

**THE LEGAL SERVICES BOARD'S DISCUSSION DOCUMENT  
REFERRAL FEES, REFERRAL ARRANGEMENTS AND FEE SHARING  
RESPONSE BY IRWIN MITCHELL**

**Introduction**

1. As a major National firm providing a wide range of legal services to consumers of all kinds, Irwin Mitchell has taken an active interest in the post Legal Services Act (LSA) regulatory reforms and, as a supporter of the general thrust of the LSA reforms of the legal services market, has responded to all consultations since the first report by Sir David Clementi.
2. Our response to the discussion document dated September 2010 takes account of our responses to the LSB consultations (i) "Wider access, better values, strong protection", (ii) "Alternative business structures and approaches to licensing" and (iii) to the LSB Consumer Panel's Call for Evidence (the latter is **enclosed**).
3. As stated in our previous responses to the LSB, we believe that regulators of the legal profession should behave in a manner that is proportionate, fair and reasonable, coupled with a clear understanding of the commercial drivers likely to influence practitioners as they face up to the most significant challenges and changes in the legal services market for generations.
4. By the nature of its business, which includes the nationwide supply of a wide range of legal services, often in volume, to large institutions such as banks and insurance companies, as well as the representation of numerous personal injury clients, Irwin Mitchell has closely followed the debate and developing scene involving referral fees over the past decade or so. (This is a complex and difficult regime for practitioners to follow and comply with as can be seen from the **Appendix** to our response to the Call for Evidence). Where there are doubts about compliance, it is fair to say that even those who strive very hard to meet their regulatory obligations have found compliance with the Rules and Guidance a serious challenge. The need for proportionate and outcome focused regulation in relation to referral fees is very important for the consumer and the practitioner.
5. We are therefore pleased to respond to the LSB's discussion paper on referral fees, referral arrangements and fee sharing. We are pleased and not surprised by the Legal Services Board's finding that there is insufficient evidence to sustain a prohibition of referral fees in the Personal Injury and Conveyancing markets or indeed in any other consumer facing legal services market.

6. We share the LSB's view that "reveal, regulate so retain" provides a basis for further discussion and we are pleased to add our views to the debate about disclosure which is more complex in practice than in theory.
7. We have extensive knowledge and experience of operating a legal practice that uses referral fee arrangements as part of its business model. As we explained in our previous response to the consumer panel, we have considerable experience of working with the referral fee Rules and Guidance and explaining the relevant provisions to clients, work introducers and fee earners. In our return of practice information to the SRA in October 2010 we reported on our current level of referral fee and fee sharing arrangements. Although the detail of that return contains commercially sensitive information, we are willing to disclose that such arrangements today represent 25.38 % of the firm's revenue in 2009/10.
8. We note the wide definition of a referral fee as "any payment made for the referral or introduction of any client or potential client". We also note that the discussion paper does not consider arrangements between a work referrer and a solicitor **where the solicitor is paid by an introducer** such as a bank to do work for the bank's customers, which are currently covered by Rule 9 of the Solicitors Code of Conduct 2007.
9. We agree with the benefit of incentives to reinforce ethical behaviour although Rule 9 of the SRA's Code of Conduct already sets out clearly the compliance obligations for practitioners.
10. The move to Outcomes Focussed Regulation (OFR) should maintain the *status quo* on the basis that outcomes and indicative behaviours should require the same approach and obligations for practitioners to observe under Rule 9. It is equally essential that any reform of the referral fee regime is proportionate, fair and consistent across all practitioners (including ABS) and takes into account the considerable expense that is required for a firm to implement and maintain systems that ensure proper information and disclosure to clients.
11. In preparing this response, we have found helpful the research by CRA and Vanilla on cost benefit and consumer perspectives. We hope that the outcome of the LSB consultation will result in a sensible and pragmatic outcome for consumers, legal services providers and introducers.

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

12. The analysis in chapters 2,3 and 4 is thorough and largely supports the conclusions set out in chapter 5

**a) We agree** with the conclusions reached:

- in paragraphs 5.15 (referral fees keep costs down for consumers);
- 5.16 to 5.21 (referral fees promote competition for the benefit of consumers especially in the advent of ABS);
- 5.22 to 5.25 (referral fees do not influence independence);
- 5.25 to 5.28 (referral fees do not undermine consumer choice);
- 5.29 to 5.33 (referral fees are not harmful to access to justice); and
- 5.35 (overall conclusion that referral fees and arrangements should be allowed to continue).

**b) We do not agree** with paragraph 2.13 which asserts that insurers “pay out more in referral fees than they receive by way of income from them”. The correct analysis is that they pay out more in settling the costs of valid claims against them as **liability** insurers than they receive in referral fee payments made to them as **legal expense** insurers.

13. The benefits of transparent referral arrangements between intermediaries and solicitors who comply with the regulations far outweigh the risk of disadvantage to the consumer. Properly observed by the solicitor and the introducer the current regulatory regime provides adequate consumer protection.

14. Referral fee arrangements provide legitimate incentives to LEI insurers and other intermediaries to signpost their customers to solicitors who are carefully vetted and regularly monitored to ensure the provision of quality legal services according to defined service level standards. There are significant costs of marketing, administration and auditing for the introducer which are defrayed by the referral fee. At the same time, the consumer receives the benefits of access to justice as confirmed by the Consumer Panel’s own research.

15. Today, the maintenance of high quality service to consumers is non-negotiable. Failure to maintain service levels, imposed by introducers, will result in loss of work and reputation. Although in theory quality could be at risk if referral fees are too high, there is no evidence of serial complaints from consumers about quality.
16. Paragraph 5.15 refers specifically to Lord Justice Jackson's final report on his review into civil litigation costs. This was also referred to in the Consumer Panel's letter of 4 December 2009. We therefore **enclose** our response to the Consumer Panel and repeat our comments in paragraphs 7 to 14 thereof.
17. It is worth remembering that the OFT, as watchdog of competition in the interests of the consumer, was the drive behind the relaxation of the Introduction and Referral Code in 2004. Appointment to the panel of a legal expense insurer is extremely competitive and firms must satisfy the introducer that they can meet high standards of service, robust levels of compliance and efficient processes so that they will enhance (and not damage) the introducer's "brand". The level of referral fee is only part of the determining factor for an introducer in deciding who is successful in a competition to be appointed to a panel.
18. The advent of ABS will encourage greater competition but care will be necessary to ensure that any changes to the requirements of transparency (see later) do not have a negative effect on the market at a time when it should be at its most competitive.
19. Where a legal expense insurer introduces a policy holder to a solicitor in return for a referral fee the insurer will maintain a legitimate interest in the level of fees being incurred by the solicitor and, if the matter is litigious, in the merits and prospects of success. This is no different in principle from the legitimate interest of the Legal Services Commission in cases it funds nor is it any different in principle from the client's case supported by a third party litigation funder who has a financial interest in the proceeds of the outcome.
20. A legal expense insurance policy holder who "trusts the brand" is likely to be content to be referred by the insurer to a panel solicitor as long as the referral arrangement is adequately transparent.
21. Some additional points about BTE insurance are appropriate, particularly in view of Lord Justice Jackson's support for the extension of BTE:

- The Financial Ombudsman does not suggest that current BTE arrangements compromise freedom of choice for consumers.
  - The sustainability of the BTE market depends on underwriting certainty for insurers who gain costs predictability by using panel solicitors.
  - BTE insurers know that levels of quality ensured by closely monitored service level agreements with panel firms is an effective way of guaranteeing that their policy holders receive an efficient and cost effective service
  - If BTE insurers are forced to move away from competitive panel arrangements, there is a risk that a currently efficient market will be seriously damaged because of the need to underwrite a two tier system of insurance where the consumer;
    - opts in to limit freedom of choice and pays a premium at the current level **or**
    - opts out to achieve freedom of choice of non-panel representation at a higher premium level.
  - Any reversal of the Insurance Companies (Legal Expenses Insurance) Regulations 1990 that would prevent Legal Expense Insurers from referring a BTE policy holder to a panel firm would work against the overall interests of the consumer and risk an increase in the level of insurance premiums.
22. Significant investment in IT and case management systems to provide high quality service to large volumes of clients is now required by firms that depend on referral arrangements with BTE insurers.
23. The Vanilla Research refers to the difficulty of consumers finding their way to a good solicitor, so the referral by a BTE insurer to a solicitor tied to audited service level agreements that benefit the consumer is an enhancement of access to justice.
24. We do **not** agree with the assertion in paragraph 5.28 that the current disclosure mechanisms need to be addressed (see below).
25. Referral fee arrangements promote access to justice by allowing intermediaries with a sophisticated knowledge of legal services swiftly and efficiently to put a less sophisticated consumer in touch with a lawyer suitable to their legal needs. This may be achieved by prompt access to legal advice from a 24/7 legal helpline to solve problems on the spot. That positive is not diminished because the introducer and the solicitor have a commercial referral fee arrangement that includes access to a helpline that is often a free of charge benefit.

26. Referral fees do not inflate costs in personal injury claims which have already been made the subject of fixed fee regimes in two national schemes. The first (the predictable costs scheme for RTA cases under £10,000), set up in 2003, has remained static as to costs (no increase in levels since 2003). The second, commenced in May 2010 (the MoJ portal scheme for undefended motor cases under £10,000), has even lower levels of costs. Meanwhile referral fees are still being paid at market rates despite lower costs recovery, suggesting that lawyers have become more efficient and able to pay referral fees through efficiency savings that drive costs down.

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

27. No.

**Question 3. Do you agree with our analysis of the operation of referral fees or fee sharing arrangements in criminal advocacy?**

**Question 4. Do you have additional evidence about the operation of referral fees or fee sharing arrangements that should be considered by the LSB?**

**Question 5. In particular, do you have any evidence about the impact of referral fees or fee sharing arrangements on the quality of criminal advocacy?**

28. We have no comments on these questions.

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

29. The recommendations in chapter 7 of the discussion paper are **flawed** in failing to appreciate the effectiveness of the level of consumer protection under the current regulatory requirements for disclosure by introducers and solicitors. The recommendations also fail to appreciate the crucial importance of commercial sensitivity (and confidentiality) attached to insurers' financial arrangements with their policy holders and with their solicitors to whom they introduce work in return for a referral fee.

30. We strongly **disagree** with paragraphs:

- 7.7 The recommendations will impose considerable additional costs

- 7.10 Additional transparency will not aid “general economic efficiency”
- 7.11 Publication of agreements by the regulator will create considerable administrative burdens and the benefit of any differentiation by firms will be far outweighed by the business threats of losing commercial confidentiality
- 7.13 The reference to lack of experience highlights the danger of making major costly adjustments to a regulatory system that already works satisfactorily for the consumer.

31. We agree with paragraph 7.16 that standard disclosure is not appropriate and with paragraph 7.17 that, as now, information should be disclosed only once.

32. We note that in paragraph 7.18 the LSB is willing to meet ‘relevant bodies’. We would be happy to meet to discuss the contents of this response containing our broad agreement with chapter 5 and our disagreement with chapter 7.

33. The current SRA obligations require solicitors to provide clients with detailed disclosure about the financial arrangement and the amount of the payment, or where the payment is more general in nature, to provide sufficient information to enable the client to give informed consent. The LSB’s “recommendation one” is similar to the existing SRA provisions but goes too far in relation to disclosure of the value of the referral fee and rights to shop around.

34. The difficulty in making disclosure of the value of the referral fee in pounds is that many referral arrangements are complex. We favour the SRA’s current approach in the guidance to Rule 9 where disclosure is only made where it is reasonably possible to calculate how much of the payment relates to a particular client. (There may be circumstances where this requirement will result in additional costs for no real value particularly as the client is more concerned about the total cost.)

35. As stated, we support the proposal for consumers to be given the disclosure once by the lawyer at the point of referral as opposed to the existing double disclosure. The current requirement, effectively imposed on introducers (most of whom are already regulated) by another regulator, has required significant explanation, considerable resource in obtaining the undertaking and checking the disclosure both at the outset and on an ongoing basis, with little obvious benefit to the consumer other than duplication.

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

36. Not that we can think of.

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

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

37. Disclosure of referral agreements to ARs who are required to publish raises serious issues of:

- Commercial confidentiality;
- Costs to firms and to the regulator in collating and publishing the data;
- Concern as to who really benefits from such disclosure and publication.

38. The findings in the Vanilla Research that consumers were not aware at the outset of the Rule 9 obligation to make disclosure has to be seen in context because section 6 of the research makes it clear that once consumers were made aware of the obligations under Rule 9, "the clear majority of consumers suggest that the regulations are adequate, and that if they are enforced then on the whole they are relatively comfortable with the existence of referral arrangements."

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

39. No. The CRA report says that there is lack of evidence that referral fees are causing consumer detriment and that increasing disclosure to regulators beyond current levels is not currently required.

40. Solicitors currently report to the SRA annually on their referral arrangements giving details of the referral fees paid and income received. This already provides the SRA with a sound base of knowledge to assist in assessing the actual operation of referral fees.

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

41. This is primarily an issue for ARs. The SRA already has targets in place.



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

42. Looking ahead, undertaking similar research to the Vanilla Research to measure consumer confidence would be useful. We have previously made the point that public legal education is a regulatory objective which should include education to consumers about referral fee arrangements.

43. In addition to complying with current regulations on disclosure to clients, we undertake surveys to check that clients are satisfied with information received. We note that the CRA research concludes that there are few complaints about referral fees which is mirrored by our own experience.

**Conclusion**

44. Referral fees should not be banned or capped. In anticipation of the introduction of ABS reforms in October 2011, it is anticipated that the role of referral fees as an integral part of the everyday methods of doing business will continue and will expand. Proportionate regulation needs to be no more complex than already in place to ensure that disclosure and transparency relating to referral fees provide adequate protection for the consumer.

**Irwin Mitchell  
21 December 2010**