

<b>Title:</b> <b>Referral Fees in Personal Injury Claims</b> <b>Lead department or agency:</b> Ministry of Justice (MoJ) <b>Other departments or agencies:</b>	Impact Assessment (IA)
	<b>IA No:</b> MoJ 105
	<b>Date:</b> 05/07/2012
	<b>Stage</b> Royal Assent
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Primary legislation
	<b>Contact for enquiries:</b> Iram Akhtar Tel: 0203 334 4202

## Summary: Intervention and Options

### What is the problem under consideration? Why is government intervention necessary?

The concern highlighted by Lord Justice Jackson in his *Review of Civil Litigation Costs*, and by Lord Young of Graffham in his report *Common Sense, Common Safety*, is that referral fees in personal injury cases contribute to the high costs and volumes of personal injury litigation. The Government considers that the activity of paying intermediaries such as claims management companies to buy access to claimants is in principle not in the public interest. The actions undertaken by claims management companies to identify potential claimants and encourage them to claim can also be objectionable. They may encourage excessive litigation for low value claims and fuel a compensation culture or perception of one. Legislation was needed to ban referral fees.

### What are the policy objectives and the intended effects?

The policy objectives and intended effects are:

- to cease payment for gaining access to personal injury claimants;
- to reduce incentives to excessive litigation, especially weak or unnecessary claims;
- to reduce the overall level of legal costs involved in personal injury cases, and hence in the process to reduce insurance premiums.

### What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

In addition to the 'do nothing' option the Government's favoured option was:

Option 1: Lord Justice Jackson's recommendation of a ban on the payment and receipt of referral fees.

The Government considered alternative options including recommendations by the Legal Services Board (LSB) to improve transparency of referral fees in personal litigation, and capping the amount that may be paid as a referral fee. However they do not address the objectives as well as Option 1. The Government's policy is to ban referral fees in personal injury cases with a view to extending the ban to other areas if necessary.

**Will the policy be reviewed?** It will be reviewed 3 to 5 years after implementation. **If applicable, set review date:** 04/2016

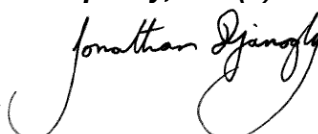
**What is the basis for this review?** PIR. **If applicable, set sunset clause date:** N/A

**Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?** No

**SELECT SIGNATORY Sign-off** For final proposal stage Impact Assessments:

**I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.**

Signed by the responsible Minister:



Date: 13 July 2012

# Summary: Analysis and Evidence

Policy Option 1

Description:

To prohibit the payment of referral fees

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition) (Constant Price)	Annual (Constant Price)	Total (Present Value)	Cost
Low						
High						
Best Estimate						

## Description and scale of key monetised costs by 'main affected groups'

The costs associated with this measure are not quantifiable.

## Other key non-monetised costs by 'main affected groups'

Claims management companies and insurers will not receive referral fee income.  
 Claims management companies and lawyers will deal with fewer cases and incur adjustment costs  
 Lawyers may incur increased costs relating to advertising and informing clients.  
 Claimants may pursue fewer cases and receive less compensation in aggregate  
 Regulated bodies will cover increased regulatory costs of monitoring and enforcing the ban.

BENEFITS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition) (Constant Price)	Annual (Constant Price)	Total (Present Value)	Benefit
Low						
High						
Best Estimate						

## Description and scale of key monetised benefits by 'main affected groups'

The benefits associated with banning referral fees are not quantifiable.

## Other key non-monetised benefits by 'main affected groups'

Lawyers will no longer pay referral fees  
 Insurers and other defendants will gain from reduced aggregate compensation paid and reduced overall legal costs, and this may feed through to lower insurance premiums.  
 Advertisers may gain from more business

## Key assumptions/sensitivities/risks

Neutral overall impact for HM Court and Tribunal Service  
 Assume no change in case outcomes  
 Assume the referral fee ban is enforceable  
 Assume referral fees lead to an overall increase in legal costs per case and an overall increase in the number of cases

Discount rate (%)

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	Yes	IN/OUT

## Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			England and Wales		
From what date will the policy be implemented?			April 2013		
Which organisation(s) will enforce the policy?			Relevant regulators		
What is the annual change in enforcement cost (£m)?			TBC		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			Yes		
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			Traded:		Non-traded:
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs:		Benefits:
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

## Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
<b>Statutory equality duties<sup>1</sup></b> <a href="#">Statutory Equality Duties Impact Test guidance</a>	No	
<b>Economic impacts</b>		
Competition <a href="#">Competition Assessment Impact Test guidance</a>	Yes	
Small firms <a href="#">Small Firms Impact Test guidance</a>	Yes	
<b>Environmental impacts</b>		
Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>	No	
Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>	No	
<b>Social impacts</b>		
Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>	Yes	
Human rights <a href="#">Human Rights Impact Test guidance</a>	No	
Justice system <a href="#">Justice Impact Test guidance</a>	Yes	
Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>	No	
<b>Sustainable development</b> <a href="#">Sustainable Development Impact Test guidance</a>	No	

<sup>1</sup> Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

# Evidence Base (for summary sheets) – Notes

## References

### No. Legislation or publication

1. Review of Civil Litigation Costs: Preliminary Report - <http://www.judiciary.gov.uk/publications-and-reports/reports/civil/review-of-civil-litigation-costs>
2. Review of Civil Litigation Costs: Final Report - <http://www.judiciary.gov.uk/publications-and-reports/reports/civil/review-of-civil-litigation-costs>
3. <http://www.justice.gov.uk/consultations/jackson-review.htm>
4. [http://www.legalservicesboard.org.uk/what\\_we\\_do/consultations/closed/index.htm](http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/index.htm)
5. Transport Committee, The Cost of Motor Insurance  
<http://www.parliament.uk/business/committees/committees-a-z/commons-select/transport-committee/publications/>

# Evidence Base (for summary sheets)

## Introduction and the problem under consideration

1. Referral fees are paid by solicitors to third parties who 'refer' business to them. Claims management companies (CMCs) and insurers are the main recipients of referral fees from solicitors in return for gaining access to claimants. CMCs may undertake a range of actions, including advertising, sending text messages and cold calling to identify potential claimants and encourage them to make a claim. Some CMCs also offer financial inducements to people to make claims, where the claimant receives a reward prior to the case being settled. In addition to attracting potential claims some CMCs undertake vetting and sifting activities on behalf of solicitors to ensure that claims are meritorious. In cases where policy holders contact insurers to make a claim on their motor insurance policy, the insurer can check if there is a related personal injury claim and then refer them to a lawyer in return for a fee. In addition to insurers, other bodies which hold details of claimants, e.g. car hire companies, accident management companies and garages, also sell lawyers access to these claimants for a fee.
2. In 2010-11 there were around 3,200 authorised CMCs, of which about 2,600 operated in the personal injury sector. CMCs operating in the personal injury sector reported an annual turnover of approximately £380 million in 2010-11 compared to around £280 million the previous year, representing around 65% of total CMC industry turnover in 2010-11. In summary the CMC sector has grown significantly in recent years.
3. Various sources suggest that referral fee payments have increased from around £250 per case in 2004 to around £800 per case in 2009, with most cases receiving a referral fee in the range of £600 to £800.
4. Road Traffic Accidents (RTAs) account for the significant majority of all personal injury claims<sup>1</sup>. The total volume of road accidents has been falling, by around 25% between 2000 and 2007, and by around a further 15% between 2007 and 2010<sup>2</sup>. However, the volume of motor-related cases registered for compensation increased by around 45% between 2007/08 and 2010/11<sup>3</sup>, reaching almost 800,000. Anecdotal evidence suggests that a substantial increase in claims might relate to small injuries. Furthermore the litigation cost in relation to each accident appears to be high, and possibly growing, relative to the actual compensation claim. An ABI report<sup>4</sup> indicates that, in motor claims under £5,000, for every £1 paid by insurers in personal injury compensation an additional 88p is paid to claimant lawyers. The ABI further reports that a significant volume, over 430,000 in 2007, of motor accidents claim whiplash, which represents around 1 person in every 140 of the UK population. Most whiplash claims fall below £5,000 and the incidence of whiplash claims has increased by 25% from 2002 to 2008. This might be reflected in higher insurance premiums, driving insurance costs up for policyholders including the general public. .
5. Coordination failures might in part be responsible rising costs. Insurance policy holders contact their insurers when they wish to make a claim and many insurers then sell details of these claims to lawyers, receiving a referral fee in return. If the case is successful then the lawyers' costs, including the referral fee, would be recovered from the losing defendant. In many cases the losing defendant would be another insurance company. Both the Law Society and Association of British Insurers (ABI) have raised concerns that such circular flows generated by referral fees ultimately drive up overall litigation costs, and hence insurance costs. In the absence of legislation the industry has been unable to tackle these costs in a coordinated way. The ABI and Deloitte<sup>5</sup> have indicated that the average insurance premium increased by approximately 10% from 2009 to 2010, in order to make up for insurance underwriting losses of over £2 billion in 2010, when 20p was lost for every £1 of premium earned. Reports by Deloitte indicate that the premium increases were still not enough for the market to return to previous levels of profitability.

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<sup>1</sup> ABI Research Paper no. 15, Marketing Costs for Personal Injury Claims, Evidence of market Failure. Report from Oxera Consulting Ltd. 2009.

<sup>2</sup> Department for Transport Statistics, all reported casualties by road.

<sup>3</sup> Department for Work and Pensions, Compensation Recovery Unit Performance Statistics.

<sup>4</sup> ABI, Tackling whiplash Prevention, Care, Compensation. November 2008

<sup>5</sup> [http://www.deloitte.com/view/en\\_GB/uk/industries/financial-services/sector-focus/insurance/ae86ddf8dec90310VgnVCM3000001c56f00aRCRD.htm](http://www.deloitte.com/view/en_GB/uk/industries/financial-services/sector-focus/insurance/ae86ddf8dec90310VgnVCM3000001c56f00aRCRD.htm)

6. Referral fees might be contributing to these high legal costs. Claimants are not always exposed to the costs they generate as these are recoverable from the losing defendant. A claimant might, therefore, have limited interest in the size of the referral fee attached to their case and generated by their claim, and the losing defendant is unable to control such costs. As such referral fees might collectively rise with limited control, as the figures suggest.
7. A report commissioned by the LSB finds that some of the larger firms in the CMC industry see their primary role as marketing, and it was estimated that CMC marketing expenditure during 2005-08 was around £35 million to £40 million. The Law Society considers that the value added by claim handlers does not match the overall increase in costs associated with them, and that the solicitors' profession is capable of providing information to potential claimants without incurring such high costs, which in successful cases are recoverable from the losing defendant.
8. Research by Moulton Hall suggested that the extent of vetting done on each claimant case by introducers varies significantly, and case refusal rates vary from 15% to 50%. This also depends on the introducers' policies on sending cases to solicitors that have already been refused by other solicitors, which creates some duplication in vetting and possibly in referral fees paid. While such intermediaries may be performing a matching process between claimants and legal providers, it is unclear how effective this matching process is. Furthermore it might not be possible for the claimant to tell whether they have been matched to the most appropriate lawyer.
9. The combined effect of high levels of advertising and limited vetting may lead to a large number of weak or unmeritorious cases being referred to solicitors. Once solicitors have paid a referral fee for a case they would have an incentive to secure a return from that case. If the claim is low value, especially in relation to the legal costs of resolving the claim, the defendant may have an incentive to settle the claim in order to minimise their total outlay, even if the claim is weak. Under this scenario referral fees would be associated with a higher volume of less meritorious claims and settlements, resulting in higher overall costs which may ultimately feed through to higher insurance costs.
10. Growing referral fees may finance high powered CMC marketing, advertising and proactive texting, which may encourage or proactively persuade people to make a claim when they might otherwise not do so. If a claimant has a weak and low value claim then they might not be willing to expend much time or effort in pursuing it or might not think it is appropriate to do so. The activities of CMCs may reduce these initial claimant search costs and as a result encourage such claims to surface when otherwise they might not. This would apply less in relation to stronger and more valid claims. Under this scenario referral fees might be supporting an increasing volume of weaker claims.
11. Finally, some intermediaries may be using parts of the referral fees they receive to pay inducements directly to claimants to attract them into making a claim. This may influence the claimant's choice of intermediary. Claimants might have limited choice over the solicitor handling their case, as this would be determined by the intermediary, and claimants might possibly be allocated to the lawyer paying the highest referral fee rather than to the most appropriate lawyer for their particular needs. The LSB report provides some evidence of this through interviews held which indicated that most consumers selected their provider on the basis of marketing, which was unusual for most markets where typically the price would play a strong role in selection of legal services. Under this scenario referral fees might be associated with clients not matching up with the most suitable lawyer.
12. In summary various aspects of market dynamics as outlined above indicate that referral fees might be generating increased overall legal costs and might be associated with an increased volume of less meritorious claims. This might be feeding through to higher overall insurance premiums.

## Policy background

13. Concerns have been raised about the high costs of civil litigation in England and Wales. As a result, Lord Justice Jackson was appointed in late 2008 by the then Master of the Rolls to review the rules and principles governing the costs of civil litigation. Lord Justice Jackson's report<sup>6</sup>

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<sup>6</sup> Review of Civil Litigation Costs: Final Report - <http://www.judiciary.gov.uk/publications-and-reports/reports/civil/review-of-civil-litigation-costs>

contains 109 recommendations, including on the reform of no win no fee conditional fee agreements (CFAs). Lord Justice Jackson recommended that the payment of referral fees should be banned. If this recommendation was not accepted he proposed that referral fees should be capped at £200 in personal injury cases.

14. Having considered the recommendations included in Lord Justice Jackson's Final Report, the Government published its consultation 'Proposals for Reform of Civil Litigation Funding and Costs in England and Wales' in November 2010. This consultation did not include Lord Justice Jackson's recommendations on referral fees as the Government wished to consider parallel research by the Legal Services Board (LSB) before confirming its position, and this research was not complete at the time. The Government published its response in March 2011 and is now implementing the key recommendations on the reform of CFAs. The Government consultation and response may be found at [www.justice.gov.uk](http://www.justice.gov.uk).
15. Lord Young of Graffham in his review of health and safety laws and the compensation culture, *Common Sense Common Safety*, expressed strong support for implementing Lord Justice Jackson's recommendations to ban referral fees. The payment of referral fees by solicitors was banned by the Law Society until 2004. The Bar Council still maintains its ban on barristers paying referral fees.
16. The Legal Services Board (LSB), as the oversight regulator for the legal profession, considered the role and impact of referral fees including on costs and access to justice within the legal service market. The LSB's examination<sup>7</sup> of referral fees reported that based on their research there was insufficient evidence of consumer detriment requiring a ban. However, it identified concerns around transparency of referral fees, and that competition to access introducer panels had led to referral fees increasing from around £250 to £800 per case. They reported that this level of referral fees was linked to the services provided by introducers, as well as to issues such as economies of scale and bargaining power. The research indicated that disclosure is important to consumer confidence and that there were problems with this. The LSB's consultation, "*Referral fees, referral arrangements and fee sharing*"<sup>8</sup>, published in September 2010 contains proposals for improving transparency and disclosure. It also proposed compliance and enforcement reforms to address concerns around how referral fees impact on outcomes for consumers. Similarly, The House of Commons Transport Select Committee conducted an inquiry into the cost of motor insurance. This was published in March 2011 and urged insurers to improve transparency around the operation of referral fees.
17. The Government's consultation paper on Lord Justice Jackson's recommendations indicated that it would await the conclusions of the LSB's report before reaching a conclusion on the way forward on referral fees. Having considered the LSB report, and the work of the Transport Select Committee, the Government has selected the option of banning referral fees, as outlined below.

## Policy objectives

18. The main policy objectives are:
  - i. **To reduce the overall level of legal costs in personal injury cases, and related insurance costs.** This may stem from the costs per case being lower and from there being fewer cases. One outcome of reduced overall legal costs and from reduced claims volumes might be reduced insurance premiums.
  - ii. **To discourage people from bringing unnecessary claims for compensation, including unmeritorious lower value claims.** The Government is already implementing significant changes to CFAs (abolishing recoverability of success fees and after the event insurance premiums from the losing side), which should encourage claimants to consider whether they ought to be pursuing their case, and the ban on referral fees would complement and enhance these other policies.

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<sup>7</sup> This consisted of research by Charles Rivers Associates into the impact of referral fees on the legal services market as well as the Consumer Panel's advice on the impact on referral on consumers. For more details please refer to the LSB consultation.

<sup>8</sup> [http://www.legalservicesboard.org.uk/what\\_we\\_do/consultations/open/index.htm](http://www.legalservicesboard.org.uk/what_we_do/consultations/open/index.htm)

- iii. **To prohibit the payment of referral fees for gaining access to personal injury claimants.** Lord Justice Jackson considered that such payments to intermediaries were wrong in principle. The Government considers that it is not in the public interest for firms to receive direct payments for proactively seeking out people who have suffered a personal injury and encouraging them to make claims.

## Policy

19. The policy is to prohibit the payment and receipt of referral fees for introducing personal injury claimants to solicitors by making it a regulatory offence to pay or receive a referral fee to intermediaries. Those involved in the claims process such as CMCs, insurance firms, personal injury solicitors, barristers<sup>9</sup> and others authorised to bring claims would be subject to regulatory rules from the regulatory authorities which oversee them which prevent them from paying referral fees.
20. A ban prevents solicitors and others from paying and receiving fees for claims to be referred so impacts indirectly on those who introduce claimants to solicitors for a fee. This would help deal with concerns in personal injury cases where the high volume low value market appears to be particularly susceptible to encouraging speculative claims. However, the Government may extend the ban to other categories of case in due course (such as, for example, employment cases) should the case be made for doing so.

## Alternative options considered

21. Because this is a Royal Assent Stage Impact Assessment the alternative options which were considered are set out below together with a summary of why they are not being pursued, rather than being subject to the same degree of explanation as the policy which is being adopted.
22. The Government considered the alternative option of increasing transparency, as recommended by the LSB and the Transport Select Committee. Whilst this would make it clearer what referral fees are being paid, and what services are being provided, this would not directly tackle the market dynamics outlined above. In particular those responsible for triggering the referral fee may still have a limited incentive to reduce or control that fee as it might be recovered by another party. The coordination failures within the insurance industry would also not be addressed. The Law Society has expressed concerns that the result of the LSB guidance on increased transparency would be increased burdens on both regulators and the professions, which may work against the objective of reducing overall litigation costs, and which could be avoided by prohibiting referral fee payments altogether.
23. Lord Justice Jackson's alternative recommendation of introducing a £200 cap on the level of referral fees was also considered. Whilst limiting the increased costs generated by referral fees this option might be associated with a lower quality of service provided by intermediaries. For example, there may be weaker CMC vetting processes around which cases should be accepted and how they should be allocated to lawyers. CMCs might also engage in lower cost claims generation activities, and it is conceivable that this might involve more aggressive and direct approaches to those who have just suffered personal injury, contrary to the Government's objectives. Lord Justice Jackson's alternative recommendation would also not directly tackle the market dynamics outlined above, as referral fees would still be paid, albeit at a capped amount, and the incentive to encourage weak or unmeritorious claims would remain.

## Economic rationale

24. The conventional economic approach to Government intervention is based on efficiency or equity arguments. The Government may consider intervening if there are strong enough failures in the way markets operate, e.g. monopolies overcharging debtors, or if there are strong enough failures in existing Government interventions, e.g. outdated regulations generating inefficiencies. In all cases the proposed intervention should avoid generating a further set of disproportionate.

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<sup>9</sup> But note that barristers are already prevented by their professional rules of conduct from paying referral fees.



costs and distortions. The Government may also intervene for reasons of equity or fairness and for redistributive reasons (e.g. reallocating resources from one group in society to another).

25. In this case it is possible that referral fees might be adding to the overall legal costs of resolving a case without making a material difference to case outcomes. If so then a reduction in legal costs associated with banning referral fees would generate an improvement in overall resource efficiency.
26. It is also possible that banning referral fees might lead to a reduction in low value and less meritorious cases being pursued in future. Where the value of damages claimed is much lower than the resource costs used in resolving a claim this might constitute the inefficient use of resources. Resolving such claims still might be justified if society places a high value in justice being provided, but this might not be so for unmeritorious or lower value claims.
27. Finally if the ban on referral fees led to a reduction in successful claims then there would be distributional implications. Those who would have made successful claims would lose out and defendants would gain. The claimants might be individuals and the defendants might be insurers, funded by insurance premiums paid by policy holders including the general public.
28. In terms of the overall economic rationale, the value placed by society on the distributional implications would need to be assessed alongside the value of any increased resource efficiency.

## **Main affected groups**

29. The following individuals/sectors likely to be affected by the policy are:
  - Litigators working on personal injury cases;
  - Claimants;
  - Defendants;
  - Claims Management Companies, and other intermediary firms;
  - Insurance Companies;
  - Regulators, including the Financial Services Authority, Solicitor's Regulatory Authority, the Claims Management Regulator, the Bar Standards Board and more;
  - HM Courts and Tribunal Services (HMCTS);
  - Other sectors that derive income from civil litigation.

## **Costs and Benefits**

30. This Impact Assessment attempts to identify both monetised and non-monetised impacts on individuals, groups and businesses in the UK, with the aim of understanding what the overall impact to society might be from implementing this policy. The costs and benefits of each option are compared to the do nothing option. Impact Assessments place a strong emphasis on valuing the costs and benefits in monetary terms (including estimating the value of goods and services that are not traded). However there are important aspects that cannot sensibly be monetised. These might include how the policy impacts differently on particular groups of society or changes in equity and fairness, either positive or negative.
31. A qualitative assessment is provided here as the aggregate impacts could not be quantified. To provide a quantitative assessment would require obtaining specific details such as how many cases involve lawyers paying referral fees, how much referral fee income is received by CMCs and by insurers, how many cases might not be pursued in future, what level of damages and legal costs might attach to those cases, what is the net reduction in lawyers' costs per case bearing in mind the costs of any increased advertising they may incur, what is the total reduction in legal costs paid by insurers, and what other activities might CMCs and lawyers engage in if the volume of personal injury cases falls. This information is either unknown or is commercially sensitive and not readily available to Government. Even where information is available there may be issues with data from samples being representative of the whole industry, and also with self-reported data reflecting bias. This Impact Assessment therefore provides some anecdotal evidence received from various sources and research reports from industry bodies, which are included here for indicative purposes to inform this Impact Assessment.

## **Option 0 – Base case (do nothing)**

### **Description**

32. Under this option, no intervention would be made. This means the current regime would continue in its existing form, with the problems outlined above remaining. The recommendation to ban referral fees made in Lord Justice Jackson's report would not be taken up.
33. The do nothing option is included for comparative purposes. As its costs and benefits are compared against themselves, they are necessarily zero, as is its net present value.
34. If the other reforms proposed by Lord Justice Jackson are adopted then the base case would change in future. In particular this package of other reforms should lead to some reduction in legal costs and a reduction in lower value and less meritorious cases. As explained above, the proposed ban on referral fees would further contribute to this package and to these impacts.

## **Option 1: Introduce a ban on the payment and receipt of referral fees**

### **Description**

35. This policy will prohibit the payment and receipt of referral fees in return for gaining access to claimants in personal injury cases.
36. The banning of referral fees is expected to reduce the volume of litigation as it is anticipated that a dampener would be placed on the activity of CMCs and other intermediaries which encourage more claims than would otherwise be the case. As a result of less litigation it is assumed that the overall sum of damages paid to individuals would be lower as would overall costs paid by defendants. These damages and legal costs may be paid by businesses or by other individuals (e.g. via insurance). Lawyers will also save from not paying referral fees. The overall costs of litigation per case may therefore fall as a result of banning referral fees.

## **Option 1: Costs**

### ***Costs to lawyers***

37. The overall volume of personal injury litigation cases is expected to be lower as claimants might no longer pursue some cases in future. This will generate a cost in terms of reduced business for lawyers who currently work on such cases. The volume of such cases is unknown, but these are expected to be low value cases. Lawyers might respond to this changing pattern of demand by focusing on other areas of business. The overall impact on lawyers is unknown, however at a minimum, adjustment costs would be incurred.
38. In relation to claims which continue to be made in future, lawyers may incur additional advertising and promotional costs associated with attracting claimants, and costs associated with dealing with and informing potential clients, instead of paying referral fees to intermediaries to attract claimants. However these costs may be lower than paying referral fees as there will be more direct control on such advertising. Any such changes in lawyers' costs might be reflected to some extent in their fees.
39. Lawyers might also be liable to meet (via licensing fees) any increase in regulatory costs associated with banning referral fees (see below).

### ***Costs to claims management companies***

40. Intermediaries such as CMCs will no longer be remunerated for providing access to claimants in personal injury cases. This is expected to lead to a reduction in the level of their business, with more claimants dealing directly with providers in future. The impact will depend upon their reliance on referral fee income for personal injury cases.
41. As for lawyers, CMCs might respond to this by focussing on other areas of business, or by changing their business models. The nature and extent of these other possible areas of business

<sup>10</sup> suggest that some of the larger firms in the claims management industry see their primary role as marketing, and the ABI report identified that the two advertisers within the UK personal injury market were CMCs. Therefore advertising may be an attractive area for CMCs to shift their business into. At a minimum, adjustment costs would be incurred.

42. CMCs might also be liable to meet (via licensing fees) any increase in regulatory costs associated with banning referral fees (see below). If CMC regulatory costs are fixed to some extent and CMCs withdraw from the market the regulatory costs per remaining CMC may rise. The timing of the implementation of a ban will be an important factor in determining the impact of CMC regulatory costs.

### ***Insurance costs***

43. Insurers would lose referral fee income if they currently provide access to claimants for a fee. However, if these claims are being made against other insured parties then it is unclear whether there would be any aggregate impact on insurers. For example, to the extent that some insurers gain from securing referral fee income, others might lose from ultimately having to cover those referral fees through the mechanism of lawyer's recoverable costs. Anecdotal evidence suggests that the current litigation costs in relation to each claim exceeds the referral fee income, and so the ban on referral fees may result in an overall benefit for the insurance industry.
44. Insurers might also be liable to meet (via licensing fees) any increase in regulatory costs associated with banning referral fees (see below).

### ***Costs to claimants***

45. Some claimants may experience higher search and selection costs in future from having to shop around to find a lawyer instead of relying upon a CMC to do so. Claimants who are less capable of selecting the right provider might make worse choices as a result of not drawing on the intermediary's advice, who might have better knowledge of the providers in the market. The extent of this is unclear.
46. Some claimants may not pursue cases as a result of the ban on referral fees, for example because they might be unaware that they can do so, or unaware of the chances of success and of the possible damages available, or are otherwise not persuaded to go through the process. In such cases claimants may lose out from not securing compensation payments. The extent of any reduction in case volumes is unknown, as is the size of compensation payments involved.

### ***Costs to regulators***

47. There may be costs to the regulators of solicitors and intermediary firms from monitoring that no referral payments are made, and taking enforcement action if necessary. Regulators include the Financial Services Authority for insurers, the Solicitor's Regulatory Authority and the Bar Standards Board for lawyers and the Claim Management Regulator. Other regulators of legal services businesses might be affected. Regulatory costs are usually covered by fee income from those subject to regulation, hence regulators themselves might incur no change in net costs.

### ***Costs to HMCTS***

48. HMCTS may experience a reduced volume of cases, and associated reduced court fee income. However HMCTS operates a full cost recovery regime, under which any reduced court fee income would reflect reduced operating costs. The overall financial impact on HMCTS is, therefore, considered to be neutral.

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<sup>10</sup> Charles Rivers Associated, Cost Benefit Analysis of policy options related to referral fees in legal services. May 2010.

## **Option 1: Benefits**

### ***Benefits to lawyers***

49. Lawyers will benefit from no longer paying referral fees. There is evidence that currently referral fees may range between £250 to £800 per case<sup>11</sup>, but can be higher<sup>12</sup>. It is not clear what level of referral fees apply in what volume of cases, hence an aggregate saving cannot be calculated.
50. Lawyers may benefit from getting more direct control of screening and vetting potential clients rather than relying on intermediaries to do this. The Law Society considers that this will benefit the legal profession. This may also remove duplication of vetting, and related costs, in relation to cases that in the past would have been referred by intermediaries to successive lawyers. A Moulton Hall report considers that in the personal injury sector lawyers will benefit from competing on reputation rather than on the ability to pay referral fees.

### ***Benefits to advertisers***

51. Lawyers might make greater use of advertisers and other promotional activities in future in order to attract claimants directly rather than going through CMCs.

### ***Benefits to claimants***

52. Claimants might benefit from selecting their lawyer directly rather than by going through an intermediary, who decides to whom they would sell the case on the basis of the highest referral fee, if this improves the exercise of their choice or if this provides them with more reassurance about the lawyer that is dealing with their case. Claimants might gain from making a better selection, for example by choosing a higher quality solicitor that may be more suitable for their case.
53. There may be benefits to potential claimants, i.e. to members of the public, from reduced exposure to particular activities by some introducers, such as cold calling and texting.

### ***Insurance benefits***

54. Insurers will gain from reduced costs to the extent that referral fees generate increased overall legal costs which losing defendants will meet. Insurers will also benefit from a reduction in weak or unmeritorious claims, as they would no longer have to defend them. Some anecdotal evidence indicates that over the last few years, legal costs in relation to claims may have driven insurance profitability per policy premium down. The ABI and Deloitte<sup>13</sup> have indicated that the average insurance premium has increased by approximately 10% from 2009 to 2010, in response to insurance underwriting losses of 20p for every £1 of premium earned in 2010. The ABI indicate that insurers view a ban on referral fees as beneficial in reducing the amount of petty litigation cases and the costs of defending such cases.

### ***Benefits to defendants***

55. In addition to insurers, defendants may include businesses and others who are liable directly to pay compensation and also all those (businesses and individuals) who are liable indirectly via insurers and who pay insurance premiums to cover their liabilities.
56. There are expected to be overall benefits to defendants associated with the reduction in case volumes and reduced overall levels of compensation and legal costs. This may include reductions in insurance premiums.

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<sup>11</sup> Charles Rivers Associates "Cost Benefit Analysis of policy options related to referral fees in legal services" May 2010.

<sup>12</sup> Response of Allianz Insurance PLC to the Legal Services Board Review of referral fees, referral arrangements and fee sharing.

<sup>13</sup> [http://www.deloitte.com/view/en\\_GB/uk/industries/financial-services/sector-focus/insurance/ae86ddf8dec90310VgnVCM3000001c56f00aRCRD.htm](http://www.deloitte.com/view/en_GB/uk/industries/financial-services/sector-focus/insurance/ae86ddf8dec90310VgnVCM3000001c56f00aRCRD.htm)

## ***Benefits to HMCTS***

57. HMCTS may experience a reduced volume of cases, and associated reduced operating costs. However HMCTS operates a full cost recovery regime, hence any reduction in operational costs would be accompanied by reduced court fee income. The overall financial impact on HMCTS is considered to be neutral.

## ***Benefits to wider economy and society***

58. If the overall level of legal costs per case falls as a result of banning referral fees and if case outcomes for claims taken forward remain the same then there would be an overall gain in the economic efficiency of case resolution.
59. There may be additional wider economic gains relating to the reduction in case volumes, if the value to society of resolving such claims was lower than the total amount of resource used to resolve them. This may be so if the cases which are no longer pursued are considered to be more trivial from society's perspective and not worth the cost of pursuing.
60. There may be wider benefits to society from any reduced perception of a compensation culture.

## **Option 1: Overall summary and One-In One Out implications**

### ***Lawyers***

61. Lawyers who currently pay referral fees may lose out from the reduced volume of personal injury business. Whilst they might move into alternative types of business the extent of this is unknown and there would be adjustment and advertising costs. However, such costs are expected to be offset as lawyers would gain from no longer paying referral fees. It is possible that there might be net savings for lawyers. Furthermore, in future Alternative Business Structures may see lawyers entering into partnerships with non-lawyers and this may negate the need for referral fees. Finally, lawyers might benefit from getting more direct control over which cases to take on, achieving a more efficient matching process between lawyers and the claimants taken on. The Law Society welcomes the policy and identifies such benefits. Overall lawyers might incur no net additional costs.

### ***Claims management companies***

62. The position for CMCs and other intermediaries is similar in part to that for lawyers. In particular they are expected to lose out from a reduction in business levels, which may be significant. CMCs might adapt their business models so that they are not reliant on referral fees paid by lawyers, or they might move into alternative types of business such as marketing or advertising. The extent of this is unknown and there would be adjustment costs. CMCs would also need to cover increased regulatory costs. Overall CMCs would lose out.

### ***Advertisers***

63. Advertisers might gain from increased business as a result of lawyers using their services more to attract claimants directly rather than going through CMCs. As discussed above, some of these advertising firms may be past CMCs who are already key advertisers in the personal injury market. Overall advertisers might gain.

### ***Insurance***

64. There is anecdotal evidence from the ABI which suggests that the insurance industry will benefit from this policy, which the ABI supports. In particular insurers may lose out from reduced referral fee income, but they would gain from the reduced volume of claims and also from the reduced legal costs which losing defendants such as insurers have to meet. Insurers are expected to gain overall.

## ***Claimants***

65. Some potential claimants may lose out if their claim is not brought without referral fees being paid, although there would be nothing to stop them contacting a lawyer direct to see if they have a valid claim. It is unclear whether in the exercise of claimant choice in relation to selecting a lawyer would be better or worse without going through CMCs. This will depend upon the claimant's ability to select the right lawyer for their case and upon the CMCs incentives to do so. In addition claimants might lose out from higher search and selection costs but may also gain from searching out a firm offering better value for money/lower legal costs. Claimants in personal injury cases are likely to be individuals not businesses. Overall claimants might lose out.

## ***Defendants***

66. The ABI welcomes a ban on referral fees on the basis that defendants, including businesses, insurers, and individuals, will gain from the reduction in total compensation and legal costs associated with the reduced volume of cases and possibly reduced legal costs per claim. Where defendants or potential defendants have taken out insurance these benefits may take the form of reduced insurance premia. Overall defendants are expected to gain.

## ***HMCTS***

67. The overall impacts on HMCTS are expected to be neutral. HMCTS operates a full cost recovery regime, hence any change in income would reflect a change in operating costs and vice versa.

## ***Wider economic impacts***

68. There may wider be benefits to economic efficiency, which may lead to resources being freed up for other more productive uses.

## **Summary of One In One Out position**

69. CMCs and insurers would lose out from reduced referral fee income. CMCs and lawyers would lose out from a reduced volume of cases, and from associated business adjustment costs including increased advertising costs for lawyers. These would count as INs.
70. Lawyers would gain from not paying referral fees and may gain from more efficient case matching. Advertisers may gain from an increase in business from lawyers. Insurers and other business defendants would gain from the reduced volume of cases and from lower legal fees associated with no longer paying referral fees. These would count as OUTs.
71. The ABI have indicated that insurers would gain overall (and hence that insurance premia might fall). Other businesses which are defendants in personal injury claims would gain overall. Lawyers might incur no additional costs overall. CMCs would lose out but advertisers would gain, to a lesser extent. To illustrate some relativities, CMC annual turnover was approximately £380m in 2010-11, and the ABI and LSB estimate that total personal injury case payments exceeded £5bn in 2007 and 2008.
72. In conclusion, taking into consideration that the aggregate impacts have not been quantified, the overall One In One Out impact has been assessed as ZERO NET COST.

## ***Risks and Assumptions***

73. It has been assumed that banning referral fees would reduce the overall volume of personal injury litigation cases.
74. It has been assumed that referral fees paid to CMCs and others may be recoverable indirectly from claimants, or defendants (through legal fees and recoverable costs), and that ultimately referral fees increase the overall costs of litigation per case.
75. It has been assumed that case outcomes will remain the same for cases which continue to proceed.

76. It has been assumed that lawyers will spend more on alternative arrangements such as advertising to attract claimants in future and that this might generate savings for lawyers compared to paying referral fees.
77. It has been assumed that, in aggregate, claimant choice would continue to be exercised at least as well as it is now, i.e. that claimant requirements would be matched to what individual lawyers are able to provide.
78. It has been assumed that the ban on referral fees is enforceable in practice and that referral fees will no longer be paid in future.
79. The analysis in this Impact Assessment assumes that alternatives to referral fees would not be provided in future. It is possible, however, that CMCs might adopt different business models. For example fees might be charged to claimants for providing them with a search and selection service. If such alternative models were adopted then the impacts outlined above might differ. In the absence of evidence about how CMCs might respond to the ban on referral fees potential alternative business models have not been assessed in detail.

### **Micro Business Exemption Waiver**

80. The policy in this Impact Assessment would affect micro businesses, especially smaller CMCs<sup>14</sup> and smaller legal firms. They may be less able to absorb the impact of the change or to redirect resources to other areas. However, smaller legal providers may gain because of a better ability to compete on quality of service than on the amount of referral fees paid. Also smaller advertisers might gain by securing more business.
81. If the policy were not applied to micro businesses then it is unlikely that they would be applied at all. This is because partial application to part of the industry would not meet the policy objectives, and would also generate competition issues. Partial application might also lead to some businesses reconfiguring and becoming micro businesses in order to avoid the referral fee ban.

### **Enforcement and implementation**

82. The reforms will be implemented through the Legal Aid, Sentencing and Punishment of Offenders Act. It is intended that the relevant regulators (the SRA, FSA, claims management regulator and others) will take the necessary steps to enforce the ban.

### **Specific Impact Tests**

#### **Statutory equality duties**

83. See the attached Equalities Impact Assessment.

#### **Competition**

84. The impact on competition depends upon whether lawyers compete more vigorously for business when they obtain this via CMCs, or whether they compete more vigorously when doing business with claimants directly. There is no evidence to suggest that the ban on referral fees might lead to less vigorous competition amongst lawyers although this is possible.

#### **Small Firms**

85. As explained in the micro business exemption section of this Impact Assessment the ban on referral fees may impact negatively on small firms (solicitors and CMCs), if they experience a reduction in business. However some evidence suggests that firms with larger turnover are more likely to pay referral fees. Exempting small business would not meet the policy objectives and might also generate competition issues between those who are exempt and those who are not. It is envisaged that small businesses which face personal injury claims would benefit from a ban on

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<sup>14</sup> As part of the 2010/11 annual claims management company authorisation renewal exercise, 2,907 out of a total of 3,270 currently regulated CMCs declared that they employed or were due to employ between 0 to 10 staff over the forthcoming year.

referral fees as the number of speculative cases which are currently pursued may reduce in number.

### **Greenhouse gas assessment**

86. We do not anticipate that a ban of referral fees would lead to a change in the emission of greenhouse gases.

### **Wider environmental issues**

87. We do not anticipate any significant wider environmental impacts as a result of a ban on referral fees.

### **Health and well-being**

88. We do not anticipate any direct health impact from a ban on referral fees. It is possible that claimants who do not pursue cases in future may incur a loss of well being. These claimants would continue to get treatment for injuries from the NHS although this may differ from the private treatment they may have received if the claim had been successful. This could also increase NHS waiting times for treatment. If a ban on referral fees reduces total NHS compensation payments and legal costs this might free up funds for other health care.

### **Human Rights**

89. This policy is considered to be compatible with the Human Rights Act

### **Justice system**

90. Justice system impacts outlined in the main body of this Impact Assessment.

### **Rural Proofing**

91. We do not anticipate any specific impact on rural areas as a result of this policy.

### **Sustainable Development**

92. The policy to ban referral fees is not expected to have a significant an impact on sustainable development.



# Annexes

## Annex 1: Post Implementation Review (PIR) Plan

**Basis of the review:** A ban on referral fees will be reviewed as part of the wider post implementation review plan which the MoJ is committed to undertaking in 3-5 years.

### **Review objective**

To ascertain whether the policy has had the requisite impact of making the costs of civil litigation more proportionate, discouraging unmeritorious claims and effectively stopping the payment and receipt of referral fees.

**Review approach and rationale:** It is envisaged that the MoJ would conduct an impact evaluation (option 5 of the PIR options) of the other Jackson reforms after three to five years of implementation. The objective would be to assess the impact on civil litigation costs of implementing the Jackson reforms. This may require the collation and analysis of quantitative data on the number, type and size of cases, the amount of damages awarded and claimant and defendant costs. The size of the review would be subject to budgetary approval and resources. It may be that the MoJ would need to work in partnership with claimant and defendant representative group for the collection and evaluation of this data. A review of a ban on referral fees would form part of the wider review of the Jackson reforms which the Government is implementing.

**Baseline:** Due to the lack of consistent, routinely collected data covering private funding arrangements, we will rely on the data included in the Review of Civil Litigation Costs by Lord Justice Jackson, published in 2009, as our baseline.

### **Success criteria:**

Successful enforcement of a ban on referral fees.

**Monitoring information arrangements:** MoJ would work with the relevant regulators (Solicitors Regulation Authority, Financial Services Authority, Claims Management Regulator and others as necessary) in respect of monitoring and enforcing the ban.

### **Reasons for not planning a review:**