

<p><b>Prohibit the offering of inducements or similar rewards as an encouragement to make a personal injury compensation claim</b></p> <p>IA No: MoJ 022/2014</p> <p>Lead department or agency: Ministry of Justice</p> <p>Other departments or agencies:</p>	<p>Date: 16 September 2014  Stage: Introduction of Legislation  Source of intervention: Domestic  Type of measure: Primary legislation  Contact for enquiries:  general.queries@justice.gsi.gov.uk</p>
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<b>Summary: Intervention and Options</b>	<b>RPC Opinion: GREEN</b>
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<b>Cost of Preferred (or more likely) Option</b>
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Total Net Present Value (2014 prices)	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
Not quantified		Zero net cost	Yes	IN

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

Some personal injury claimant lawyers are offering financial inducements or similar rewards to claimants in return for making a personal injury claim. This encourages an additional volume of weaker claims which would not otherwise be made, ultimately increasing costs for motor insurers and hence leading to higher motor insurance premiums than otherwise. Many inducements which appear to be offered do not materialise in practice, thereby misleading claimants. The Government seeks to ban claimant lawyers from offering inducements or similar rewards, either directly or through a third party. A similar ban has already been introduced for claims management companies. The reform requires primary legislation to provide consistency across the professions and so Government intervention is necessary.

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

The policy objectives are; (i) to discourage weaker personal injury compensation claims from being made which would not otherwise be pursued if a financial inducement had not been offered; (ii) to prevent claimants from being misled by offers of inducements which do not materialise in practice. The intended effects are to reduce the volume of weaker claims and to protect claimants from inducement advertising which is misleading. Banning inducements would also help ensure that claimants select a lawyer based on criteria other than the inducement on offer, such as whether the lawyer is most suitable for them and their claim.

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

Option 0: Do Nothing  
Option 1: Ban the offering of inducements or similar rewards as an encouragement to make a personal injury compensation claim.  
The Government's preferred option is Option 1 as this would meet the policy objectives.

<b>Will the policy be reviewed? It will be reviewed. If applicable, set review date:</b>
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Does implementation go beyond minimum EU requirements?	N/A				
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)	<b>Traded:</b> N/A		<b>Non-traded:</b> N/A		

*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) that the benefits justify the costs.*

Signed by the responsible SELECT SIGNATORY: \_\_\_\_\_ Date: \_\_\_\_\_

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Ban the offering of inducements or similar rewards by claimant solicitors as an inducement to make a claim

## FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year* 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate**:

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			
High			
Best Estimate**	£0.125 million	£38.16 million	

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

- Claimants lose around £160,000 in lost inducements. Claimants no longer receive around £20m in compensation (net of success fees they pay to their lawyers) as a result of pursuing fewer cases in future.
- Due to reduced case volumes claimant lawyers incur losses in the short term of around £10m from reduced fee income (with £5m less from defendant insurers and £5m less from claimant success fees).
- Claimant lawyers engaged in inducement advertising incur around £125,000 transitional costs from changing their advertisements.
- Individual claimant lawyers lose around £8m of income to other individual claimant lawyers if claimants change provider as a result of the reforms.

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

The claimant lawyer sector may incur business adjustment costs. The legal services regulators may incur additional costs from monitoring and enforcing the reforms. Wider economic costs may arise if cases were pursued by less efficient providers in future.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate**		£38.016 million	

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

- Defendant insurers save around £25m from no longer paying compensation plus around £5m from no longer paying claimant lawyers in relation to claims which are not pursued in future.
- Claimant lawyers which fund inducements via excess profits would retain those excess profits in future in relation to cases still brought via them. These retained excess profits amount to £16,000 in aggregate.
- Individual claimant lawyers gain around £8m of income from other individual claimant lawyers if claimants change provider as a result of the reforms.

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

Claimants gain from no longer being misled by inducement advertising. Claimants may benefit if they select a claimant lawyer more suitable to them and their claim in future. The reputation of the claimant lawyer profession may benefit if the reforms in effect prevent some lawyers from misleading consumers. Wider economic benefits from resources no longer used to settle personal injury claims being allocated to other activities which generate economic welfare. Wider benefits in the longer term from reduced upward pressure on insurance premiums.

### Key assumptions/sensitivities/risks Discount rate (%)

3.5%

Assume that around 20,000 personal injury cases per year stem from inducement advertising. Of these, 10,000 claims would not otherwise be made, 8,000 claims would be pursued by a different claimant lawyer in future and 2,000 would be pursued via the same claimant lawyer; Assume that all cases involve no win no fee claimant lawyers subject to fixed recoverable costs of £500 per case plus a success fee of £500 per case; Consider that 90% of inducement advertisements are misleading with inducements not offered due to hidden terms and conditions; Consider that in cases where inducements are actually provided, in 80% of cases a cash advance is given with a cash flow cost of £50 per case for the claimant law firm, and in 20% of cases a gift is given which costs between £100-£300.

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m			In scope of OITO?	Measure qualifies as
Costs: N/A	Benefits: N/A	Net: zero net cost	YES	IN

# Evidence Base

## Introduction

- 1.1 In June 2010, the Prime Minister commissioned Lord Young to conduct a review of the operation of health and safety law and the growth of a perceived "compensation culture". Lord Young in his review, *Common Sense Common Safety*<sup>1</sup> raised a number of concerns and made recommendations for changes in the way firms of solicitors and claims management companies ("CMCs"), in particular, were regulated. As part of his review, Lord Young was of the view that incentives for claiming compensation had to change and he proposed that advertising required tighter regulation. In a letter to the Advertising Standards Authority (at Annex I of his report), he highlighted concerns about newspaper advertisements which offered substantial up front cash payments which encouraged additional personal injury claims.
- 1.2 In September 2012, the Ministry of Justice's Claims Management Regulator ("CMR") announced a complete ban on the offering of inducements by CMCs, which came into effect in April 2013. The ban was implemented via the CMR's Client Specific Rules. Rule 6b in the Claims Management Regulation – Marketing and Advertising Guidance Note July 2013 provided that:

*"Client Specific Rules, 6b: In soliciting business through advertising, marketing and other means a business must not offer any cash payment or other similar benefit as an inducement for making a claim.*

*You must not offer any payments to clients for making a claim. In addition paying clients for making a personal injury claim may put you in breach of the Legal Aid, Sentencing and Punishment of Offenders Act 2012."*
- 1.3 Concerns have continued to be raised in relation to legal services providers, and solicitors in particular, offering money or other gifts to claimants pursuing a personal injury claim. Such incentives encourage weaker claims which would not otherwise be made, thereby contributing to a perceived "compensation culture" where some people may consider they can be rewarded simply for bringing a claim regardless of its merits and whether they are ultimately successful or not.
- 1.4 Furthermore, in a significant number of cases, the client does not receive the money or other benefit initially offered, due to hidden terms and conditions. The current Solicitors Regulation Authority (SRA) Principles, which all solicitors must adhere to, require solicitors to act with integrity and in a way that maintains the trust of the public in lawyers and in the provision of legal services. Inducement advertising may not accord with this, especially when the inducements do not materialise.
- 1.5 There is both Government and industry support for introducing a ban on the offer of such benefits. Claimant lawyer representative bodies such APIL and MASS<sup>2</sup>, supported by the Chartered Institute of Legal Executives,) have been pressing for the proposed reform.

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<sup>1</sup> HM Government (2010) *Common Sense Common Safety*.  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/60905/402906\\_Common\\_Sense\\_acc.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60905/402906_Common_Sense_acc.pdf)

<sup>2</sup> Association of Personal Injury Lawyers (APIL), Motor Accident Solicitors Society (MASS)

## Key stakeholders – and how the market works

1.6 The process of making and securing a claim for personal injury claims involves the following key stakeholders:

- Claimants are individuals who have incurred a personal injury and who are seeking financial compensation. The limitation period in which to claim for this type of injury is three years, and it is more difficult to assess when a low value claim is made some time after the injury has been incurred, and hence after the injury has wholly or partially healed. This makes it difficult to challenge some types of low value claims, including potentially exaggerated claims and weaker claims which are less meritorious.
- A claimant's decision to make a claim may be influenced or encouraged by claimant solicitors, through advertising and other means of business acquisition. In some cases claimants may be encouraged or influenced to make a claim when they might otherwise have not done so, for example through an inducement.
- Whilst personal injury claims are made against individuals or firms, for example in a road traffic accident they are made against the other party, in practice most claims are made against the defendant's insurers. When the defendant insurer admits liability for the incident and settles the claim, not only do they pay financial compensation to the claimant but they also pay the costs of the claimant's solicitors.
- In relation to lower value personal injuries of less than £25,000, the costs which claimant lawyers can recover from the defendant insurer are fixed and the success fee which may be payable from the claimant's damages is capped. As part of this fixed costs regime, these recoverable costs are lower if liability is admitted (and therefore the claim does not have to be pursued through the courts) and if quantum is settled without the need for a court hearing<sup>3</sup>.
- Defendant insurers tend to resolve claims using their own staff resources, usually paralegals or claims handlers to negotiate settlements. External defendant solicitors may be used in particular cases which are challenged and which are pursued through the courts. If so their costs would always form part of the defendant insurer's overall costs of resolving the claim, even if the defendant insurer wins the case<sup>4</sup>. Claimant solicitors are a distinctly different category of stakeholder from defendant solicitors -as claimant solicitors are engaged in virtually all cases, they may encourage and influence some claims to be made, they have a central role in pursuing the claim, and they generate costs which are passed on to the other side.
- Whilst insurers cover the costs of paying financial settlements to claimants and the costs of claimant solicitors, these costs are ultimately passed on to insurance policy holders via insurance premiums. The legal requirement to hold certain types of insurance means that the volume of policies taken out is relatively inelastic to the insurance premium.
- An overall reduction in the costs to insurers of meeting personal injury claims ought to be passed through by insurers to policy holders in the form of lower

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<sup>3</sup> For more information on fixed recoverable costs for personal injury claims, see <http://www.justice.gov.uk/courts/procedure-rules/civil/rules/part45-fixed-costs>

<sup>4</sup> The Jackson reforms to the no win no fee market included defendants always meeting their own costs even when they win a case, except when some particular specific conditions apply.

premiums than would otherwise be the case, if all else is held equal. Insurance premiums are, however, determined by a number of other factors which are often changing, including investment returns.

### **Non-compliant activity**

- 1.7 In this Impact Assessment 'non-compliant' activity on the part of the claimant is considered to apply to claims which are fraudulent. The definition and identification of fraudulent claims are not straightforward. Claims which are exaggerated are not necessarily fraudulent, indeed many personal injury claims may involve an element of negotiation around the financial settlement and the initial claim may be lower than the final settlement. Furthermore, given the difficulty with the diagnosis and prognosis of soft tissue injuries (which form the majority of personal injury cases), it may be difficult to determine beyond reasonable doubt that a claim has been fraudulently exaggerated. Claims which claimants in future choose not to bring in the first place would not necessarily have been fraudulent claims. They may have been weaker and less meritorious claims, and the Government intends that people who have suffered genuine personal injuries should continue to be able to get appropriate compensation in future.
- 1.8 Where a legal service provider has offered an inducement and not paid the inducement, for instance due to hidden terms and conditions, the legal services provider is considered to be non-compliant as they could be considered to be misleading consumers and not acting in accordance with the SRA Principles. Indeed, a recent judgment by the Advertising Standards Authority concluded that one such advertisement was misleading to consumers and ordered it to be withdrawn. The advertisement implied that all claimants would receive an up front gift of £2,000 when in fact there were a number of hidden terms and conditions<sup>5</sup>. In cases where the inducement is paid, the legal services provider is considered to be compliant.
- 1.9 Where defendant insurers admit liability and settle claims they are considered to be compliant. Non-compliance on the part of defendant insurers would relate to e.g. not settling a claim following an admission of liability, or not admitting liability in relation to genuine claims.

### **Policy rationale and objective**

- 1.10 The policy rationale and objectives are to discourage weaker personal injury compensation claims from being made which would not otherwise be pursued if an inducement was not offered. These are likely to be weaker and less meritorious claims. This does not relate primarily to improving economic efficiency or to tackling market failures but instead relates to distributional and equity (fairness) considerations. In particular that it would be preferable for claimants not to make such claims and instead for motor insurance premiums to be lower than they otherwise would be, all other things equal.
- 1.11 In addition the rationale and objectives are to prevent claimants from being misled by offers of inducements which, in practice, are subject to stringent terms and conditions or which do not materialise at all. The key market failures

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<sup>5</sup> Advertising Standards Authority (2014) ASA Adjudication on Hampson Hughes Solicitors [http://www.asa.org.uk/Rulings/Adjudications/2014/3/Hampson-Hughes-Solicitors/SHP\\_ADJ\\_251321.aspx#.U7axVFMulSM](http://www.asa.org.uk/Rulings/Adjudications/2014/3/Hampson-Hughes-Solicitors/SHP_ADJ_251321.aspx#.U7axVFMulSM)

here relate to information asymmetries and to principal-agent relations. In particular to avoid consumers being misled by expert providers they commission to act on their behalves.

- 1.12 In addition, the Government considers that in order for the legal services market to work effectively claimants should select lawyers based on appropriate considerations, and not necessarily on the size and nature of inducements on offer. Banning inducements may support better decision making by claimants. The key market failure here relates to consumer choice and the basis upon which this is being exercised.
- 1.13 There is strong industry support for a ban on the offering of inducements, including groups representing both claimant and defendant interests. The Government considers that urgent action is required to stem the adverse impacts of this behaviour, and it has decided to introduce a ban through primary legislation which will provide consistency across the industry and different professional groups. The measure will be implemented by the relevant legal services regulators through their regulatory regimes, and the Ministry of Justice is working with them to ensure that this is done in a consistent and effective way.
- 1.14 In practical terms, the impact on providers of this statutory provision will be similar to that of a prohibition introduced by the various legal services regulators themselves via their own rules. The Government considers that a single provision in statute would provide a common framework for all legal services regulators, helping to ensure that the measure is applied consistently across the legal services sector in terms of both timing and content. A statutory ban applied to legal services providers would mirror the statutory ban already in place in respect of Claims Management Companies and hence would deliver consistency more broadly across the market.

## **Description of options**

### **Option 0 – Base case: Do Nothing**

- 1.15 Under the 'do nothing' base case the current situation would continue to apply.
- 1.16 The underlying volume of all personal injury claims is assumed to remain at current levels. This is further explained in the section on key data and assumptions. In addition the percentage of claims which are subject to inducements is considered to remain at current levels in future, as explained in the same section. The sensitivity analysis considers the impact on costs and benefits if the volume of claims offered with inducements is higher or lower in future than it is now.

### **Option 1: Ban lawyers from offering inducements or similar rewards as an encouragement to make a claim**

- 1.17 Under Option 1 the Government would introduce legislation to ban legal services providers from offering inducements to claimants in personal injury cases, including benefits offered through third parties. The intention is to ban any inducement which encourages - or might have the effect of encouraging - a person to make a claim or seek advice about making a claim. This includes gifts (such as a tablet computer) and cash advances. The ban applies only in England and Wales and will be enforced and monitored by legal services regulators – namely, the General Council of the Bar (barristers), the Chartered

Institute of Legal Executives (legal executives), the Law Society (solicitors), and relevant licensing authorities for alternative business structures.

### **Other options considered**

- 1.18 The Government considered the possibility of making the terms and conditions of inducements more transparent instead of banning inducements themselves. This may address the consumer protection concerns identified above in relation to consumers being misled as a result of hidden terms and conditions. However, this would only be achieved if all consumers read and understood the terms and conditions. In addition, it would still enable inducements to be offered in future and would not address the behaviour of offering inducements provided that the terms and conditions were sufficiently transparent. Therefore, it may not effectively address the problem of inducements generating additional claims which are weaker and less meritorious. Existing regulation of misleading advertising is already subject to regulation by the Advertising Standards Authority (ASA) but this does not wholly address the behaviour of offering inducements, largely because much of the ASA's regulatory action is reactive.
- 1.19 The Government considered the scope for enhancing consumer education and capability in relation to selecting a lawyer based on the most appropriate criteria. This might include encouraging and supporting consumers to read and understand the terms and conditions attached to instructing a particular lawyer. As above, this would enable inducements to continue and hence would not address the problem of inducements generating additional claims which are weaker and less meritorious. Enhancing consumer education and capability is likely to be a longer term measure and might not have an immediate or consistent impact.
- 1.20 The Government has previously engaged with legal services regulators about the possibility of them introducing a regulatory ban via their rules. However, as the legal services regulators are independent from the Government, this is not something the Government can require the regulators to do under the existing regulatory framework. Consequently, it was not clear whether, or how quickly, it would be possible to achieve the policy objective in this way. In addition, a ban established solely via the rules of the legal services regulators (which would be dependent on implementation by several different regulators acting independently and separately from each other) may not ensure consistent implementation or compliance across the sector, both in terms of content and timing, in the same way as a statutory prohibition would.
- 1.21 A ban on the offering of inducements would both tackle the consumer protection concerns head on as well as resolving the problem of additional weaker claims being generated through the behaviour of offering inducements. In addition, its impact would be immediate and consistent across the industry.

### **Costs and Benefits**

#### **Data and key assumptions**

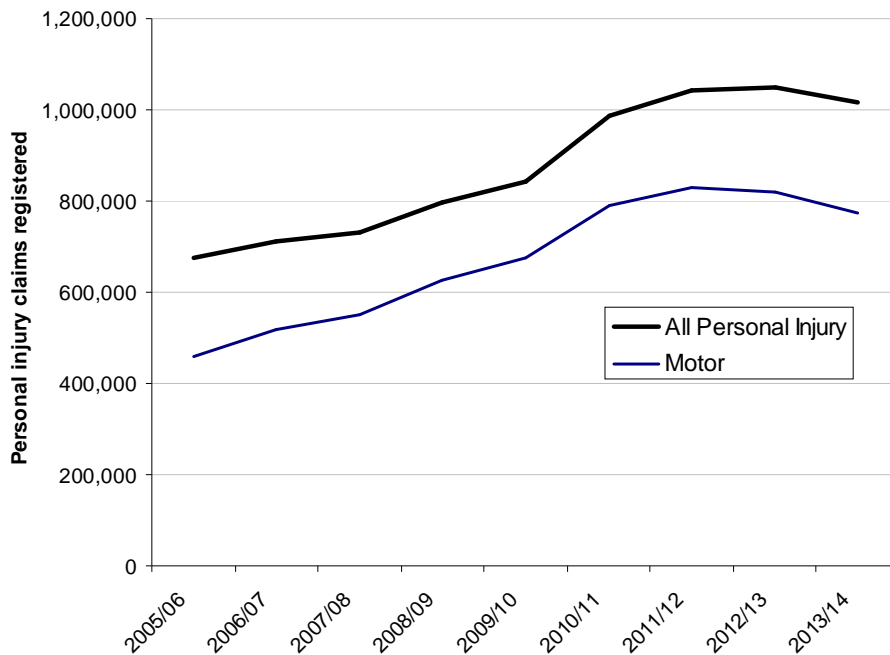
- 1.22 Figures from the Compensation Recovery Unit (CRU)<sup>6</sup> indicate that in 2013/14 there were around 1.02 million personal injury and disease claims. The majority

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<sup>6</sup> Compensation Recovery Unit (DWP) Performance Statistics Snapshot taken as at 24<sup>th</sup> April 2014.  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/306064/cases-registered-cru-2013-14.csv/preview](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/306064/cases-registered-cru-2013-14.csv/preview)

of claims are motor claims (76%). The remainder relate to employer liability (10%), public liability (10%), clinical negligence (2%) and other/unknown (2%). Motor claim volumes have increased by around a quarter over the last five years (since 2008/09), which has largely fuelled the increase in all claims, although there has been some increase in claims in all areas. However over the past two years the volume of all personal injury and disease claims and of those relating to motor accidents has flattened and started to decline. Figure 1 illustrates the increase in volume of personal injury and disease claims from 2005/06 to 2013/14 registered to the Compensation Recovery Unit in DWP.

**Figure 1: Personal injury claims registered to the Compensation Recovery Unit<sup>7</sup>**



1.23 The Government does not produce forecasts on future claim volumes. It may be that claim volumes have now flattened and will remain broadly at current levels in future, or that volumes are now on a declining trend and may continue to decrease to levels seen in previous years, or that claim volumes over recent years have temporarily dipped and that the previous historic upward trend will resume in future. The driving factors behind personal injury and disease claim volumes are varied and are not all predictable. Other government reforms, especially the Jackson reforms which came into effect in April 2013, may have affected recent baseline volumes. Looking ahead, in the absence of strong evidence about the future trend direction in personal injury and disease claim volumes from this point in time, this Impact Assessment assumes that there will be a steady constant baseline volume of personal injury and disease claims in future, of around 1.02 million claims per year. Sensitivity analysis considers the impact of a declining trend and of a growing trend in the baseline volume of personal injury and disease claims.

<sup>7</sup> Compensation Recovery Unit: (2007 to 2014) DWP web site snapshots taken between December 2007 and October 2010 for data between 2005/6 and 2007/08. Data snapshots taken between 2013 and 2014 for data post 2008/09. Figures may be subject to revision. <http://www.dwp.gov.uk/other-specialists/compensation-recovery-unit/performance-and-statistics/>



- 1.24 Figures from the Law Society indicate that around 2,500 law firms undertook personal injury work in 2012/13<sup>8</sup>. The Government and the Law Society do not collect data on the number of firms offering inducements.
- 1.25 The volume of personal injury claims made in the light of inducement advertising is not centrally monitored or recorded. Claimant lawyer representative bodies such as APIL and MASS, supported by the Chartered Institute of Legal Executives, have suggested that inducement advertising applies to a very small proportion of all personal injury claims each year. Their information indicates that we may assume that inducement advertising by claimant legal service providers applies to around 2% of all personal injury claims, i.e. to around 20,000 personal injury claims per year. In light of the views expressed by representative bodies, this proportion of 2% is assumed to remain the same in future and not to rise or fall.
- 1.26 In light of information provided by claimant lawyer trade bodies, it has been assumed that:
- i. In around 50% of those cases where inducements are offered, the claim would not have been made if the inducement had not been offered.
  - ii. In around 40% of those cases where inducements are offered, inducement advertising leads to one law firm gaining business at the expense of another law firm. In which case these claims would be pursued by other law firms in future.
  - iii. In around 10% of those claims where inducements are offered, the claimant would select the same law firm in the absence of an inducement.
- These proportions apply evenly across all cases where inducements are offered, including where inducements are offered but not provided and also where inducements are both offered and provided.
- 1.27 To provide an indication of the number of law firms involved, if the total volume of 1.02 million personal injury claims was spread evenly across all 2,500 personal injury law firms then each would pursue around 400 claims per year. Under these calculations the 20,000 claims linked to inducement advertising could be pursued by a minimum of around 50 law firms. In practice the number of law firms engaged in inducement advertising may be significantly higher, because law firms may attract business through a variety of means. In order not to underestimate the number of law firms affected by the reforms, we have assumed for illustrative purposes that around five times this number of law firms might be engaging in inducement advertising, i.e. around 250 law firms. This relates to around 10% of all personal injury law firms.
- 1.28 Based on information provided by claimant lawyer trade bodies, inducement advertising is assumed to relate largely to soft tissue claims such as whiplash claims. These low value claims involve average compensation of around £2,500<sup>9</sup>, liability is usually admitted, claims are usually resolved without going to court, and no win no fee claimant lawyers are usually engaged, who are subject to fixed recoverable costs of £500 for claims of this size which are settled without going to court.
- 1.29 It has been assumed that claimants pay their no win no fee lawyers a success fee in relation to all personal injury claims brought through an inducement

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<sup>8</sup> Law Society Market Assessment Report (2012/13)

<sup>9</sup> The average compensation paid for whiplash claims is around £2,500. Written evidence from AA motor insurance to the Transport Committee. The Cost of Motor Insurance, Volume 1 (March 2011). Written evidence page 62.

offering claimant lawyer. Success fees paid to claimant lawyers are in effect paid out of the claimant's settlement. Success fees are assumed to be £500 per case, in line with existing rules which place a cap on such fees.

- 1.30 These fixed recoverable costs were established via a past consultation exercise which involved the exchange of detailed information from claimant lawyers and from defendant insurers about how much work is involved at what cost in order to resolve a claim. This led to fixed recoverable cost figures which make no provision for claimant lawyers to make excess profits. Claimant lawyers are therefore assumed to make no excess profits.
- 1.31 This general assumption does not, however, apply to claimant lawyers who provide inducements. Inducements generate additional costs for claimant lawyers yet their income is fixed per case, as explained above (at £1,000 - £500 fixed recoverable cost plus £500 success fee). It has been assumed that inducements are only provided by claimant lawyers who are more efficient than others, and who as a result would otherwise make excess profits if they did not provide the inducement. It has been assumed that these excess profits only arise in those cases where inducements are provided. In other words, to the extent that a claimant lawyer might make excess profits on a case by being particularly efficient, it has been assumed that those profits are all spent on inducements which are provided to claimants, thereby leaving the claimant lawyer with no excess profits. In all other cases where inducements are not provided, including other cases handled by the same claimant lawyer, there are assumed to be no excess profits.
- 1.32 Information provided by claimant lawyer trade bodies suggests that claimants do not actually receive the gift or cash advance in the vast majority of cases where an inducement is offered, due to hidden terms and conditions, and that we can assume that this is so in at least 90% of cases. This would imply that inducements may actually be provided in around 2,000 cases per year. (As explained above, following introduction of the reforms we consider that 1,000 of these cases (50%) would no longer be brought in future, that 800 of these cases (40%) would be undertaken by a different law firm in future which did not used to provide inducements, and that 200 of these cases (10%) would be undertaken by the same law firm in future).
- 1.33 Anecdotal information supported by the views of claimant lawyer trade bodies indicates that in the majority of cases, law firms which provide inducements offer cash advances on liability admitted claims. There may be a cash flow cost to the law firm of advancing the claimant a proportion of their final damages. In the remainder of cases the inducement often takes the form of a gift of around £100-£300 per case, such as a tablet computer. Based on this information it has been assumed that:
  - i. In around 80% of cases where inducements are actually provided (around 1,600 cases) the inducement takes the form of a cash advance of between £500 and £2,000, with an average cash advance of £1,250. It has been assumed that claimant lawyers incur a maximum cash flow cost of around £50 per case as a result of providing cash advances of this scale, which also equates to the cash flow benefit received by the claimant;
  - ii. In the remainder of cases (around 400 cases), the inducement takes the form of an up front gift of around £100 to £300 per case (average £200), such as a tablet computer or other piece of IT equipment. It has been assumed that this cost is not deducted from the final settlement, i.e. it is not some form of advance.

- 1.34 Based on the information provided by claimant lawyer representatives, the burden of familiarisation for practitioners is likely to be minimal given that industry representatives have been calling for a ban and that it is a relatively new market. For claimant lawyers (the main affected group), each firm is already required – as an integral part of the SRA’s regulatory requirements – to appoint a Compliance Officer for Legal Practice (COLP) who, together with the Compliance Officer for Finance and Administration, is responsible for ensuring that the firm has in place systems and controls to enable compliance with regulatory requirements. Such requirements are communicated to COLPs by the SRA in the form of online updates. It is anticipated that these reforms will be communicated in this way. Other relevant legal services regulators also have existing systems for the dissemination of, and for monitoring compliance with, regulatory changes.
- 1.35 It has been assumed that the average cost to claimant lawyers of redesigning advertising in light of the ban is around £500 per firm<sup>10</sup>. On one hand there may be no costs at all if a law firm uses many different types of advertisement and if they simply withdraw their inducement advertisement and replace it with another of their advertisements. If there were any costs they would relate to redesigning the advertisements rather than to the costs of placing advertisements (as advertisements lapse after a period of time and the reforms would be subject to a lead-in time). The costs of redesigning advertisements may be small if the advertisements are on web sites or if the law firms in question return to using older advertisements which did not offer inducements. This may be feasible if the law firm has only recently started to offer inducements and if their earlier advertisements are not dated and may still be used. Indeed the claimant lawyer market for inducements is relatively new, having emerged after the ban on inducements by Claims Management Companies in mid-2012. On the other hand, whilst many advertising designers offer to devise relatively straightforward adverts for modest sums, a particularly cutting edge advertisement designed by a leading advertising agency could cost considerably more. In relation to these low value claims, however, the fixed recoverable costs do not really provide for claimant lawyers to spend large amounts on designing advertisements. Taking all these factors into account an average sum of around £500 per law firm has been assumed. Sensitivity analysis considers the impact of this sum being larger.
- 1.36 It is intended that the ban will prevent claimant lawyers from circumventing the ban by routing the offer of inducements through unregulated parties with which they have a commercial connection. However, the Ministry of Justice is not aware that inducements are currently offered through third parties in this way, as claimant lawyers can currently offer them directly to prospective clients. This measure therefore closes a potential loophole rather than preventing a current business activity and, consequently, it is assumed that there will be no impact on relevant third parties.
- 1.37 The definitions of direct and indirect impacts used in this Impact Assessment are taken from the Better Regulation Framework Manual, paragraphs 1.9.32 and 1.9.33, as follows. In particular, where an impact arises as a consequence of the reforms triggering a behavioural response to inducements no longer being offered, these impacts are considered to be indirect :

*“A direct impact on business is defined as “an impact that can be identified as resulting directly from the implementation or removal/simplification of the*

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<sup>10</sup> It is assumed that these are in house costs for the law firm and are comparable to the fees charged for this type of work by advertising designers, and that each law firm needs to redesign one advert.

*measure"... Subsequent effects that occur as a result of the direct impacts, including behaviour change, are indirect."*

- 1.38 **Monetised costs and benefits above £1 million have been rounded to the nearest £1 million and costs and benefits below £1 million have been rounded to the nearest £1,000.**

### **Option 0 – Base Case: Do Nothing**

- 1.39 Under the 'do nothing' base case the current situation would continue to apply. The 'do nothing' option is compared against itself and therefore its costs and benefits are necessarily zero, as is its Net Present Value (NPV).

### **Option 1: Introduce legislation to ban the offering of inducements or similar rewards as an encouragement to make a personal injury compensation claim**

#### **Costs of Option 1**

##### *Legal service providers*

- 1.40 In aggregate, claimant law firms would see a reduction in overall business volumes if there is a reduction in the volume of personal injury claims from claimants no longer pursuing some weaker claims due to the ban on inducements. This would relate to claims which are only made because an inducement has been offered. These would be direct ongoing impacts of the reforms. Taking the assumptions explained above, 10,000 such claims would no longer be made. As each of these claims is subject to a fixed recoverable cost of £500 and success fee of £500, this would lead to reduced aggregate income of around £10 million. Of this, around £1 million (10%) would relate to compliant claimant law firms. As explained in the assumptions section, claimant lawyers are considered to make no excess profits from cases which are currently pursued. In the short term their costs are considered to be fixed, and this reduction in income would generate losses for them. In the longer term claimant lawyers may allocate resources which are no longer required for these cases to other profitable activities.
- 1.41 In relation to the remaining volume of personal injury claims which are still made, some individual law firms currently engaged in inducement advertising may lose business to other individual law firms which are not. This would be so if inducement advertising enables one law firm to acquire business at the expense of another. These impacts on individual law firms would stem from behavioural change on the part of claimants and hence would be indirect ongoing impacts of the reforms. In particular, as a consequence of inducement advertisements no longer existing, people would no longer be attracted into selecting the particular law firm which offers inducements. Instead they would choose to select a different law firm. They would not be directly prevented from selecting the same law firm as before. Taking the assumptions explained above, around 8,000 claims might switch away from law firms currently offering inducements towards other law firms. As above these cases are associated with a fixed recoverable fee per case of £500 and a success fee of £500. This would lead to further reduced aggregate income to some claimant law firms which offer inducements of around £8 million. Of this, around £0.8 million (10%) would relate to compliant law firms. As explained in the assumptions

section, claimant lawyers are considered to make no excess profits from cases which are currently pursued. In the short term their costs are considered to be fixed, and this reduction in income for those affected would generate losses for them. In the longer term these claimant lawyers may allocate resources which are no longer required for these cases to other profitable activities.

- 1.42 Any such substitution amongst law firms in relation to the volume of claims pursued by individual law firms increasing or decreasing may also generate business adjustment costs. Claimant law firms which use inducement advertising may incur one-off costs from changing their advertising. These would be direct one-off costs as the reforms would directly prevent inducement advertisements from being made, thereby requiring them to be changed or withdrawn. Taking the assumptions explained above, if around 250 law firms are engaged in inducement advertising then total one-off costs of redesigning this advertising at around £500 on average per firm would amount to around £0.125 million. Of this around £13,000 (10%) would relate to compliant law firms.
- 1.43 There may be additional costs incurred by those legal services regulators required to monitor the ban on inducements and take enforcement action if necessary. If any additional costs are not absorbed they may be passed onto the legal services providers they regulate through higher Practising Certificate fees, Firm fees and ABS fees than would otherwise be the case. Legal services providers in turn may pass any increase in their regulatory fees onto their customers through their charges, except in cases where charges are fixed e.g. via the fixed recoverable costs. These costs are included here for the sake of completeness and have not been monetised. At this stage the relevant legal services regulators have not indicated that these reforms would make a significant impact on their operating costs, and they have not suggested that they would lead to any change in their regulatory fees.

### *Defendant insurers*

- 1.44 There are no expected additional costs for defendant insurers.

### *Claimants*

- 1.45 Claimants who currently receive cash advances or gifts (assumed to be so for 2,000 claims) would lose out if these are not provided in future. Based on the assumptions adopted, in around 400 cases claimants may lose around £80,000 in aggregate from not receiving a gift of around £200. In addition claimants would lose the benefit of a cash advance in around 1,600 cases. It has been assumed that the cash flow value of the average advance of £1,250 is around £50, totalling around £80,000. The total aggregate cost to claimants would be around £160,000. This would be a direct ongoing impact of the reforms as the reforms would directly prevent inducements from being offered.
- 1.46 Claimants would receive no compensation if they no longer pursue weaker or less meritorious claims. If there is a reduction of around 10,000 claims with an average settlement of around £2,500, on aggregate claimants would see a reduction of around £25 million in compensation. In relation to each of these cases claimants would pay their lawyer a success fee of £500, amounting to £5 million in aggregate. In which case the net aggregate loss to claimants from receiving less compensation would be £20 million. This would be a direct cost

as the ban on inducements leads to some claimants no longer pursuing their claims.

### *Wider economic costs*

- 1.47 The reforms involve some cases which were previously pursued by law firms which provide inducements being pursued by other law firms in future. There may be a reduction in productive efficiency if this resulted in cases being pursued by less efficient providers in future.

## **Benefits of Option 1**

### *Legal Service Providers*

- 1.48 Those law firms which gain business from other law firms which no longer offer inducements would receive more income as a result of pursuing these claims. As explained above, if 8,000 claims are pursued by different claimant lawyer firms, these firms would gain £8 million in additional aggregate income. All such claimant law firms would be regarded as being compliant. As explained in the costs section, these impacts would be indirect as they would stem from behavioural change on the part of claimants. Claimants would no longer be attracted to selecting law firms which offer inducements, but the reforms would not directly prevent them from doing so.
- 1.49 As explained above, 2,000 claims which are currently made following the offer of an inducement are considered to still be pursued in future via the same claimant law firm. Given that inducements are actually provided in around 10% of cases, in 200 cases inducements would no longer be provided by a law firm which continues to pursue the same case. Rather than funding inducements via excess profits those law firms would retain these excess profits in future. This would be a direct impact of the reforms. This would amount to £8,000 in aggregate for those law firms providing a cash advance plus £8,000 in aggregate for those law firms providing a gift of between £100 and £300, equating to £16,000 in total. In relation to the other 1,800 of these 2,000 cases which are pursued via the same claimant law firm in future, no impacts would apply to them – except that these particular claimant law firms would be regarded as non-compliant now (as they would be offering but not providing inducements) and as compliant in future (as they would simply not offer inducements).
- 1.50 The reputation of the claimant lawyer profession may benefit if the reforms in effect prevent some lawyers from misleading consumers.

### *Defendant insurers*

- 1.51 Defendant insurers would benefit from paying less compensation in aggregate to claimants if 10,000 fewer settled claims are pursued as a consequence of the reforms. With an average settlement of around £2,500 this would lead to a direct benefit of around £25 million in reduced compensation settlements. All defendant insurers affected are regarded as being compliant.
- 1.52 Defendant insurers would gain from no longer paying claimant lawyer fees at £500 per claim. This would generate an additional direct benefit of around £5 million. As explained in the costs section these would be direct impacts as the

ban on inducements leads to some claimants no longer pursuing their claims. All defendant insurers affected are regarded as being compliant.

### *Claimants*

- 1.53 As explained above, in relation to the 10,000 claims which are no longer pursued in future, claimants would no longer pay £500 per case to claimant lawyers in the form of success fees, amounting to £5 million in aggregate. In practice it is not the case that claimants would receive additional income of £5 million in future – instead their net losses from receiving less compensation would amount to £20 million instead of £25 million, as explained in the costs section. This Impact Assessment therefore does not score claimants as securing a benefit of £5 million.
- 1.54 Claimants would be protected by not being misled by inducement advertising and they may place a value on not being treated this way.
- 1.55 Claimants may benefit if they select a lawyer based more on other considerations (i.e. not solely on the inducement offer) and if as a result they select a law firm which is more suitable for them and for their claim.

### *Wider economic benefits*

- 1.56 There are long run wider economic benefits from resources no longer used to settle personal injury claims being allocated to other activities which generate economic welfare.
- 1.57 There should be wider benefits in the longer term from reduced upward pressure on insurance premiums. An overall reduction in the costs to insurers of meeting personal injury claims ought in the longer term to be passed through by insurers to policy holders in the form of lower premiums than would otherwise be the case, if all else is held equal. Insurance premiums are, however, determined by a number of other factors which are often changing, including investment returns.

### **One In Two Out assessment**

- 1.58 This section only refers to the direct impacts on compliant businesses and does not refer to any indirect impacts, nor to any impacts on non-compliant businesses or on individuals. The earlier costs and benefits sections explained which impacts are direct and apply to compliant businesses and this is summarised below. The proposals are regarded in principle as an IN because they are regulatory in nature.
- 1.59 Claimants are considered no longer to pursue some claims which they only made because of the inducements on offer. In the short term compliant defendant insurers would save costs of around £25 million by no longer paying compensation settlements to claimants in relation to these claims.
- 1.60 In addition in the short term in relation to these claims compliant defendant insurers would save ongoing costs of around £5 million from no longer paying claimant lawyer fees. At the same time compliant claimant lawyers would in the short term incur losses of around £0.5 million as a result of receiving less income from defendant insurers in relation to these claims.

- 1.61 In addition in relation to these claims claimant lawyers would not receive success fees from claimants. Compliant claimant lawyers would in the short term incur losses of around £0.5 million as a result of receiving less success fee income from such claims.
- 1.62 Some cases would continue to be brought via the same compliant claimant lawyers in future despite inducements not being offered and provided by them. In relation to these cases compliant claimant lawyers would gain by retaining the excess profits which they would otherwise have spent on inducements. In aggregate this would amount to a direct benefit of around £16,000.
- 1.63 Compliant claimant lawyers are considered to incur direct costs of £13,000 relating to the redesign of their advertisements. Unlike the other impacts mentioned in this One In Two Out section, these would be one-off transitional impacts.
- 1.64 It is possible that legal services regulators may incur increased costs from monitoring and enforcing the reforms. Their costs are funded by the legal services sector via regulatory fees. There is no indication that these reforms would have a significant impact on the operating costs of legal services regulators, and no suggestion that they would lead to an increase in regulatory fees.
- 1.65 In conclusion the reforms have been assessed as an IN with ZERO NET COST.

### **Risks and Assumptions**

1.66 These are summarised below.

<b>Assumption</b>	<b>Sensitivity of costs and benefits to changing the assumption</b>
It has been assumed that inducement advertising applies to a small number of claims and that these are spread evenly across all personal injury firms.	There is a risk that inducements may be provided in a larger number of claims. If so the overall net impact of the reforms would be of a larger scale.
It has been assumed that in future claimants would no longer pursue some weaker claims.	There is a risk that this may not materialise. If so the indirect benefits to defendant insurers would not arise, nor would the associated indirect costs to claimants and to claimant lawyers.
It is assumed that the majority of personal injury claims are low value claims with fixed recoverable costs.	If inducements apply to higher value claims, there is a risk that some higher value claims may not be pursued in future. If so, the costs to claimants and claimant lawyers may be greater, as would the benefits to defendant insurers.
It is assumed that in the majority of cases the inducement is not provided due to hidden terms and conditions.	If inducements are provided in more cases, the direct benefits to claimant lawyers from not providing inducements in future would be greater, and the direct costs to claimants would be greater.



<p>It is assumed that in the majority of cases a cash advance is provided, and in the remainder a gift.</p>	<p>If gifts are more likely to be offered than cash advances, the direct benefits to claimant lawyers from not providing inducements in future would be greater, and the direct costs to claimants would be greater.</p>
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### **Sensitivity Analysis and Risks**

1.67 An increase of 10% in baseline volumes and claims brought through an inducement would result in the following changes to the costs and benefits:

- Claimant law firms would see a greater reduction in overall business volumes as a result of fewer claims brought (around 11,000 claims no longer made instead of around 10,000 in the main analysis). This would lead to increased losses in the short term for claimant lawyers – of around £11 million instead of around £10 million in the main analysis.
- More claimant lawyers (around 9,000 instead of around 8,000 in the main analysis) would lose business to other claimant lawyers.
- Claimant law firms that currently provide inducements and retain their business in future after implementation of the reforms would in future secure around £18,000 in excess profit (compared to around £16,000 in the main analysis).
- One off transitional advertisement redesign costs for legal service providers would increase to around £0.135 million (compared to around £0.125 million in the main analysis).
- Claimants would lose around £88,000 in aggregate (instead of around £80,000 in the main analysis) from not receiving a gift and £88,000 in aggregate (instead of around £80,000 in the main analysis) from not receiving a cash advance.
- Defendant insurers would benefit from paying around £27.5 million less in compensation (compared to around £25 million less in the main analysis) and would benefit by around £5.5 million (compared to around £5 million in the main analysis) from no longer paying claimant lawyer fees.

1.68 An decrease of 10% in baseline volumes and claims brought through an inducement would result in the following changes to the costs and benefits:

- Claimant law firms would see a smaller reduction in overall business volumes as a result of fewer claims brought (around 9,000 claims no longer made instead of around 10,000 in the main analysis). This would lead to reduced losses in the short term for claimant lawyers – of around £9 million instead of around £10 million in the main analysis.
- Fewer claimant lawyer providers (around 7,000 instead of around 8,000 in the main analysis) would lose business to other claimant lawyer providers.
- Claimant law firms that currently provide inducements and retain their business in future after implementation of the reforms would in future secure around £14,000 in excess profit (compared to around £16,000 in the main analysis).

- One off transitional advertisement redesign costs for legal service providers would decrease to around £0.11 million (compared to around £0.125 million in the main analysis).
  - Claimants would lose around £72,000 in aggregate (instead of around £80,000 in the main analysis) from not receiving a gift and £72,000 in aggregate (instead of around £80,000 in the main analysis) from not receiving a cash advance.
  - Defendant insurers would benefit from paying around £22.5 million less in compensation (compared to around £25 million less in the main analysis) and would benefit by around £4.5 million (compared to around £5 million in the main analysis) from no longer paying claimant lawyer fees.
- 1.69 If the volume of inducements is increasing over time, banning inducements may lead to a greater reduction in case volumes and the associated reduced business income for claimant lawyers. Claimants would receive less compensation in aggregate. There would be an equivalent increase in savings to defendant insurers. In addition, there may be greater savings to compliant claimant lawyers that would not provide inducements in future and an increase in one off adjustment costs to change advertising.
- 1.70 The main analysis assumes that the average cost of redesigning adverts is around £500 per law firm. If the average cost is greater than £500, the aggregate cost to claimant law firms for redesigning adverts would also increase. If the average cost to claimant law firms increased by a magnitude of ten, the aggregate cost to claimant law firms would be around £1.25 million.
- 1.71 In addition, if inducements continued in future and became more prevalent over time, the longer term impact may be that the costs to all law firms of acquiring business may be higher if offering inducements becomes part of normal business practice. Law firms are subject to fixed recoverable costs for lower value personal injury claims, and so an increase in the number of paid inducements would lead to an increase in costs for law firms which they themselves would have to meet. Banning inducements may in the longer term enable all personal injury law firms to operate with lower costs than might otherwise be so.

### **Small and Micro Business Assessment**

- 1.72 The main stakeholders affected by the proposals are claimant lawyers. Claimant lawyer trade bodies have been pressing for the proposed ban on inducement advertising by lawyers, primarily as they consider that these advertisements mislead claimants in the vast majority of cases: this harms claimants and the reputation of claimant lawyers more generally.
- 1.73 Data from the Law Society suggests that the majority of solicitor firms to be small. Last year around 55% of firms undertaking personal injury work had up to five solicitors, and around 40% had between six and forty solicitors<sup>11</sup>.

#### *Full Exemption*

- 1.74 The proposals outlined above are based on discussions the Government has had with trade bodies. On the basis of these discussions, the Government

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<sup>11</sup> Source: Law Society Market Assessment 2012/2013

has formed the assumption that a full exemption would not be applicable as small businesses make up a significant proportion of claimant law firms therefore would undermine the policy objectives.

#### *Partial Exemption*

- 1.75 A partial exemption may reduce the impact on small and micro claimant law firms who would need to adjust their advertising and may lose business due to the ban. A partial exemption applied to small and micro law firms would make the ban of referral fees automatically defunct as they make up a significant proportion of the market. On the basis of discussions with the industry, the Government has formed the assumption that a partial exemption would not be applicable as the proposals would not achieve the stated objectives.

#### *Extended Transition Period*

- 1.76 An extended transition period may reduce the impact on small and micro claimant law firms who need to adjust their advertising. The Government announced its intention to implement the ban in June 2014, which will be implemented when the CJC Bill has been granted Royal Assent. The representative trade bodies, which have been pressing for the ban, have been discussing the proposals with their key stakeholders and therefore providing them with a transitional period. An extended transition period for small and micro businesses would not be possible as this would undermine the policy objectives.

#### *Temporary Exemption*

- 1.77 A temporary exemption may reduce the impact on small and micro claimant law firms offering inducements who need to adjust their advertising. The Government has been working closely with the industry in relation to these proposals and has formed the assumption that a temporary exemption would undermine the policy objectives.

#### *Varying Requirements by Type and/or Size of Business*

- 1.78 Varying requirements by size of business may reduce the impact on small and micro claimant law firms who need to adjust advertising. However a ban cannot have varying requirements, a firm can either be allowed to offer inducements or not.

#### *Specific Information Campaigns or User Guides*

- 1.79 The Government has been working closely with the industry in relation to these proposals. Claimant lawyer trade bodies have been calling for the reforms and have been discussing the proposals with their key stakeholders and therefore providing them with a transitional period.

#### *Direct Financial Aid for Smaller Business*

- 1.80 The costs associated with changing advertising may be proportionally greater for small claimant law firms. The Government has formed the assumption that direct financial aid should not be given to smaller businesses.

#### *Opt-in and Voluntary Solutions*

- 1.81 It is not possible to create a voluntary or opt-in solution for small and micro businesses as individual firms would likely decide to be in the same position as they currently are. As discussed above the proposals require all claimant law firms to cease offering inducements.

## **Implementation and Enforcement**

- 1.82 The Government intends to use primary legislation to implement the reforms. This approach was selected following discussions with industry stakeholders. The ban will be enforced by the appropriate legal services regulators through their regulatory frameworks. As the legal profession is regulated by regulatory bodies which are independent from the Government, the way in which the ban is implemented and policed is essentially a matter for the regulators, but the Ministry of Justice is engaging with them on this to ensure effectiveness and consistency. The resulting arrangements will be subject to the compliance and audit requirements which apply to their regulatory function more generally.