unclear Conclusions in LSB Paper**
- 3.1 We found the paper to be unclear in its conclusion at 5.15 in respect of whether referral fees negatively contribute to costs for consumers. The reality is that the fees are not directly relevant to claimants as they don't pay them. The fees are recovered by solicitors via costs, and funded ultimately by insurance customers in most cases, who are powerless to apply the efficiencies of a functional marketplace.
- 3.2 The paper has adopted a very unclear position regarding consumer choice (see 5.25). The LSB paper effectively ignored the strong representation made by the LSB Consumer Panel that referral fees restrict competition. LSB then comment that solicitors act in the best interests of their clients, a point which is irrelevant to the issue of choice. LSB then repeat the contrary view to that adopted by their own Consumer Panel, and then concludes by stating that the current disclosure rules are inadequate to protect consumers! This passage seems highly confused. We doubt that the mooted proposal will actually improve consumer choice.
- 3.3 The Consumer Panel *'found no evidence that quality had diminished or that prices had risen'*. We would suggest that the Panel measured predictable costs only, and that solicitors are routinely funding referral fee payments through revenue raised from other areas of the claim, for instance commissions on ATE premiums, referral fees paid by medical agencies, credit hire companies etc. It seems highly unlikely that these issues were factored in.

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