

## **Research Specification: Cost Benefit Analysis of the impact of referral arrangements**

### **Purpose**

To assess the impact of referral arrangements on the market, analyse the impact of alternative policy options and set out a range of costs and benefits for the Legal Services Board to consider in its subsequent analysis.

### **Background**

The LSB has been set up to reform and modernise the legal services market place in the interests of consumers, enhancing quality, ensuring value for money and improving access to justice across England and Wales. The LSB will achieve this pursuing our regulatory objectives and providing regulatory oversight for the eight approved frontline regulators<sup>1</sup>.

Referral arrangements are any arrangements under which business is received from or referred to a third party. In the legal sector, the third party can include another lawyer or a non legal business. Referral arrangements often include the payment of a fee, but fees need not be involved. Regulatory data suggests that most referrals occur in conveyancing (where estate agents introduce clients for a typical fee of £100) and personal injury cases (where the introducers are typically claims management companies and insurers, where fees are thought to be £250-900, averaging around £600). Some lawyers also receive income through referrals, for example a solicitor introducing a client to a surveyor. Our investigation will mainly focus on referrals between lawyers and non lawyers, but we will also look at referral arrangements between different types of lawyer, e.g. solicitors and barristers.

Referral arrangements, especially when fees are involved, are a controversial issue. Opponents of referrals argue that they can introduce conflicts of interest and may compromise the quality of work as lawyers seek to recoup payments for referrals by saving costs elsewhere. Supporters of referral fees argue that such arrangements are common across the economy and are a more cost-effective means than advertising of obtaining work. Further, the Service Level Agreements imposed by introducers safeguard quality. Claims management companies in particular argue that referral fees can improve access to justice, as without their marketing activities the public may otherwise be unaware of their right to bring valid claims for personal injury.

In recent years the impact of referral fees on the market has provoked significant debate with research reports published by The Law Society<sup>2</sup> and the Association of British Insurers<sup>3</sup>. Following their 2007 report The Law Society announced that they would back referral fees together with strict rules aimed at ensuring solicitor's independence<sup>4</sup>.

The regulation of referral fees is, similar to other areas of law, patchy with the different Approved Regulators each taking different approaches (see Annex B). This research would need to cut through

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<sup>1</sup> The Law Society, General Council of the Bar, Council for Licensed Conveyancers, The Institute of Legal Executives, The Chartered Institute of Patent Attorneys, The Institute of Trade Mark Attorneys, Association of Law Costs Draftsmen, Master of the Faculties.

<sup>2</sup> [Referral arrangements and legal services research report](#)

<sup>3</sup> [Marketing Costs for Personal Injury Claims: Evidence of Market Failure](#), ABI, 2009

<sup>4</sup> [TLS 2007 Referral Fees Statement](#)

the different regulatory approaches to improve our understanding of the overall impact of referral fees.

The Association of British Insurers in its 2009 report were concerned that high referral fees were artificially raising the cost of personal injury claims. In November 2009 The Law Society announced in change of policy that it was seeking the abolition of referral fees<sup>5</sup>.

As oversight regulator for legal services the LSB has a duty to consider the overall impact of referral fees on the market and determine whether they work in the best interests of consumers. Existing research evidence is summarised in Annex A. To support the LSB, the independent LSB Consumer Panel has been asked to investigate the consumer perspective on referral fees. They are commissioning a separate research project to explore referral fees qualitatively with consumers.

The qualitative research, which is being commissioned by the Consumer Panel, will explore a range of issues including: whether consumers shop around when they are referred to a lawyer, consumer perceptions of service quality and the value that consumers place on marketing. Project materials and early sight of results will be available as part of this project.

### **Aims and Objectives**

Given recent calls from The Law Society to abolish referral fees and the current investigation from the LSB's Consumer Panel the LSB are keen to develop robust evidence base to support any subsequent regulatory intervention. The LSB will only form a view of whether any regulatory invention is required and if so what, once we have sufficient evidence. This research is intended to fill the evidence gap by providing robust economic analysis of the impact of referral fees on market outcomes.

The research should set out the costs and benefits of existing rules for permitting referral arrangements and assess the relative costs and benefits of alternative policy options. In particular the research should consider the relative costs and benefits of:

- No change to existing rules.
- Requirement of firms to publish referral fee arrangements in an agreed format.
- Capping referral fees as a proportion of charge.
- Banning all referral fees.
- Banning all referral arrangements.

The research should consider both the impact on the market of each option, but also the regulatory cost imposed by different options. The research should also indicate whether the costs and benefits fall on consumers or as a reduction in the profitability of the sector. Equally the research should determine whether the impact of any policy option falls disproportionately on any particular segment of the market.

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<sup>5</sup> [Law Society Council votes against referral fees | The Law Gazette](#)

The research should provide robust evidence that will be used by the LSB to determine what, if any, regulatory action should be taken to address industry concerns over the use of referral arrangements.

### **Issues and scope**

Referral arrangements are often seen as a substitute for marketing costs, particularly in legal services where there are few household brands supplying services. Rather than pay for advertising, lawyers buy and sell client data so that individuals can be targeted directly. Lawyers are restricted in their ability to advertise their services directly

The research should consider the impact of referral arrangements on:

- access to justice
  - Do referral arrangements result in more people receiving justice than would otherwise be the case? If yes, how big is the effect?
  - Does the impact of referral arrangements fall differently on different types of customer?
  - How would consumers find a lawyer in the absence of referral arrangements?
  - Do referral fees lead to an increase or decrease in the supply of services?
  - Do they alter the way in which services are provided in a way which causes detriment/benefit?
- quality of service
  - How do referral arrangements affect the quality of service offered to customers (are they leading to great efficiency or lower quality)?
  - What differences exist between the quality of service offered by lawyers using referral arrangements and those who don't and what value do consumers place on this difference?
- cost of service
  - What impact do referral arrangements have on the cost of legal services?
  - In the absence of referral arrangements what would legal firms do to attract clients?

This research is likely to pose a number of challenges, in particular:

- the LSB acts as oversight regulator for all legal services, any research would therefore have to consider how referral arrangements affect different types of legal service provider (see Annex B for a summary of the rules);

- a number of research studies already exist, the researcher will have to determine how best to build on these existing studies;
- quality is not easy to measure in legal services where problems may only emerge years later (e.g. when a house is resold), the researcher will have to determine how best to proxy quality;
- services provided are not always homogenous and cost information may be difficult to standardise;
- results should be disaggregated to allow analysis of the impact on different groups of consumers and categories of law;
- many legal services firms are relatively small high-street firms while intermediaries, such as claims management companies, are national firms with significant market power;
- significant changes to referral fee arrangements will impact on other markets, the research should consider in analysing options the relative scale and type of impact on these other markets e.g. claims management, insurance, estate agencies etc.;
- the Legal Services Act 07 places a series of regulatory objectives on the LSB only one of which relates to competition and we welcome views on the interaction of these objectives in the light of the outcome of the research.

### **Tender Evaluation Criteria**

All projects commissioned by the LSB are subject to our standard terms of contract. Tenders will be evaluated on best value for money and will be assessed on the basis of:

1. Overall cost. Please include appropriate breakdowns
2. The extent to which tenders are clearly written and meet the specified objectives, present a sound methodology, identifying any potential problems, and proposing suitable solutions
3. Address outputs and ensure these are in line with requirements and the required timing of the project
4. Proposed team composition, expertise and management and the organisation's diversity policy
5. How diversity issues would be addressed in the research.

### **Deliverables**

#### Output

The output for this research should be an executive summary, a short report (no more than 50 pages) with supporting evidence that addresses the specification. The report should be suitable for publication, although any decision to publish will remain with the LSB. It is essential that the report and underlying research is sufficiently robust so that the LSB can use this in discussions with external stakeholders. The research should have clear conclusions that the LSB will consider in developing future policy proposals.

Researchers should expect to present the results of this analysis on a small number of occasions (up to 4). Please cost for this separately.

The LSB will retain ownership of the research, report and any underlying data.

### Project plan

Tenders should include a project plan and time schedule for the work that identifies the main task and key milestones that will be used to monitor progress. The plan should be accompanied by a resource profile, giving a breakdown of the resources in person days allocated to each task.

### **Duration**

The research should commence in 2010. Tenders should set out dates for completing key milestones such as information gathering, analysis, synthesis and report writing. Interviews with all shortlisted consultants will take place on 14 and 15 January. The first draft should be submitted to the LSB by 30 March, with the finalised report due by 30 April 2010.

### **Legal Services Board Contact Details**

Tenders with any queries about the research specification should contact:

Policy team: Lesley Davies 020 7271 0071

Research: Alex Roy 020 7271 0060

**Tenders must be submitted by 5pm on 11 January 2010.**

## Existing Research Evidence on Referral Arrangements

### Market Picture

- Numbers of firms with referral arrangements, and in what sectors:
  - As at 2007/08, 18% solicitor firms (SRA regulated) had referral arrangements. 39% of these relate to conveyancing and 39% to personal injury matters. All other categories of work accounted for 1% or less of all referral arrangements. (SRA Board Paper, December 2008, Item 4)
  - Based on calculations from numbers in Moulton Hall (2007) (from REGIS database) – around 30% of firms practising conveyancing have referral arrangements, 40% firms practising PI have referral arrangements and 32% of firms conducting both PI and conveyancing have referral arrangements.
  - Assoc. of PI lawyers (APIL) (2007 survey of 787 members) found that 53% of responding members were involved in a referral fee or fee-sharing arrangement.
  
- How are any referral fees paid: mostly on a fee-per-case basis, paid after the case has been accepted by a firm. Other, less common, arrangements include payment of an annual fee or a marketing fee.
  
- How much is a single case payment:
  - PI - £250-700/case, on average £600 (Moulton Hall, 2007). Conveyancing - £50 to £700/case and averaging from £75 to £125/case (Moulton Hall, 2007)
  - APIL (2007 survey of 787 members) found that the majority of firms paying referral fees were paying £200-£600 per case (77%). The highest level of mentions is in the £401-£500 category. Arrangements where firms pay referral fees only are much more common than fee sharing only arrangements or any combination of fee sharing and paying.
  - Oxera (2009 for ABI) found that the per case referral fee for PI has been rising - from around £400 in 2005, to around £600 in 2007, to in excess of £850-1000 in 2009.
  - Oxera (2009 for ABI) found other legal work – basic single wills (£20), property trust wills (£70), uncontested divorce first stage (£75), conveyancing (£75-£125, median £100), discretionary trust wills (£100), divorce ancillary relief (£150), employment law (£300)
  
- Reliance for business:
  - Moulton Hall (2007) - firms with less than 5 partners, 10-15% of overall business comes from paid introductions and for firms with 5 partners or more the proportion is 2-5%. In the main, business still comes to firms via recommendation and repeat business.
  - APIL survey (2007) - 27% of respondents are heavily reliant on payment of referrals fees for PI work - with over 80% of their personal injury work coming through this route.
  - APIL (2007 survey) found that 19% of respondents' PI work was linked to an LEI panel.
  - APIL (2007 survey) - of those who carry out personal injury work linked to LEI panels, 80% pay referral fees and/or have a fee sharing agreement. Of those not linked to LEI panels, almost half (49%) still pay referral fees or have fee sharing arrangements.

- APIL (2007) LEI panel members are more likely to have a high proportion of their PI work come through paid for referrals. 59% of firms linked to LEI panels gain 61% or more of this work from paid for referrals compared with 44% of firms not linked to LEI panels.
- Number of referrers per solicitor firm: PI - 1 to 4 for firms with less than 5 partners and from 3 to 60 for firms with 5 or more partners. (Moulton Hall report, 2007)
- Lawyers costs in PI
  - Oxera (2009) – PI defendant solicitor costs are around 20-35% lower than claimant solicitor costs.

#### Areas of non-compliance

- In the first half of 2008, in respect of rule 9.02(b) (the requirement for an undertaking from the introducer to comply with the rule) the level of non-compliance remains high at 58.9%.
- In the first half of 2008, in respect of rule 9.02 (g), the requirement for disclosure by the solicitor, 43.3% of firms breached this requirement.
- SRA comment - although the level of breaches of rule 9 appears to be high, only a small number of the PSU matters appeared to involve potentially serious misconduct. The number of complaints received in respect of referral arrangements also appears to be very low.

#### Recipients of referral fees from solicitors and conveyancers include:

- CMCs
- Insurers
- Real-estate agents
- Property developers
- Trade unions
- Website 'matching'/referral sites
- Other, non-web-based, intermediaries – eg. Legal Referral Services Limited who links funeral directors and solicitors (referral fee to intermediary, who then passes share to original referrer)
- Other misc. third parties (eg. garages, hairdressers, etc)
- Other lawyers
- Surveyors?

#### Models of Payment

- There are a range of different models of fees – some more transparent than others.
- Solicitors/Conveyancers may pay a third-party directly for each case referred to them
- Solicitors may pay one third party (eg. an insurer) to be on their solicitor panel (this could be by the case referred or by an annual/quarterly fee). Cases are then referred to the solicitor by a different third party (eg. the insurer's broker or a CMC that the insurer uses). This means that the recipient of referral fee (eg the insurer) does not do the actual referring.

- Solicitors may pay a referral fee to a third party intermediary, who then pays another third party for referring the client initially.
- Solicitors may also provide free of charge business in place of paying a referral fee eg. provide another service free to a trade union in exchange for all PI work.
- Solicitors/Conveyancers may also pay to be members of a referral or matching website – this could be on a case basis or via an annual fee or membership.

#### Referral fees received by solicitors for recommending clients to other services

- It may be that surveyors pay referral fees to solicitors/conveyancers
- Equally, insurance companies may pay referral fees for a solicitor to recommend a certain product (eg. ATE insurance) – need to check!
- Could financial advisors as well?
- Referral fees received from other lawyers

#### Other sectors

- Referral payments are allowed to be made by insurers to financial service providers, as well as with other third parties
- Referral fees are banned for insolvency practitioners
- Do insurers pay CMCs to recommend their products, or just commission?
- HIPs providers pay referral fees to real estate agents – this is completely unregulated.
- Unregulated referral arrangements also exist in all sorts of other sectors, eg. between interior designers and furniture makers (this could be a percentage or a flat fee). This seems to be typically passed onto clients.
- In Canada, investment fund managers can have referral arrangements (mostly in receipt of payments), subject to disclosure.

#### Findings of Current Research Studies

##### *Legal sector*

- Mostly based on studies of lawyers views and lawyers experiences
- Most prevalent in PI, then in conveyancing, but occurs in other fields as well.
- Many studies find that many lawyers don't want them.
- APIL undertook a survey in 2007. It found just over half its members were involved in referral fee or fee sharing arrangements. General findings included fees being too high. APIL wants more stringent enforcement and control for referral fees – also issues about consumer choice and limiting access to justice.
- A Hampshire Incorporated Law Society review of referral fees in 2006 found that 95% of members were opposed to the allowing of referral fees. But, less than 10% of respondents paid referral fees.

##### *Consumer views*

- Research undertaken by SRA finds that it isn't a concern because those surveyed haven't heard very much back about.

- Another SRA survey also found that once they explained referral fees to consumers, they were not concerned about them.

#### Other points

- Trade unions seem to be exempt from disclosure (see Moulton Hall report for SRA 2007)
- Commissions are essentially another form of referral fees.
- Ability to pay fees seems to influence likelihood of being selected to be on solicitor panels, such as insurers LEI panels. Some insurance firms do not allow solicitors who are not members of panels to act for clients (see APIL 2007 survey).
- Much of the discussion around whether to ban or not focuses on whether referral fees are bringing the solicitor profession into disrepute, whether it affects their independence and the impact of staffing within law firms (eg. increasing use of lower paid and less qualified staff is one issue cited).

Table 1: summary of rules for use of referral fees

Type of Authorised Person	Regulating body	Permissibility of Referral Fees
Solicitor	SRA	<ul style="list-style-type: none"> <li>▪ Referral fees between lawyers permitted</li> <li>▪ Referral fees between lawyers and non-lawyers permitted, subject to Rule 9 of the SRA code and guidance</li> <li>▪ Fee-sharing permitted between lawyers, subject to SRA Code</li> <li>▪ Law Society has called for a ban on referral fees</li> </ul>
Barrister	BSB	<ul style="list-style-type: none"> <li>▪ Referral fees banned under Rule 307 of the Code of Conduct.</li> <li>▪ Public access barristers can pay to advertise on a website, provided potential clients generated by the website contact the barrister directly. Clients can also pay a company to be introduced to a public access barrister, provided no money changes hands between the public access barrister and the referral company.</li> </ul>
Conveyancer	CLC	<ul style="list-style-type: none"> <li>▪ Referral arrangements (payment and receipt) permitted subject to rule 5.2 and guidance 6</li> </ul>
Legal Executive	ILEX Professional Standards	<ul style="list-style-type: none"> <li>▪ Referral fees appear to be permitted, subject to compliance with SRA rules on this matter.</li> </ul>
Trade Mark and Patent attorney's	IPREG	<ul style="list-style-type: none"> <li>▪ There does not appear to be anything specific about referrals/introductions in the Code of Conduct that would either allow or ban referral arrangements – so therefore assume allowed.</li> </ul>
Law Cost Draftsmen	ALCD	<ul style="list-style-type: none"> <li>▪ No specific reference in rules. ALCD has advised that "To date there has been no restriction upon the basis of charging structure of the membership owing to the fact that this was considered to reflect restrictive practice"</li> </ul>
Notaries	Faculty Office	<ul style="list-style-type: none"> <li>▪ Referral fees permitted under Practice Rule 13.</li> </ul>