



ABI's Response to the Legal Services Consumer Panel Investigation into Referral Arrangements

Introduction

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. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters. And through the ABI they come together to improve customers' experience of the industry, to raise standards of corporate governance in British business and to protect the public against crime. The ABI prides itself on thinking for tomorrow, providing solutions to policy challenges based on the industry's analysis and understanding of the risks we all face.
2. The ABI welcomes the opportunity to provide input into the investigation into referral arrangements. Our 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 act as intermediaries and receive referral income. Our members are also defendant compensators, who ultimately foot the bill for referral fees.

Executive Summary

3. The ABI believes that lawyers paying referral fees should be banned, and in tandem, legal fees should be reduced by a corresponding amount to ensure that any aspect that is intended to reflect a supposed marketing or acquisition cost is 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 which have become increasingly disproportionate over the last few years.
4. Although paying referral fees may have enabled more people to become aware of their rights with regard to claiming compensation through advertising, this has come at a disproportionately high cost to the insurance industry and ultimately consumers. The ABI believes that referral fees can be removed without significantly affecting access to justice, with the added benefit of reducing legal costs. For example, a centralised education campaign led by government and supported by stakeholders could inform the same market which is currently targeted by those who receive referral fees.

5. By banning the payment of referral fees, the associated issues such as persistent unwanted targeting of potential claimants, and the potential incentives to bring spurious or fraudulent claims will be reduced.

Outcomes for consumers under existing referral arrangements

6. Since 2000, when changes to legislation governing the claims process 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, 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.¹ The fees represent an increasing percentage of the costs they recover.

The impacts of referral arrangements on access to justice

7. The activities of, in particular, claims management companies has raised awareness of people's rights to compensation and increased the numbers of people making a claim for compensation. However, the cost of marketing in this way is very high, when compared with other sectors.² For example, the expenditure by the Government on tobacco control in 2007-8 was less than half the total level of advertising in the personal injury claims market over the same period.
8. ABI-commissioned research by Oxera ('the Oxera research') concluded that because presently, 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 are likely to be the residual between the costs of actually processing the case and the costs that can be recovered from the defendant. Referral fees have increased over time,³ indicating that claimant solicitors have been able to drive efficiencies, but this has not 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 them to increase their referral fees/marketing spend. The result as noted by Lord Justice Jackson in his preliminary report on the Review of Civil Litigation Costs is that there are too many 'middle men' involved, adding no value.
9. 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.⁴ Therefore, it is possible that referral fees could be removed whilst maintaining access to justice.

¹ ABI Research Paper no 15, 2009 , *Marketing costs for personal injury claims*, p 3

² Ibid.

³ Ibid.

⁴ Ibid, p 42

Quality of Claims

10. 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 (CMCs), present opportunities for those without integrity 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 CMCs may engage in suspect practices. This impacts on 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.

What are the impacts of referral arrangements on the quality of legal service provided?

11. 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. Moreover, as legal services can be considered to provide deferred value, the claimant may not be able to observe the quality of the service either before or after, it may be difficult to measure the impact of referral arrangements has had on quality.

Choice and Independence of Solicitor

12. The choice of solicitor sits with the claimant, although in practice, most often the claimant will normally be referred to a legal representative who has a relationship with the intermediary. 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.

Consumer Safeguards

13. If legal fees are not reduced in line with a ban, then there is incentive for the arrangements to continue, but in a less transparent manner. It is important that care is taken to ensure that there is no move to a situation where referral fees are disguised as something else.
14. It is also important that, should referral arrangements continue, full disclosure of any referral fee arrangement is made to the claimant. While the introduction of the claims management regulator has helped to improve transparency, it is concerning that the Solicitors Review Authority are still identifying significant non-compliance with the Introduction and Referral Fee Code.

15. A centralised education campaign, supported by stakeholders, which raises consumer awareness of their legal rights may also assist in reaching those who are dissuaded from making a claim as a result of personal injuries advertising, and remove the need for the existing high-cost referral arrangements.

The role of referral arrangements in driving or inhibiting competition in the legal services market

16. We do not have any substantive information about how referral arrangements drive or inhibit competition within the legal services market, apart from the observation that the current referral arrangements system encourages solicitors to compete against each other in order to secure referrals, by squeezing their own costs, to pay a higher referral fee, as opposed to competing on quality or cost to the consumer.

How does the referral fee reflect equivalent marketing costs?

17. The Oxera research found that, for personal injury claims, marketing costs in the form of referral fees were high when compared to other 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%. Other legal services, (e.g. wills and conveyancing) marketing spends were around 18% of base legal costs. The high marketing cost can be attributed to the lack of market constraints for claimant solicitor's costs.

Alternatives to referral fees

18. 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 sector campaign which fulfils the same role. Oxera's research showed that a government 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.⁵
19. The ABI understands that many CMC's are deducting significant parts of compensation recovered in non-personal injury claims and this needs to be monitored by the Claims Management Regulator, as any ban may see a spread and increase of this activity. Claimants have the option of dealing with an insurer directly and not have to lose part of any compensation.

Risks and benefits of a ban on referral fees

20. A ban on referral fees should be properly enforced and teamed with a re-balancing of the market dynamics, leading to a reduction in recoverable legal costs and therefore lower marketing costs. A ban on referral fees without a commensurate

⁵ *ibid*, p 43

reduction in legal costs does present some risks for consumers. As discussed at para 13 above, If solicitors are still in a position to pay referral fees, then it is likely that the referral arrangements would continue under another guise, at the same cost and with less transparency for the consumer.

21. Where the ban is combined with a reduction in legal fees, the savings can be passed back to the consumer. Another potential outcome of banning referral fees would be that intermediaries such as claims management companies seek other lines of business, lessening the risk of fraudulent claims being presented, which benefits the genuine claimant.

Relevant parallels with referral and commission arrangements used in other sectors in relation to customer introduction

22. The Oxera report looked at a range of other sectors, in particular looking at the mobile telephony market, which exhibited similar market dynamics to the market for personal injury claims, in which referral fees exist. In that situation, regulators intervened.⁶

Conclusions

23. The ABI believes that referral fees should be removed altogether, as part of wider reform to ensure legal costs are re-set at appropriate levels. This would benefit consumers by reducing legal costs and reducing the undesirable associated activities such as persistent cold calling of potential claimants. However, a ban on referral fees without a commensurate reduction in legal costs does present some risks for consumers.
24. 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.

⁶ Ibid, p 28.