Solicitors Regulation Authority

SRA response

Referral fees, referral arrangements and fee sharing, Legal Services Board discussion document

Published on 31 December 2010

Introduction

1.

The Solicitors Regulation Authority (SRA) is the independent regulatory body of the Law Society in England and Wales.

2.

We welcome the Legal Services Board's (LSB) discussion document. The findings in respect of the consumer benefits of some aspects of referral arrangements are particularly helpful.

3.

We note that the key findings and recommendations of the LSB are largely in line with our own current approach. Our view, informed by our own consumer research and experience, remains that transparency of referral arrangements and the safeguarding of independent advice by legal advisers are vital to the regulation of referral fees and arrangements.

4.

We are concerned, however, that the risks posed to independence of advice by referral arrangements may not have been properly understood. Within this response we have therefore reiterated the clear evidence of the risks posed in this area and have stressed the need for caution in relying too heavily upon the interpretation of raw data, particularly in areas where the data available is limited. Whilst statistical data and the theories arising from the interpretation of such data are clearly valuable, they must be tested against and assessed in light of past disciplinary cases and the experiences of the regulators. The value of such evidence when assessing the risks posed and the theories advanced must not be underestimated.

5.

We are broadly supportive of many of the recommendations made by the LSB.

6.

However, we disagree strongly with the proposal that approved regulators should collate and publish all referral arrangements. We believe that a requirement to publish all arrangements would be neither risk based nor targeted and that there are more proportionate means by which to achieve the benefits sought. There are in the region of 8,000 different introducers operating constantly varying schemes. The resources required to implement the proposals would be significant. We would urge the LSB to reconsider its approach in this respect. We welcome the LSB's recent offer of informal discussions with us to discuss more proportionate solutions.

7.

We would finally add that referral arrangements are just one area of regulatory risk. A risk-based approach puts the onus on approved regulators to allocate resources on a risk-based basis and develop approaches to issues such as data publication and compliance strategies which are consistent and appropriate in the context of all other regulatory activities.

8.

As the LSB's proposals develop care must also be taken to ensure that any cross-sector provisions are appropriate to each regulator's regulatory approach.

9.

We look forward to working with the LSB in the development of these proposals.

Terminology

10.

The terms ‘referral fees', ‘fee sharing' and ‘referral arrangements' have been used to different effect during the Legal Services Consumer Panel (LSCP) and LSB reviews. For ease, within this document, references to ‘referral fee' is intended to mean any arrangement whereby a firm receives a referral of a client from a third party in return for some form of payment or other consideration and ‘referral arrangement' is intended to mean any arrangement whereby a firm simply receives a referral of a client from a third party, whether in return for some form of consideration or not.

LSB conclusions – personal injury (PI) and conveyancing

- Do you agree with our analysis of the operation of referral fees and arrangements?
- Do you have any additional comments about the operation of referral fees and arrangements that should be considered by the LSB?

11.

In many respects we are in agreement with the analysis. However, there are some key conclusions which we feel may be unsound and we have some concerns about the evidence relied upon in arriving at these conclusions.

Independent advice and referral arrangements - the evidence of detriment

12.

We agree that if a referral arrangement were to compromise a lawyer's independence then this could result in some detriment to the consumer. We also agree that such detriment could include increased costs being paid by consumers or a poor quality of service. However, we would stress that these cannot be the only areas of potential detriment. We are concerned that in assessing the impact upon independence and firms acting in the best interests of clients, the LSB have relied too heavily upon a restricted set of statistical analyses rather than the numerous examples of findings and admissions of actual misconduct in this area. An economic analysis concluding that a particular assessment of a limited set of data does not indicate the presence of a certain behaviour must not be interpreted as evidence that there is no such behaviour. This would be a dangerous mistake to make – particularly in an area where there is well documented evidence to the contrary.

13.

The discussion document states that following an economic analysis Charles River Associates (CRA) "found no evidence that lawyers were not acting in consumers' best interests". This conclusion was reached after CRA considered whether there had been a rise or fall in complaint levels, solicitors' charges or quality indicators (such as success rates or damages levels in personal injury (PI) cases) since the relaxation on referral payments by the Law Society in 2004 and since the increased cost of referral fees.

14.

However, CRA themselves conclude that referral fees were in effect commonly paid prior to the ban in 20041 [#ftn1] . The data available cannot therefore be relied upon to provide an accurate assessment of the impact of referral fees as the prevalence and cost of referral fees prior to 2004 cannot be assessed. The required data to soundly make such an assessment of the impact of referral fees is not available as the arrangements before 2004 were secretive and at times intentionally obscure2 [#ftn2] .

15.

The reliability of the assessment is further impacted upon by the fact that the economic assessment of detriment to the consumer in terms of the costs paid for services was limited to an assessment of whether the solicitors' costs were impacted upon by referral arrangements. In our submission to the LSCP we stressed the risk that the overall costs paid by clients in referral arrangements can rise but this is not necessarily as a result of an increase in the solicitors' costs. There are numerous examples of costs being passed on to clients by introducers of business directly which, but for the referral arrangement, the client would not be liable for. There is also evidence that some firms have failed to advise clients independently in respect of such costs. This risk cannot be assessed by looking at the solicitor's costs alone. Without assessing these risks the analysis of detriment is incomplete.

16.

Finally, there is clear evidence in the form of numerous Tribunal and Court cases that detriment to consumers owing to a lack of independent advice is not, as the discussion document appears to suggest, academic. In serious cases such detriment tends to involve a failure to advise the client upon the impact of an introducer's scheme upon his or her legal matter (which may involve, for example, additional costs being passed on to the consumer). Examples which we submitted during the course of this review have included

The Accident Group scheme;

the old Claims Direct scheme;

Barber and others SDT 9698-2007 (‘Raleys');

Reed SDT 9703-2007;

Beresford and Smith [2009] EWHC 3155 (Admin);

Tilbury SDT 9880-2008;

Akther & Darby 9631-2006;

Brooke Hartley Hodgson Kaur 9658-2007; and

Mandelson 9212-2005.

17.

A number of other examples have been provided and within our submissions to the LSCP we made it clear that we continued to encounter concerning arrangements in this respect and invited further discussion on the current issues faced by regulators.

18.

We would therefore suggest that the assessment of the evidence of detriment to consumers in terms of independence of advice be reconsidered.

The extent of the risks posed to independence of advice

19.

We do not agree that a firm as an entity must be reliant upon an introducer in order for there to be a significant risk posed to the independence of the advice provided to clients. In Tilbury, for example, it is clear that the only risk factor present was a conflict between the interests of the client in receiving maximum compensation, those of the introducer in receiving money from that compensation and the lawyer in receiving future business. Very little work was referred to the firm. Nevertheless, the conflicting interests were found to have resulted in a failure to act with independence and a failure to act in the best interests of the client. There are numerous other examples which equally demonstrate that the theories advanced in the discussion document to the effect that unequal bargaining power between law firm and introducer and a restricted freedom of choice of lawyer on the part of the consumer must also be present before independence of advice is at risk cannot be correct. The disciplinary cases make it clear that conflicting incentives for each party is all that is needed and the assessment of the extent of the risks posed to consumers in this respect should therefore be reconsidered.

20.

In particular, it must be remembered that advice in individual client matters is provided by individual lawyers – not by the firm as a whole. Focusing upon the percentage of fees which referred business brings to a firm overall when assessing the risks posed to independence of advice ignores the fact that the job of an individual fee earner who uses referral arrangements to bring in the work and who may be required to advise clients on a scheme connected to the arrangement will often depend entirely upon the maintenance of that arrangement. By way of illustration, a firm which

receives only 10% of its work from a referred source may appear to present a low risk to independence, in that the firm is not reliant upon the introducer, but the reality will be that individuals and potentially even departments will be entirely reliant upon the introducer when providing advice to clients day to day.

21.

We are also concerned that the risks posed by the incidence of breaches of independence may have been underestimated. Whilst SRA data from some Practice Standards Unit investigations indicates that the incidence of breaches of independence are relatively low, other themed visits have revealed more widespread problems. In the miners compensation themed visits approximately one third of the firms investigated were involved in schemes which deducted monies from client compensation awards in addition to the firm receiving costs in the matter – an approach which the Solicitors Disciplinary Tribunal has viewed as not being in the best interests of the client. Furthermore, incidence of breaches by firm number cannot be interpreted as an accurate snapshot of the risks posed to consumers. As stressed in the SRA's submission to the LSCP, where independence issues do arise they tend to pose a significant risk to the client and can involve a lot of work being undertaken by one firm. Raleys solicitors (as referred to above), for example, by statistical incidence would constitute just one firm but they undertook over 60,000 miners' compensation cases.

Inducements to bring a claim for personal injury and bidding auctions

22.

We acknowledge the concerns expressed by some stakeholders about these issues, including those raised by Lord Young of Graffham in his October 2010 report ‘Common Sense, Common Safety".

23.

However, we consider that the risks posed in these areas are similar to those associated with referral fees. If it is accepted that there should not be a ban on referral fees – as the LSB has proposed – it is difficult to justify from a regulatory perspective a ban on auctioning work (in that referral fees by their nature already encourage allocation of work on the basis of financial incentives) and firms making a marketing payment directly to clients rather than to third parties. In addition, the positive impact of some personal injury marketing upon access to justice was recently noted by the LSCP. Whilst the Claims Management Regulator has prohibited certain incentives to bring litigation (and plans to tighten these provisions) the same risks are not present in the context of solicitors. Solicitors would gain

no advantage from attracting unmeritorious claims in that the solicitors would be unlikely to recover their costs. Whether there is merit in a separate debate as to the appropriateness of inducements to commence litigation from a public policy perspective rather than from a regulatory perspective will form part of the government's work on Lord Young's recommendations. We are engaging with the government team which is considering implementation of Lord Young's proposals. We have asked for evidence on which the recommendations concerning solicitors' conduct were based.

24.

We would stress the need for a cross-sector approach if any intervention in this area is proposed by the government (i.e. not simply in respect of solicitors) and with this in mind it would be highly beneficial for the LSB to publish its own response to the recommendations made by Lord Young in this area.

Conclusions Reached

25.

Whilst we do have concerns about the LSB's assessment of the risks posed to independence of legal advice by referral arrangements, it is significant that such risks are not attributable solely to referral fees. The risk of a conflict between a firm's interest in continuing to receive work and the client's interests can exist where no referral fees are paid. Whilst we agree therefore that a ban on referral fees alone would not be an appropriate step, it is important that the risks posed are not underestimated as the LSB's proposals develop.

26.

We agree that if referral fees are to be retained then the arrangements must be transparent to the consumer and compliance with transparency requirements and the duty to act with independence must be enforced.

LSB conclusions – criminal advocacy

- Do you agree with our analysis of the operation of referral fees or fee sharing arrangements in criminal advocacy?
- Do you have any additional comments about the operation of referral fees and arrangements that should be considered by the LSB?
- In particular, do you have any evidence about the impact of referral fees or free sharing arrangements on the quality of criminal advocacy?

27.

We have no further evidence to provide in respect of the operation of referral fees and fee sharing arrangements in respect of criminal advocacy. The LSB's conclusion that there is no evidence that lawyers are consistently putting financial interests ahead of their duties to clients is consistent with the SRA's own experience in this area.

Recommendations for improving transparency and disclosure

- Will the proposals assist in improving disclosure to consumers?
- Are there other options for disclosure that ARs should consider?

28.

For the most part, the transparency proposals are reflected in the SRA's existing and proposed ‘outcomes-focused' requirements (intended to take effect from October 2011 onwards). A specific requirement to inform the client of his or her right to ‘shop around' would, however, be new. We acknowledge that there could be some benefit in such an approach in some cases, but not all. For example, in some conveyancing transactions clients agree to pay their legal fees as part of the overall agreement with the estate agent and so by the time that the client speaks to the law firm the ‘shopping' has already concluded. We suggest that a more flexible requirement would be appropriate such as that proposed for Chapter 9 of the draft SRA Code of Conduct 2011 (i.e. that clients must be in a position to make an informed decision about how to pursue their matter).

29.

We would also be grateful for confirmation of whether the LSB proposes that such a requirement would be imposed in respect of all referral arrangements or simply those involving the payment of a referral fee. It should be noted that the risks identified in the LSB findings are not limited to referral fee scenarios. Some referral arrangements which involve no referral fees do in fact involve substantially greater consumer risk in that they facilitate additional fees being paid by the client to the introducer direct from compensation awards.

30.

The requirement for all referral arrangements to be in writing does form part of the existing SRA requirements but in moving to an outcomes-focused approach we have proposed to remove this requirement. Whilst we acknowledge the practical benefits of retaining such an approach we are concerned that this requirement is highly prescriptive. We would suggest

that this proposal be reviewed alongside the proposal of publishing all referral arrangements (as these proposals would appear to be linked).

31.

We query the practicality of requiring firms to specifically disclose the value of a referral fee in pounds and feels that a broader provision is required. Firstly, referral arrangements are not limited to financial payments. Often referral fees will be made in return for some other form of consideration such as referrals in return for the provision of services. It would be helpful for the LSB to clarify its views on whether the consumer should also be informed of such arrangements (as required by the current SRA provisions unless the client referrals are wholly unconnected to the consideration in question). It is the SRA's experience that the disclosure requirements must be sufficiently flexible to ensure clear disclosure in each case regardless of how unusual an arrangement may be. So, for example, disclosure could currently include an overview of the relationship if this better conveys the true nature of the arrangement to the consumer.

32.

If adopted across the legal sectors and subject to the points raised above, we agree that the proposals could assist in improving disclosure. It is essential, however, that any cross-sector provisions allow each regulator to implement the requirements in a manner which is consistent to the overall regulatory approach adopted by that regulator.

33.

We welcome the LSB's plans to engage with appropriate markets outside of the legal profession with a view to achieving a consistent set of principles for the use of referral arrangements. We would refer to our submissions to the LSCP in terms of the principles which should be adopted. In particular, it is important that consumers are in a position to make an informed choice about how to pursue their legal matter and are not bound to pursue their matter in a particular way before legal advice is provided on the options available. We would welcome information from the LSB on what progress has been achieved in this respect in due course.

- What are the issues relating to the disclosure of referral contracts by firms to approved regulators and their publication by approved regulators?
- How should these be addressed?

34.

We are firmly opposed to the proposal that approved regulators should collect and publish all agreements between introducers and lawyers and

believe that there are more proportionate means of achieving the outcomes desired in this respect.

35.

The sheer volume of referral arrangements and the fact that the schemes are constantly being re-written raises serious concerns. There are approximately 2,000 law firms working with approximately 8,000 different referral businesses. Each business may operate more than one scheme and our experience is that scheme documentation (which can range from a few pages to hundreds of pages in length) is regularly revised. A separate project would need to be undertaken once the LSB's specific requirements are confirmed to properly assess the feasibility of publishing such a number of arrangements but as a preliminary assessment there are significant concerns as to resources. From a technical perspective, even if money were to be successfully invested in building a usable and accessible automated web-based interface, ongoing resource implications would remain e.g. to ensure that the content is up to date, accurate and appropriate. From a compliance perspective, it is difficult to see how we could effectively monitor, without investing disproportionate resources, whether each firm has in fact fulfilled its obligations and resources would also need to be committed to enforcing the requirements where problems are discovered.

36.

The LSB's desired outcomes are that the relevant information from the arrangements is available to the market, consumer organisations and consumers. The intention is that such a step would aid general economic efficiency, allow for the tracking of trends by regulators and give firms incentives to assess how they can bring work in most efficiently. The discussion document also suggests that such disclosure will increase compliance and increase competition in terms of what is offered to consumers.

37.

We operate within limited resources which are funded, ultimately, by the consumer through legal fees. We must operate a risk-based approach in order to fulfil our objectives within budget. Obtaining and publishing copies of every single referral arrangement in existence is not risk based. There is no evidence to suggest that every referral arrangement poses such a risk as to justify the expense which would be involved in implementing and enforcing such a proposal. Whilst the LSB has undertaken detailed research in respect of referral arrangements, this is only one area requiring regulatory attention. There may be other, considerably higher risk areas which we are required to monitor within existing resources and mandatory

attention to referral arrangements would not always be the best use of the limited resources available.

38.

Our existing provisions ensure that arrangements are in writing and are available to the SRA upon request for inspection. This allows us to examine arrangements where risks are identified (through our annual data collection exercise, for example). In our view, such a targeted approach is in accordance with the principles of better regulation.

39.

We agree that transparency for the consumer is crucial but this can be achieved through the transparency provisions. Our consumer research has shown that consumers are not overly concerned about referral arrangements provided that they are informed of the existence of the arrangements. This is further supported by Charles River Associates' findings that few consumers seek further information about a referral arrangement once disclosure has taken place3 [#ftn3] . The transparency requirements are therefore clearly sufficient for consumers, even if the consumer were to somehow be aware that the full arrangement can be viewed on the relevant regulator's website. If the LSB is minded to increase consumer transparency further then this should be done by ensuring that firms, at the time of making the other disclosures to the client about the arrangement, make it clear that the arrangement itself is available from the firm for inspection by the client if the client wishes to see it. This would be a far more proportionate method of maximising consumer transparency. Indeed, it would be difficult to imagine implementing the LSB's proposal without also requiring firms to make the arrangements available direct from the firm as many clients will not have access to the internet.

40.

In terms of scrutiny by the market and consumer organisations, the LSCP findings specifically noted the value of the data collected and supplied by the SRA, in particular that the quality of the information gathered allows an assessment of the risks posed in respect of solicitors. Indeed we currently gather a significant amount of annual data in respect of referral arrangements4 [#ftn4] . This includes the names of each introducer, the date of commencement of the arrangement, the type of work undertaken, the total fee income expected from the arrangement and the sums paid under the arrangement. We are reviewing our information gathering requirements at this stage and would be happy to receive views on the merits of receiving any additional information, such as details of any charges made to the client by virtue of the arrangement. If the LSB ultimately requires the

collection of every referral arrangement we would need to consider whether continuing to gather this information each year could continue to be justified on proportionality grounds. The end result could be unhelpful as the current information gathering exercise allows us to collate the relevant risk based data in a format which can be assessed without having to analyse each and every referral agreement.

41.

A more proportionate and targeted alternative therefore would be to ensure proper information gathering and publication by each approved regulator. Indeed, this is what the LSB's own consumer panel recommended – no call was made by the panel for every regulator to disclose every referral arrangement in existence. We are currently consulting on new information gathering requirements and are upgrading our IT systems and processes. We can give full consideration to how the relevant data could be published once the new information infrastructure is in place. This data could include levels of referral fees and other information relevant for market scrutiny with a view to promoting competition.

42.

We would also stress that the benefits sought in respect of this proposal are, at this stage, theoretical. It is unclear whether such a proposal would in fact have the desired impact and clearly in terms of competition in the market this is very difficult to predict. This must be borne in mind when assessing the proportionality of the proposals.

43.

We would therefore strongly urge the LSB to reconsider its proposal of requiring approved regulators to publish all referral agreements and all changes to all agreements. Such a proposal is not risk based and would involve a burden upon the limited resources of approved regulators which cannot be justified. The theoretical benefits sought can be achieved through more proportionate and targeted means without the need for such a significant administrative and operational burden. In line with the principles of better regulation we are firmly of the view that the simple and more effective alternatives such as those set out above must instead be pursued if the LSB wishes to intervene in this area.

Recommendations for delivering active regulation

- Will the proposals assist in improving compliance and enforcement of referral fee rules?

- What measures should be the subject of key performance indicators or targets?
- What metrics should be used to measure consumer confidence?

Proposal that approved regulators should publish a compliance strategy for referral arrangements

44.

We already have a strategy for addressing compliance in respect of referral arrangement provisions and could potentially publish a formal strategy. However, we would again stress that we have a broad regulatory remit across many risk areas. Care must be taken to ensure that an approach is not adopted which would entail bespoke published compliance strategies for every area of potential regulatory risk. The SRA is considering compliance strategies for specific areas and proposes to prepare any such strategies on a risk based basis (see our case selection strategy as set out in the draft SRA Enforcement Strategy published as an annex to the May consultation).

Proposal that approved regulators should publish information about the operation of referral fees amongst their regulated community

45.

We already gather extensive information about the operation of referral fees amongst solicitors and will consider the feasibility of periodic publication once the new information infrastructure is in place.

46.

More generally, it is important to recognise the costs involved in this proposal and it would be helpful if the LSB could expand its thinking in terms of the methodology and regularity of such assessments. We can then assess the proposals more fully against our existing consumer research programme.

Proposal that, where compliance with referral fee rules is low, approved regulators should have targets for improved compliance

47.

We have previously acknowledged concerns about compliance with transparency requirements by firms and believe that the new outcomes-focused approach will improve compliance in this area.

48.

We have no objection in principle to publishing targets for improving compliance with disclosure requirements under the outcomes-focused regime. From our perspective, key performance indicators and targets will need to develop alongside our shift to outcomes-focused regulation. The existing data relies largely upon the standard process which we undertake in respect of each firm visit and this will be changing significantly. Approved regulators must be permitted to publish compliance data and targets in a manner appropriate to each regulator's model of supervision and enforcement.

Approved regulators should have rules which are, where appropriate, consistent across areas of law with other approved regulators

49.

We are unclear as to the proposals made in this respect and would welcome further information and examples for consideration.

1 [#p14] Paragraph 4.4.1 of Charles River Associates "Cost benefit analysis of policy options related to referral fees in legal services" May 2010

2 [#p14] See for example the information provided about The Accident Group and the old Claims Direct scheme in the SRA's earlier submissions to the LSCP

3 [#p39] 4.7.3 of CRA report "Cost benefit analysis of policy options related to referral fees in legal services" dated May 2010

4 [#p40] See section 17 of form RB1 for example: