

Final Regulatory Impact Assessment

1. Title of Proposal

- 1.1 Compensation Bill – Regulating claims management services

2. Purpose and intended effect

Objectives

- 2.1 This proposal aims to provide better safeguards for consumers of claims management services. It is designed to encourage the provision of quality services, to enhance consumer protection and to provide consumers with a clear route to redress. In particular, the proposal aims to improve the effectiveness and efficiency of the system for those who have a genuine claim to compensation, and to tackle practices that have helped to spread the misperceptions and false expectations of compensation claims amongst consumers. This will help to build consumer confidence and promote effective competition within the sector, whilst ensuring that the sector will be able to contribute effectively to the widening of access to justice.

Devolution

- 2.2 This proposal applies to England and Wales only.

Background

a. The development of the claims management sector

- 2.3 Development of the claims management sector has been most rapid in the personal injury claims market. Conditional fee agreements (CFAs) were introduced by the Courts and Legal Services Act 1990.¹ The first CFA Order, which limited CFAs to personal injury cases, was brought into force in July 1995. With CFAs, the lawyer's costs are payable only if the case wins; in the event of not winning, the lawyer foregoes his fees. Under the 1995 legislation, lawyers' success fees – the percentage over and above base costs payable in the event of a win – were not recoverable from the losing party. As a result, winning litigants faced not only the cost of any legal after-the-event (ATE) insurance, but also found their compensation payments reduced after deduction of their own lawyer's success fee. The range of CFA proceedings was extended to all civil proceedings other than family cases in July 1998.
- 2.4 The Access to Justice Act 1999 permitted recovery of success fees, as well as recovery of the premium paid for insurance policies taken out to cover opponents' costs from the losing party. Furthermore, this Act abolished public funding (legal aid) for most personal injury claims with the exception of complex and high-value cases and medical negligence claims, on the basis that other methods of funding were available and better suited.
- 2.5 Although there were a few claims management companies (CMCs) around before 1999, the Access to Justice reforms shifted the burden of funding personal injury claims from the public to the private sector, by means of CFAs and legal expenses insurance,

¹ Section 58 of the Courts and Legal Services Act 1990

therefore increasing significantly the demand on private sector providers. This change combined with the relatively slow response of legal firms to respond to the new market opportunities, have helped to create the conditions for a rapid growth in the claims management sector.

- 2.6 CMCs have developed as intermediaries between claimants and legal services providers. They identify and obtain claims which they pass onto lawyers, primarily solicitors, often though not always for a fee. Such cases are usually gathered by advertising or direct marketing. CMCs obtain other income from activities such as conducting investigations into claims and claimants; commission received on the sale of auxiliary services such as ATE insurance and consumer credit loans taken out to cover the premiums for those policies; and making representations on behalf of the claimants. The collapse of the two largest CMCs - Claims Direct in July 2002 and the Accident Group in May 2003 - focussed attention on the conduct of some of the CMCs, and the impact of their conduct on consumers and other professions.
- 2.7 There is a range of other sectors apart from personal injury where claims management services have emerged, such as criminal injuries compensation. More recently, following allegations of mis-selling of financial products (in particular endowment policies supporting mortgages), CMCs have found a large new market. In the endowment claims sector, CMCs pursue clients' claims against insurers, taking cases all the way, if necessary, to the Financial Ombudsman Service (FOS).
- 2.8 Claims management services are also to be found managing cases that go to employment tribunals and pursuing claims for housing disrepair against local authorities, as well as in benefits cases, and in referring employment tribunal cases to solicitors. There is also a potential for claims management services to appear in other areas.

b. The claims management market

- 2.9 There are currently no exact figures on the number of CMCs operating in the claims management market. The Claims Standards Council (CSC) estimates that in 2005 there are around 400 CMCs operating in England and Wales, handling approximately 500,000 claims of various types per year.
- 2.10 Data from Datamonitor² indicates that there were 770,243 personal injury claims made to insurance companies in the year 2003-04,³ including those via CMCs. This represents a rise of 9.0% from 2002-03. However, almost all of this increase is accounted for by the large one-off compensation scheme for former miners. Numbers for motor, employer liability, public liability and clinical negligence claims all fell over the period from 2000 to 2004. Moreover, the total personal injury bill in 2004 is estimated to be £7.2 billion, with over 67% of it attributable to payouts to motor claims.
- 2.11 It is also anticipated that personal injury claims for accidents will grow by 0.1% per annum from 557,000 in 2003-04 to 560,000 in 2008-09. The total personal injury bill is predicted to increase to £10.2 billion by 2008-09, representing a 9% annual increase on 2003-04 levels.⁴
- 2.12 The Financial Ombudsman Service (FOS) received 69,737 new complaints on mortgage endowment policies sold in the year 2004-05, a 34% increase from the previous year. The FOS estimates that about 12.5% (8,750) of all mortgage endowment complaints are

² Datamonitor, 2004, 'Trial and Error' - UK Personal Injury Litigation 2004

³ Statistics extracted from Department for Work and Pensions (DWP) Compensation Recovery Unit (CRU) database

⁴ Datamonitor, 2004, *op. cit.* The forecast assumes that claims cost inflation will persist at historic rates and does not take into account any future reform on cost of personal injury claims.

now referred to the service by CMCs.⁵ Figures for the previous year were negligible. In addition, data from the Association of British Insurers indicated that of the total mortgage endowment complaints received in the second quarter of 2005, 26.1% of them came through the CMCs, of which 45.9% of them were upheld.

2.13 As negative publicity in the wake of the collapses of Claims Direct and The Accident Group in 2002 subsided, a degree of confidence has returned to the sector and new entrants have been attracted into the claims management market. This is partly reflected in the increase in advertising spending, in particular amongst the new CMCs. The spending on advertising amongst key personal injury claims competitors amounted to £11.5 million in 2003, a 104.4% increase compared to 2002.⁶

2.14 In 2004-05, the CSC received 188 consumer complaints about claims management services, of which 131 were directed at CMCs. According to figures provided by the Advertising Standards Authority (ASA), 259 complaints were received against personal injury or compensation broadcast adverts in between 1998 and 2004, with 149 being misleading and 52 being harmful or offensive. The ASA upheld 15 such complaints.

c. Current regulation of the claims management sector

2.15 Claims managers working within the legal services framework are currently not subject to any statutory sector-specific regulation. As identified by Sir David Clementi in the *Review of the Regulatory Framework for Legal Services in England and Wales*,⁷ the claims management services are not reserved and can be provided by anyone who cares to do so.

2.16 However, some aspects of claims management services are regulated by other non-legal statutory bodies. The selling of ATE insurance is regulated by the Financial Services Authority (FSA) under the Insurance Mediation Directive. The selling and management of consumer credit loans are regulated by the Office of Fair Trading (OFT). Advertising activities of CMCs are governed by the Advertising Standards Authority (ASA). Moreover, CMCs have to comply with a range of consumer legislation including:

- The Trades Descriptions Act 1968
- The Unfair Contracts Term Act 1977
- The Supply of Goods and Services Act 1982
- The Unfair Terms in Consumer Contracts Regulations 1999
- The Consumer Protection (Distance Selling) Regulations 2000
- The Electronic Commerce Regulations 2002
- The Financial Services (Distance Marketing) Regulations 2003
- The Electronic Communications (EC Directive) 2003

2.17 In May 2004 the Better Regulation Task Force (BRTF) reported in *Better Routes to Redress*⁸ on the scope of the perceived 'compensation culture' and on possible improvements to the compensation system. The BRTF identified in the report that '*the claims management sector was characterised by hard-sell advertising and direct-marketing which encouraged people to "have a go" even if there was little chance of actually achieving the large payout being dangled as an inducement*'. It then made the

⁵ Kelly, Sir Christopher, 2005, *Annual review and report & financial statements 1 April 2004 to 31 March 2005* [<http://www.financial-ombudsman.org.uk/publications/ar05/ar-05.pdf>]

⁶ Datamonitor, 2004, *op. cit.*

⁷ Clementi, Sir David, 2004, *Review of the Regulatory Framework for Legal Services in England and Wales – Final Report* [<http://www.legal-services-review.org.uk/content/report/index.htm>]

⁸ Better Regulation Task Force, 2004, *Better Routes to Redress* [<http://www.brta.gov.uk/docs/pdf/betterroutes.pdf>]

recommendation, accepted by the Government,⁹ that the sector should have until December 2005 to make self-regulation work, and that the Government should step in and regulate the sector if progress was not made by then.

- 2.18 In response to the BRTF's report sector interests established the Claims Standards Council (CSC) as a voluntary regulatory body. The CSC's aims include: vetting individuals and organisations seeking membership of the Council; setting out the rules and codes of conduct for handling claims; monitoring the behaviour of its members and enforcing its rules; and providing a forum for dealing with complaints and disciplinary matters. The CSC currently has over 150 members, including CMCs (estimated as around 25% of all the CMCs known to CSC); funders, brokers and insurance companies; medico-legal and rehabilitation service providers; and some solicitors. It has drafted a code of practice that has been submitted to the OFT for consideration under the OFT's Consumer Codes Approval Scheme (CCAS).¹⁰ The CSC has yet to successfully complete Stage One of the CCAS, and approval of the code will only be given after completion of Stage Two, which the CSC has not started.

d. Related programmes

- 2.19 This proposal forms part of a wider programme that aims to address practices that may have helped to create the perception of a 'compensation culture', and to improve the system for securing fair compensation for those with valid claims, by promoting more affordable insurance, better access to rehabilitation, and more proportionate processes for making claims.
- 2.20 The new regulatory framework proposed for the claims management sector will be consistent with the new structure proposed in the White Paper for reforming the regulatory framework for legal services.¹¹ The new structure will consist of an oversight regulator, and front-line regulators (FLRs) will be designated specifically to carry out the day-to-day regulatory functions, subject to criteria being satisfied. In this new structure an independent complaints handling body will also be created.

Rationale for government intervention

- 2.21 Some CMCs have been criticised by consumer advice agencies, legal professionals, insurance companies and others for some of their sales practices, including aggressive advertising, high-pressure selling tactics, cold calling and mis-selling of CFAs. These groups have also condemned some CMCs for the poor quality and often misleading advice they give to consumers. In addition, there have been considerable concerns over the lack of transparency of processes and fees and the minimal interest in being regulated or offering ethical services. There are fears that these activities erode consumers' confidence in legal services and fuel concerns about a 'compensation culture'.¹²
- 2.22 Customers of CMCs often lack the detailed knowledge to understand the complex legal and financial processes involved in the claims process, and thus are often unable to make an accurate assessment of the value for money of the services they procure or

⁹ Department for Constitutional Affairs, 2004, *Tackling the "Compensation Culture" - Government Response to the Better Regulation Task Force Report: 'Better Routes to Redress'* [<http://www.dca.gov.uk/majrep/bettertaskforce/better-task-force.pdf>]

¹⁰ The core criteria for approval includes a) a commitment to provide customers with adequate information about goods and services b) the use of clear and fair contracts c) user friendly and speedy procedures for dealing with customer complaints and d) low cost, independent redress if a complaint is not dealt with satisfactorily.

¹¹ Department for Constitutional Affairs, 2005, *The Future of Legal Services - Putting Consumers First* [<http://www.dca.gov.uk/legalsys/lreform.htm>]

¹² The Law Society, 2005, *The future of legal services*, Press release. [<http://www.lawsociety.org.uk/newsandevents/pressreleases/view=newsarticle.law?NEWSID=228090>]

indeed whether recourse to such firms can resolve their problems. In addition, the 'credence' nature¹³ of claims management services means that they are still unable to judge the quality of the services received even after the purchase. As claims management services are purchased infrequently, consumers often do not have the opportunities to compare the quality of services they received against previous purchases.

- 2.23 As a significant number of consumers of claims management services do not have the required information about the nature of the services to be able to make sound purchasing judgements, the claims management sector fails to deliver efficient outcomes and fails to foster effective competition. In particular, there is a risk that bad suppliers will drive out good suppliers in the sector by offering poor quality services.
- 2.24 In addition, many potential consumers of claims management services are in particularly vulnerable groups (e.g. on low incomes) and may often be targeted by unscrupulous CMCs: they may raise expectations that compensation is available for the personal physical injury or other ills they have suffered, even when elements of fault liability and causation are yet to be established. All these factors foster an environment for possible CMC malpractice, such as mis-selling of legal and financial products and inducing consumers into signing CFAs inappropriately. Consumers' rights and needs are often misunderstood or ignored by the CMCs inadvertently, or in some instances, deliberately.
- 2.25 Citizens Advice has published a range of anecdotal evidence concerning the problems consumers have encountered in its document *No win, no fee, no chance*.¹⁴ The document highlighted particular concerns around misleading sales practices with 'no win, no fee' funding arrangements and claims that consumers receive '100% compensation' often proving to be the exception rather than the rule. Consumers are subject to these claims by sales representatives and often sign binding agreements that instead state that funding packages will be tailored according to the circumstances of each case and consumer. As a result, consumers may find themselves liable for costs, and these costs may be greater than compensation payments in the event of a win. Other concerns raised include pressure selling in general and in particular approaches to injured persons in vulnerable environments such as hospitals.
- 2.26 Dissatisfaction amongst consumers about the poor quality of claims management services is also reflected in the growing number of complaints some statutory bodies and trade organisations received that are related to the claims management sector. For example, the CSC received 188 consumer complaints about claims management services in 2004-05, of which 131 were directed at CMCs. Figures from the Advertising Standards Authority (ASA) show that 259 complaints were received against personal injury or compensation broadcast adverts between 1998 and 2004, with 149 being misleading and 52 being harmful or offensive. The ASA upheld 15 such complaints.
- 2.27 There is currently no statutorily-required assessment of the claims managers' competence (legal, financial or otherwise) before they are allowed to provide claims management services. A statutory body is also absent in setting rules and regulations to govern their work and to monitor their behaviour, and to discipline where necessary. There is no complaints handling mechanism for consumers wanting to make complaints against claims managers about poor quality service or professional negligence. Nor are claims managers statutorily required to obtain professional indemnity insurance or to contribute to a compensatory fund, so making it very difficult for consumers to gain redress from claims managers for malpractice.

¹³ Darby, M and Karni, E, 1973, 'Free Competition and the Optimal Amount of Fraud' *Journal of Law and Economics*, 16, pp. 67-88

¹⁴ Citizens Advice, 2004, *No win, no fee, no chance - CAB evidence on the challenges facing access to injury compensation* [http://www.citizensadvice.org.uk/no_win_no_fee_no_chance-2]

- 2.28 As a result, claims managers may not be in a position to give quality advice to the consumer on claims-related issues, such as on the chances of success, on likely compensation payments and the amount of fees the consumer may be liable to pay. Moreover, these representatives, working on a commission basis, tend to focus on getting the consumer to make a claim and to take out a CFA, regardless of its merits. Consumers do not therefore receive impartial advice on whether to pursue compensation and on the best funding arrangements.
- 2.29 In addition, regulatory inconsistencies exist in the claims management sector, as solicitors and claims managers do not compete on a level regulatory playing field. Solicitors who offer legal advice on claims and charge for their services are currently regulated by the Law Society, while claims managers are unregulated in offering their services with little quality control and no independent complaints procedures.
- 2.30 In September 2004 the Claims Standards Council (CSC) was established as a voluntary self-regulatory body in an attempt to work towards appropriate regulations for the sector and to ensure consumer interests are safeguarded. It is the process of establishing rules and codes of conduct, monitoring and enforcement procedures, and complaints handling process for its members to follow. The typically relatively low membership of the CSC and the voluntary nature of their rules have blunted the effectiveness of CSC in protecting consumers of claims management services. In addition, the CSC has yet to successfully complete Stage One of the OFT's Consumer Codes Approval Scheme (CCAS) for its draft code of practice. It also is anticipated that it would be unable to complete Stage Two of the CCAS, and thus unable to gain OFT's approval, before December 2005. Consequently the problems in the sector mentioned above are expected to continue to fester under the current regulatory arrangements.

3. Consultation

Within government

- 3.1 A Ministerial Steering group has been formed to oversee work on the Compensation Bill and the wider "Tackling perceptions of the Compensation Culture" programme. This group consists of Ministers from the Department for Constitutional Affairs (DCA); HM Treasury; Home Office; Department of Health; Department for Education and Skills; Department for Work & Pensions; Office of the Deputy Prime Minister; Department for Culture, Media & Sport; Department of Trade and Industry (DTI), and includes the Minister without Portfolio. All Ministers in the group fully support the statutory regulation of CMCs and regard this as a key element of the wider programme. Officials from the DCA have also been in contact with officials from these departments through bi-laterals to ensure detailed policy proposals are comprehensive and consistent with the policies of other government departments.
- 3.2 DCA officials have also held discussions with other public bodies, including the Office of Fair Trading; the Financial Services Authority; the Financial Ombudsman Service; the Employment Tribunal Service; the Criminal Injuries Compensation Authority; the Office of the Immigration Services Commissioner and the Better Regulation Task Force. These bodies either have experience of regulating comparable markets or have direct experience of receiving claims brought with the involvement of CMCs.

Public consultation

- 3.3 DCA has undertaken two consultations on conditional fee agreements (CFAs) in the past two years: *Simplifying CFAs* in 2003¹⁵ and *Making simple CFAs a Reality* in 2004.¹⁶ Even though some of the activities of claims management companies were outside the scope of these consultations, many respondents expressed grave concerns over the behaviour and conduct of claims managers in marketing and selling their products. The Federation of Small Businesses (FSB) has expressed its concerns about reports of CMCs encouraging individuals to pursue compensation claims on extremely questionable grounds. Citizens Advice called for primary legislation to bring claims management services within the scope of legal services regulation, and the Association of Personal Injury Lawyers felt that consumer problems have risen not from the provision of CFAs but the mis-selling of ATE insurance products and the layering of additional costs by CMCs. In addition, the Law Society reiterated their view that claims managers should be regulated for the protection of the public. They were particularly concerned that solicitors are often forced to agree to a scheme that they themselves are unhappy with, but to which the client has already committed. However, some respondents also recognised the important role that claims managers have in informing consumers of their legal rights. Many respondents suggested that regulations should be considered to control the activities of the claims managers.
- 3.4 A Stakeholder Action Group has been formed as a forum for capturing stakeholder views on the Compensation Bill and as a mechanism for driving forward the other strands of work in the wider programme. This group consists of a wide cross-section of stakeholders including representatives from consumer groups, trade unions, legal professional bodies and associations, insurers and the judiciary. DCA officials have also held a series bi-lateral discussions with key stakeholders. There is strong support for proportionate statutory regulation in principle, and many helpful comments on the DCA's detailed proposals have helped to shape the policy. In particular, comments in relation to the treatment of the not-for-profit sector and the relationship of CMCs and the legal professional bodies have informed the development of the proposals.
- 3.5 Other stakeholders have voiced public support for the Compensation Bill. For example, the Association of British Insurers said: "*While there are arguments about whether we have a compensation culture, there is no doubt that millions of people are acting as if there is one. This is getting in the way of ensuring that compensation goes to those who need and deserve it. All efforts to change this perception will be welcomed by insurers and our policyholders.*"¹⁷
- 3.6 The remit of the Consumer Panel that advises the Government on implementing legal services reforms has also been extended to include providing advice on the regulation of claims management activities. Membership of the panel consists of Citizens Advice, Which?, the National Consumer Council, the Federation of Small Businesses and the Equal Opportunities Commission (with the Office of Fair Trading assisting the panel). The group has voiced strong support for the statutory regulation of claims management

¹⁵ Department for Constitutional Affairs, 2003, *Simplifying CFAs – A consultation on the Conditional Fee Agreement regime including the Conditional Fee Agreements, Collective Conditional Fee Agreements and Membership Organisation Regulations* [<http://www.dca.gov.uk/consult/confees/cfa.htm>]

¹⁶ Department for Constitutional Affairs, 2004, *Making simple CFAs a reality – A summary of responses to the consultation paper 'Simplifying Conditional Fee Agreements' and proposals for reform* [<http://www.dca.gov.uk/consult/simplecfa.htm>]

¹⁷ Association of British Insurers, 2005, *Queen's speech offers opportunities says ABI*, Press Release. [<http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrId=11525>]

activities. The FSB in particular are concerned about the detrimental effect on small businesses if the perception of a 'compensation culture' induces unnecessarily risk-averse behaviour influenced by a fear of litigation. DCA officials have discussed the operation of the claims management market with the CSC.

4. Options

- 4.1 The following options for the new regulatory framework for claims management sector have been considered:

Option 1 - Do nothing

- 4.2 Continuing with the existing arrangements means that the claims management services would remain unregulated and inconsistencies would persist in the regulatory framework. There would continue to be only voluntary sector-specific regulation for the claims management sector, which has been ineffective in protecting consumers' interests. Poor sales practices such as aggressive advertising, high-pressure selling tactics and mis-selling of CFAs would continue. Claims managers would continue to be in a position to provide poor quality services and misleading advice to their customers. Vulnerable groups of consumers would continue to be targeted by unscrupulous CMCs. There would be a continuing lack of complaints handling channel for consumers to seek redress for the malpractice of claims managers.

Option 2 – Statutory regulation via a new regulatory authority

- 4.3 Under this option, a new regulatory authority would be established and would exercise full regulatory control over all claims management activities, bar those that are already regulated by other statutory bodies. Its functions would include the setting and enforcement of the rules and codes governing service provision; giving guidance and advice on claims-related issues; exercising investigative, enforcement and disciplinary powers; and handling consumer complaints. It would have the power to bring different types of claims management services into, or taken out of, the scope of its regulatory reach.
- 4.4 The new authority would be an independent non-departmental public body (NDPB) headed by a chairman, appointed by and accountable to the Secretary of State. The chairman's general duty would be to promote good practice in the provision of claims management services, including to ensure that those who provide claims management services are fit and competent to do so and that they act in the best interests of their customers. Those who seek to provide claims management services would be statutorily required to be registered with the authority, or be granted a certificate of exemption by the authority in some cases (such as for not-for-profit (NfP) suppliers).

Option 3 – Statutory regulation via a front-line regulator (FLR), subject to the Secretary of State's oversight

- 4.5 Under this option, claims management activities that are not already regulated by other statutory bodies would be subject to statutory regulation. Regulatory power would be vested in the Secretary of State. He would designate an existing body to be the front-line regulator (FLR), who would carry out the day-to-day regulation of authorised persons providing claims management services. Once designated, the FLR would have regulatory and supervisory jurisdiction only over those authorised by it to provide claims management services, subject to the Secretary of State's oversight.

- 4.6 In considering the body's application for designation as the FLR, the Secretary of State would ensure that the applicant meets the requirements. These include having the required level of competence; the appropriate governance arrangements that provide for a clear split in the exercise of their regulatory and representative functions; a satisfactory and transparent complaints handling scheme, including suitable indemnity insurance and compensation arrangements; and regulatory arrangements to promote the interests of consumers and to foster competition in the claims management services market.
- 4.7 In addition, if the Secretary of State is not satisfied with the designated FLR in carrying out the day-to-day regulatory functions, he would have the power to 'call-in' rules and impose sanctions, with de-authorisation of the FLR as the last resort and bring it under his direct control.
- 4.8 Additional type of claims management services would be brought into, or taken out of, the scope of the Secretary of State's regulatory reach by secondary legislation. There would be a statutory requirement for the Secretary of State to consult the OFT and other appropriate advisory groups about its regulatory decisions.
- 4.9 Provisions about the exemption of persons or classes of persons would be made in secondary legislation. One option under consideration would be to exempt NfP organisations (including trade unions) from the requirement for regulation by order of the Secretary of State. As a condition of exemption, NfP organisations might be required to have regard to the code of practice issued by the FLR, without being required to comply with the rules set by the FLR, subject to a formal assessment of their competence, or being required to pay a regulatory fee. Alternatively, the NfP providers may be subject to formal regulation but without the requirement to pay regulatory fees.

5. Costs and benefits

Sectors and groups affected

- 5.1 The following sectors would be affected by the proposals:
- Claims managers and claims management companies that provide claims management and associated services;
 - The legal professions that pursue compensation claims or other forms of redress on behalf of claimants referred to them by claims managers;
 - Insurance companies that offer ATE and other insurance to claimants via claims managers;
 - Finance companies that offer loans and other financial products to claimants via claims managers;
 - Any individuals or organisations that have claims made against them, or believes that claims may be made against them;
 - Consumers of services offered by the claims managers, especially those in vulnerable groups (e.g. hospital patients, low-income groups); and
 - All not-for-profit organisations (including trade unions) that offer advice on claims management and associated services.

Analysis of costs and benefits

Option 1 – Do nothing

Benefits

- 5.2 There would be no additional economic or social benefit arising from this option.

Costs

- 5.3 Leaving claims management services unregulated would mean the continuation of poor sales practices such as aggressive advertising, high-pressure selling tactics and mis-selling of CFAs. Claims managers would continue to be in the position to provide poor quality services and misleading advice to their customers. Vulnerable groups of consumers would continue to be targeted by unscrupulous CMCs. The harm done to consumers is expected to increase if claims management activities remain unregulated. This is because CMCs tend to move swiftly into other areas of claims management activities by targeting areas where potential claims can be made. This is indicated by the recent rapid rise in claims made against the mis-selling of mortgage endowment policies (see para. 2.12).

Option 2 – Statutory regulation via a new regulatory authority

Benefits

- 5.4 By having the appropriate entry standards, codes of conduct, and effective monitoring and enforcement mechanisms in place, the establishment of a new regulatory authority should lead to an increase in the quality of advice and the standard of service provided by claims managers. Malpractice of CMCs such as high-pressure selling and targeting of vulnerable groups of consumers should also be curbed.
- 5.5 As a result, consumer confidence in the claims management sector should rise. Access to justice should be enhanced, as those who have a valid compensation claim would now be more likely to seek and receive the full amount of redress. Outcomes for consumers and claims managers would also increasingly be more certain. In addition, the effective enforcement of rules and the introduction of a clear redress mechanism would protect consumers of claims management services from poor quality services and malpractice.
- 5.6 Restricting the provision of claims management services to those competent persons would ensure that good quality suppliers would not be driven out of the market by poor quality suppliers, maintaining the quality of claims management service offered and the range of choice of suppliers in the market. This should help to promote effective competition in the market and encourage innovations in the provision of claims management services, to the benefits of consumers.
- 5.7 A single regulator is likely to reduce regulatory inconsistencies in the claims management sector. This should lead to a greater accountability and transparency and increase regulatory certainty, raising consumer confidence in claims management services.

- 5.8 Moreover, the reduction of regulatory burden stemming from simplification of complying with existing regulations and the resulting increases in efficiencies could lower compliance costs for suppliers. This should also prevent suppliers from taking advantage of the existing regulatory inconsistencies, reducing the risk of regulations being weakened and consumer protection endangered.
- 5.9 The improvement in the quality of advice on claims-related issues and the prohibition of the aggressive practices in the claims management sector should reduce the frequency of vexatious or frivolous claims being made against businesses and local authorities. This would enable them to reduce the perception of 'compensation culture' and make more accurate risk assessments about their behaviour, potentially encouraging more innovation and higher economic growth.
- 5.10 The reduction in the frequency of vexatious or frivolous claims being made should also help in reducing the workload of courts and the cost to businesses and local authorities (including insurance premiums) in dealing with these claims, freeing resources which could be better spent elsewhere.

Costs

Administrative costs

- 5.11 Regulations via a new regulatory authority would incur substantial costs through the establishment and running of a new NDPB. The costs for the new regulatory authority are estimated with the assumption that the authority would regulate around 500 CMCs and receive approximately 550 complaints per year. These estimates were made using the set-up and operational costs, and the regulatory workload of the Office of the Immigration Services Commissioner (OISC), a non-departmental public body that regulates immigration advisors, as references. It is also assumed that the new authority would become operational by mid-2007. The estimates are,
- One-off set-up costs of £1.5 million
 - Staff costs of £2.4 - £2.6 million per annum (including 8 management, 40 caseworkers and 10 support staff)
 - Accommodation costs of £0.45 - £0.55 million per annum
 - Other running costs including ongoing IT, legal costs, and support services of £1.35 - £1.55 million per annum.

The total operational cost for regulations via a new regulatory authority is therefore estimated at **between £4,200,000 and £4,700,000 per annum** plus one-off set-up costs of **£1,500,000**.

- 5.12 If the operational cost of the new authority is supported entirely by license fees, then it is estimated that each of the 500 CMCs would have to pay around £8,400 - £9,400 per annum to obtain the license for providing claims management services. However, this fee may vary depending on the size of the CMC.

Policy costs

- 5.13 In addition to the license fees, the creation of the new regulatory authority would produce additional regulatory burdens on claims managers and CMCs, thus incurring additional compliance costs (both monetary and time) for existing and potential new suppliers, estimated to be between £0 - £10,000 per year per CMC depending on the existing level of standard of services they provide. These costs may be significant enough to make the business of some inefficient firms financially unviable, leading to their closure. Though

the regulatory impact on NfP organisations offering claims management services would be relatively minor, as they are expected to be exempted by the Authority.

- 5.14 Moreover, the additional compliance costs may result in existing suppliers transferring the costs to consumers in the form of higher prices. An unintended consequence of the additional costs may be a rise in entry cost sizeable enough to deter potential new entrants to the claims management sector, so stifling competition and reducing the incentives for existing suppliers to innovate.
- 5.15 A new regulatory authority that has to carry out all regulatory functions, including setting entry standards and training; establishing rules, standards of services and rules of conduct; monitoring and enforcement of rules; plus handling complaints would require the organisation to be of sufficient size to carry out its duties effectively. There is a substantial risk, though, with increasing workload after its creation and without sound management, the authority would become an overly bureaucratic and inefficient organisation, with consequent issues of costs and unwieldy procedure.
- 5.16 The creation of a new authority would also go against the Hampton Principles of inspection and enforcement, which states, amongst others, that '*regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work*'.¹⁸
- 5.17 The establishment of a new authority would in itself make it less likely for the information advantage of the claims profession for setting entry standards and training, formulating rules, monitoring compliance and enforcing the necessary codes of conduct to be utilised. As a result, the cost of obtaining the information necessary in performing regulatory functions would increase.
- 5.18 Moreover, without the expertise of the claims managers, there is an increased risk of the regulatory framework being set inappropriately, to the detriment of both consumers and the claims management sector. Furthermore, the lack of a role for the claims management sector in performing regulatory functions may lessen the sense of responsibility claims managers would have for the quality standards of the services they provide and this could lead to increased monitoring and enforcement costs.
- 5.19 As the new regulatory authority would be a brand new body, setting up the infrastructure and recruiting staff would take a substantial period of time. For example, it took 17 months for the OISC to be fully operational. More time would also be required for the new authority to acquire the necessary expertise and knowledge of the claims management sector to allow it to perform its regulatory functions properly.
- 5.20 The new regulatory authority would need to be established by primary legislation, and as such it would have little inherent flexibility in performing its regulatory functions effectively. As the claims management sector has already demonstrated in the recent past that it is a fast-changing sector, the need for primary legislation when making regulatory changes may create regulatory gaps in the sector. In particular, the length of time required to bring newly-emerged claims management services into its regulatory net may leave consumers of these new activities vulnerable to poor quality services and malpractice.

¹⁸ The Government Better Regulation portal [<http://www.betterregulation.gov.uk/index.asp>]

Option 3 – Statutory regulation via a front-line regulator (FLR), subject to the Secretary of State’s oversight

Benefits

- 5.21 The regulatory framework proposed by this option would be smaller, less bureaucratic and more efficient than the regulatory authority model, as day-to-day regulatory functions would be performed at the front-line regulator (FLR) level. As such it would have a greater ability to adjust flexibly to future changes in the claims management sector, and to make the appropriate regulatory response. This should aid the future development of the claims management market and ensure that claims managers can continue in their role of contributing effectively to widening access to justice. This framework would also be in line with the Hampton principles.
- 5.22 The designation criteria the Secretary of State would set for a prospective FLR before authorisation should ensure that the FLR would be competent to perform the day-to-day regulatory functions, thus making certain that quality of advice and service supplied by the CMCs would be of satisfactory standards. Malpractice of claims managers such as high-pressure selling and targeting of vulnerable groups of consumers should also be curbed.
- 5.23 The stipulation for the authorised FLR to have a satisfactory and transparent complaints handling mechanism in place would give a clear channel to consumers to seek redress against the poor services they received. By having a suitable compensation arrangement and by requiring its members to have indemnity insurance, it would also provide consumer protection against malpractice. Consequently consumer confidence in claims managers should rise, encouraging more people with a valid claim to make to use claims management services, enhancing access to justice.
- 5.24 The clear separation of regulatory and representative functions which the Secretary of State would require the FLR to have in place, would lead to greater accountability and transparency and increase regulatory certainty. The Secretary of State’s retention of the right to carry out regulatory functions directly, should the FLR fail, would give the body real authority and ensure that the designated FLR would regulate claims managers in ways that are in consumers’ interests. Quality of claims management services should also improve as a result. These factors should increase consumer confidence in the sector.
- 5.25 A regulatory framework that gives responsibility for the regulatory functions to the FLR with the arrangement for consistent oversight means that the specialist knowledge of the claims management industry body, the infrastructure and the staff it has already in place would be retained, if the body is to be designated as the FLR for claims management services. It would take less time for this regulatory framework for claims managers’ activities to be fully operational, ensuring that consumers are adequately protected soon after the proposals are implemented.
- 5.26 Leaving the day-to-day regulation functions as far as possible to the FLR would reduce the risk of regulations being set inappropriately, minimising the chance of unnecessary regulatory burden being imposed on suppliers. This would also be more likely to increase the commitment of suppliers to high standards, reducing the risk of rising monitoring and enforcement costs.
- 5.27 The establishment of a FLR for the claims management sector would remove the current regulatory inconsistencies in the claims management sector. This should lead to greater accountability and transparency and increase regulatory certainty, raising consumer

confidence in claims managers. Moreover, the resulting reduction of regulatory burden stemming from consolidation of existing regulations, and increases in efficiencies could lower compliance costs for suppliers.

- 5.28 The improvement in the quality of advice on claims-related issues and the prohibition of aggressive practices in the claims management sector should reduce the frequency of vexatious or frivolous claims being made against businesses and local authorities. This would reduce their perception of 'compensation culture' and thus enable them to have more accurate risk assessments before making their decisions, potentially encouraging more innovation and higher economic growth. This should help in reducing the workload of courts and the cost to businesses and local authorities (including insurance premiums) in dealing with these claims, freeing resources which could be better spent elsewhere, though the savings can only be monetised in the future.
- 5.29 Reserving the provision of claims management services to those competent persons would help ensure that good quality suppliers were not driven out of the market by poor quality suppliers and maintain the quality of claims management services offered and the range of suppliers in the market. Combined with the requirement of the FLR to promote the interests of consumers, this should help to promote effective competition in the sector and encourage innovations in the provision of claims management services.

Costs

Administrative costs

- 5.30 The operational and set-up costs for the FLR to perform day-to-day regulatory functions, subject to the Secretary of State's oversight, are estimated with the assumption that the authority would regulate around 500 CMCs and receive approximately 550 complaints per year. These estimates were extrapolated using cost data provided by the CSC. It is also assumed that the new regulatory framework would become operational by mid-2007. The estimates are,
- One-off set-up costs of £0.5 million
 - Staff costs of £1.0 - £1.3 million per annum (including 5 management, 30 caseworkers and 5 support staff)
 - Accommodation costs of £0.15 - £0.3 million per annum
 - Other running costs including ongoing IT, legal costs, and support services of £0.35 - £0.5 million per annum.

The total operational cost for regulations via a FLR, subject to the Secretary of State's oversight, is therefore estimated at **between £1,500,000 and £2,100,000 per annum** plus one-off set-up costs of **£500,000**.

- 5.31 If the operational cost is supported by licensing fees, then it is estimated that each of the 500 CMCs would have to pay around £3,000 - £4,200 per annum to obtain the license for providing claims management services. However, this fee may vary depending on the size of the CMC.

Policy costs

- 5.32 The requirement for claims managers and CMCs to comply with the regulations set by the FLR would create new regulatory burdens on the sector, and would lead to an increase in operating costs for existing and potential new suppliers, such as the annual licence fees for the CMCs (expected to be around £3,000 - £4,200 per annum). This may lead to the closure of some inefficient suppliers, or may result in deterring potential new entrants to the claims management sector.

- 5.33 However compared with the regulatory authority model, the regulatory model proposed in this option should be more efficient and flexible. The utilisation of knowledge on the claims management sector, infrastructure and staff of the existing body in performing the day-to-day regulatory functions should also ensure that the additional compliance costs incurred under this option would be lower than those for option 2 (estimated to be between £0 - £5,000 per year per CMC depending on the existing level of standard of services they provide). In addition, impact on NfP organisations offering claims management services is foreseen to be relatively small as they are expected to be considered when provisions about the exemption of persons or classes of persons are being made via secondary legislation.
- 5.34 Moreover, inefficient operators in the claims management sector tend to be those that handle many vexatious and/or frivolous claims made by consumers after being misled by these operators, in order to earn more income via referral fees from solicitors and selling of claims-related financial products. As such, their elimination from the market should benefit society as a whole, allowing the freeing of resources that could be better spent elsewhere.
- 5.35 Legal firms that handle compensation claims may find their volume of business reduced, as a result of the expected reduction in vexatious and/or frivolous claims being made by consumers. Although this cost cannot be monetised, it is expected to be substantially out-weighted by the benefits of reducing the number of vexatious and/or frivolous claims being made, in terms of reducing the workload of courts and the cost to other businesses in dealing with these claims.
- 5.36 Potentially, the FLR may utilise their knowledge of the current market conditions of the claims management sector via the day-to-day business of their members, to formulate rules that put the interests of the professions above those of consumers. However, the power the Secretary of State would have to 'call-in' rules and impose sanctions, with de-authorisation of a FLR as the last resort, would substantially reduce the incentive of the FLR to set rules in such a way that harm consumers, so reducing the likelihood of this scenario happening.
- 5.37 There is a possibility that there is no existing body either willing or fit enough to be authorised as the FLR for the claims management sector. As such, extra financing from the Government may be required to cover parts of the start-up costs. Extra time and resources may also be required to strengthen the infrastructure of the fledging FLR and to employ enough staff (5 management, 30 caseworkers and 5 support staff) with the required competence to perform the day-to-day regulatory functions.

6. Small Firms Impact Test

- 6.1 As discussed earlier, there is a risk that a regulatory authority that has to carry out all regulatory functions would produce additional regulatory burdens on the CMCs, thus incurring significant additional compliance costs for existing and potential new suppliers. In particular, these costs may fall disproportionately on small CMCs.
- 6.2 It is expected that the rules and regulations small CMCs have to comply with under the proposed oversight regulatory framework for claims management services (option 3) would generally be similar to those set out in the CSC's draft rules and codes. It is anticipated that there would not be any significant additional regulatory costs for small CMCs that operate to the standards specified in these rules and codes. However, additional regulatory costs would fall onto those small CMCs that are not currently operating to those types of standards. Moreover, if the Secretary of State decided to bring new types of claims management services into its regulatory net, then additional

regulatory burdens would fall on those small CMCs that provided such services. There is also a possibility that some small inefficient CMCs would be forced out of the claims management sector as they would be unable or unwilling to comply with the rules and regulations laid down by the new regulatory framework.

- 6.3 However, the proposed regulatory framework should reduce the frequency of vexatious or frivolous claims being made against small businesses, thus enabling them to make more accurate risk assessments before making their decisions. This should reduce the incidence of excessive risk-averse behaviour amongst small firms that were influenced by the fear of claims being made against them. The new framework should also lessen the perceptions of 'compensation culture' that has been discouraging small businesses from innovating and expanding.
- 6.4 The Federation of Small Businesses (FSB) has expressed strong support for the Government's proposal. The Federation sees small businesses as consumers of claims management services as well as suppliers, and welcomes the proposed regulatory framework for the claims management sector that is designed to enhance the provision of quality services, to enhance consumer protection and to provide consumers with a clear route to redress. It also believes that the new framework would lessen the perceptions of 'compensation culture' amongst small businesses, allowing them to make more accurate risk assessments before any business decisions, potentially contributing to higher economic growth.
- 6.5 DCA officials have held discussions with three firms in the claims management sector to seek their views on the proposal. They all welcome the introduction of statutory regulation of claims management service and do not believe that the proposal will have a significant impact on their businesses. They believe that the level of impact will very much be linked to the standards already operated by the individual firms, and expect those firms that operate to a poor standard currently will be affected more than those that operate to a good standard. Their experiences show that the steps needed to be taken to improve the standard of services are not significant.
- 6.6 Overall the firms consulted see the benefits of regulation of claims management services as: driving out bad practices safeguarding consumer interests; a level playing field of regulation across the claims management sector; and quality standard for the sector; enabling good business to compete on better terms with solicitors and other providers of claims management services. There is general acceptance that there will be a regulatory cost and that the firms consulted demonstrate a willingness to pay that cost as long as it is reasonable and proportionate and is related to the size and or turnover of the company. Finally, there is support for regulation via the front-line regulator with appropriate oversight approach, rather than the regulatory authority approach.

7. Competition Assessment

- 7.1 The Department for Constitutional Affairs has completed the competition filter test and, based on the following findings, concluded that a simple competition assessment is required.
- 7.2 The market for claims management services is served by CMCs, lawyers and insurers, amongst others. Overall the market appears to be far from concentrated. The largest firm in the market by the number of claims handled, InjuryLawyers4U, operated by a consortium of solicitors, was estimated by Datamonitor to have a market share of around 7.2% (36,000 claims) in 2004. In the same year, the largest three firms in the market by

the number of claims handled were estimated to have a combined market share of around 18.7% (93,300 claims).¹⁹

- 7.3 It is expected that the rules and regulations small CMCs have to comply with under the proposed oversight regulatory framework for claims management services (option 3) would generally be *similar* to those set out in the CSC's proposed rules and codes. It is anticipated that there would not be any significant additional regulatory costs for small CMCs that operate to the standards specified in these rules and codes. However, additional regulatory costs would fall onto those small CMCs that are not currently operating to those types of standards. Moreover, if the Secretary of State decided to bring new types of claims management services into its regulatory net, then additional regulatory burdens would fall on those small CMCs that provided such services. There is also a possibility that some small inefficient CMCs would be forced out of the claims management sector as they would be unable or unwilling to comply with the rules and regulations laid down by the new regulatory framework.
- 7.4 The reservation of the provision of claims management services to those authorised by the designated FLR may have an effect on the number or size of CMCs operating in the claims management sector. Some existing CMCs may not be authorised by FLR due to their inability to act in accordance with the standards set, consequently these CMCs would be forced to leave the claims management sector. It is also possible that some authorised CMCs may join forces to share some of the additional regulatory costs.
- 7.5 As current CMCs would have to be subject to similar sets of rules and regulations set by the FLR as potential new CMCs, it is not foreseen that new entrants would have to meet higher set-up or on-going regulatory costs. The claims management sector is also traditionally not characterised by rapid technological change.
- 7.6 It is not anticipated that the new regulatory framework would restrict the ability of CMCs to choose the price, quality or location of their services. However, the range of services these firms wish to provide may be affected by the fact that the new services they want to offer may be brought by the Secretary of State into the regulatory net, thus requiring the FLR's approval in order to provide those services.

8. Enforcement, sanctions and monitoring

- 8.1 As discussed earlier, currently only non-legal statutory bodies such as the ASA and the FSA regulate some activities of the claims management companies, including advertising and selling of insurance and credit loans, and handle complaints made against these activities. Also the CSC acts as a voluntary regulatory body for claims management services. It aims to set out codes of conduct for handling claims, monitor the behaviour of its members and enforce the rules, and provide a platform for dealing with complaints and disciplinary matters. However, other CMC activities, including advisory services, are unregulated and can be provided by anyone who wishes to do so. There is also a lack of complaint handling mechanism for these services.
- 8.2 In the regulatory authority model, the authority would exercise full regulatory control over all claims management services. Amongst other functions, it would enforce the rules and codes governing service provision, all enforcement, exercise investigative, enforcement and disciplinary powers, and handle consumer complaints.
- 8.3 In the oversight model, all regulatory power would be vested in the Secretary of State, with the day-to-day enforcement, monitoring and sanctioning functions being delegated to the FLR, subject to it satisfying the Secretary of State with regard to their competence

¹⁹ Datamonitor, (November 2004), *op. cit.*

and governance arrangements. The Secretary of State would be able to impose a sliding scale of sanctions on the FLR, including de-authorisation, if it is found to have violated the authorisation to regulate.

- 8.4 Once authorised, the FLR would have powers to investigate any apparent breaches of rules or codes of conduct and to impose sanctions upon authorised persons who fall below minimum standards of competence or fail to comply with rules/codes of conduct. Authorised persons would be required to co-operate with any investigation, and the FLR would be allowed to impose penalties including the imposition of conditions upon authorisation, and suspension or revocation of authorisation, in the event of a failure to co-operate, or an attempt to obstruct the investigation.
- 8.5 The authorised FLR would also have the power to require the production of documents and to enter premises if the authorised person had failed to comply in a reasonable period with a request for documents, information or other material that it considered relevant to an investigation.

9. Compensatory simplification measures

- 9.1 The introduction of the new regulatory framework for the claims management sector would mean that CMCs would now only have to conform to a single set of consumer codes set by the FLR, as these codes would be compliant with the range of consumer legislation that currently concerns claims management activities. This would reduce the administrative burden the CMCs currently face when dealing with a number of enforcement agencies, including OFT, FSA, DTI, ASA and local trading standard authorities, in ensuring that their services comply with the various regulations set by these agencies. This would also conform to the Hampton Principles of inspection and enforcement. The new framework would also introduce a clear route to redress for consumers. These measures would enhance protection for consumers of claims management services. The proposal would also remove the regulatory inconsistencies that exist in the sector at the moment.
- 9.2 Moreover, the proposed regulatory framework for the claims management sector is designed in line with the new regulatory structure proposed in the White Paper for reforming the regulatory framework of legal services. As such, it is envisaged that the transfer of regulatory arrangement for claims management services to the new structure would be carried out in a straightforward manner.
- 9.3 In addition, the existing regulatory arrangements for CFAs are due to be simplified. From 1 November 2005 the existing CFA and Collective Conditional Fee Agreement regulations will be revoked. The Government will rely instead on the existing primary legislation²⁰ to provide the minimum government legislative framework for the use of CFAs by legal representatives and professional regulation to provide the practical governance of the use of CFAs.²¹ The CFA simplification would enhance the benefits of CFAs for consumers and would be a major step towards removing unnecessary regulations. This is supported by the BRTF in its May 2004 report *Better Routes to Redress*,²² and is consistent with the recommendations made by BRTF in its March 2005 report *Regulations – Less is More*²³ and the Hampton principles.

²⁰ via the primary provisions brought in by section 27 of the Access to Justice 1999

²¹ Department for Constitutional Affairs, 2005, *New Regulation for Conditional Fee Agreements (CFAs) – Response to Consultation* [<http://www.dca.gov.uk/consult/confees/cfa100805-part1.pdf>]

²² Better Regulation Task Force, 2004, *op. cit.*

²³ Better Regulation Task Force, 2005, *Regulation - Less is More. Reducing Burdens, Improving Outcomes* [<http://www.brta.gov.uk/reports/lessismoreentry.asp>]

10. Implementation and delivery plan

- 10.1 Subject to approval of Parliament, it is anticipated that the Bill will receive Royal Assent in 2006. Secondary legislation will be required to make provisions for the designation of a FLR (if applicable), for designating those claims management services which will initially fall within the scope of regulation, for the exemption of specified persons or specified classes of person, and for connected purposes. This legislation will be developed in parallel with the Bill's passage through Parliament. Further Regulatory Impact Assessments and consultation may take place before the statutory instruments are finalised. It is anticipated that the secondary legislation will be brought into force and a front line regulator designated by the end of 2006.
- 10.2 It is proposed that there will be a transitional period during which the front line regulator can submit rules to the Secretary of State for approval and begin the registration of CMCs.

11. Post-implementation review

- 11.1 A number of periodic reviews have been built into the proposals. To ensure that consumers would continually be protected as new types of claims management activities emerge, the Secretary of State would have the power to bring these activities into, or be taken out of, the scope of its regulatory reach by secondary legislation. The Secretary of State would also be statutorily required to consult regularly the OFT and other advisory groups on regulatory decisions.
- 11.2 It is envisaged that a review of the regulations of claims management services will be carried out before the oversight powers are transferred from the Secretary of State to an independent oversight body. It is expected that this will take place once the proposed legal services reforms are introduced. Adjustments will be made if required via secondary legislation, to allow regulation of claims management services to be fully integrated into the new regulatory framework for legal services.

12. Summary and recommendation

Summary of benefits and costs

- 12.1 The table below summarises the estimated operational and one-off set-up costs of the options considered in this proposal.

Costs	Option 1	Option 2	Option 3
<i>A. Per annum costs (£)</i>			
Staff	Nil	2,400,000 – 2,600,000	1,000,000 – 1,300,000
Accommodation	Nil	450,000 – 550,000	150,000 – 300,000
Other	Nil	1,350,000 – 1,550,000	350,000 – 500,000
Indicative licence fee per CMC	Nil	8,400 – 9,400	3,000 – 4,200
Other compliance costs for business	Nil	0 - 2,500,000	0 - 1,250,000
<i>B. One-off costs (£)</i>			
Set-up	Nil	1,500,000	500,000

12.2 The table below summarises the expected additional benefits and costs of the options considered for regulating claims management activities.

	Benefits	Costs
Option 1 - Do nothing	None.	None.
Option 2 – Statutory regulation via a new regulatory authority	<ul style="list-style-type: none"> i. Increase quality of advice and standard of services provided by claims managers. ii. More certain outcome for consumers and claims managers, enhancing access to justice and increasing consumer confidence in the sector. iii. Reduce regulatory inconsistencies in the claims management sector. iv. Reduce vexatious or frivolous claims being made against businesses and local authorities, enabling more accurate risk assessments. v. Reduce workload of courts and the cost to businesses and local authorities in dealing with frivolous claims. vi. Help to promote effective competition in the sector and encourage innovations in the provision of claims management services. 	<ul style="list-style-type: none"> i. Substantially higher set-up and operational costs incurred by the authority compared to option 3 (£1M extra in set-up costs; £2.1M - £3.2M extra per year in operational costs). ii. Risk of adding sizeable regulatory burdens on CMCs (£2.5M per year), potentially being passed onto consumers. Burdens may be large enough to deter new entrants. iii. Potential for authority to be overly bureaucratic and inefficient, which goes against the Hampton principles. iv. May lead to the closure of some inefficient suppliers, though their elimination from the market should reduce the number of vexatious and/or frivolous claims being made. v. Potential delays in making the authority fully operational and inherent inflexibility leave consumers to remain unprotected. vi. As information advantage of the claims profession for regulation would not be utilised in this model, monitoring and enforcement costs for the authority may increase, since some existing regulatory expertise would be lost.
Option 3 – Statutory regulation via a front-line regulator (FLR), subject to the Secretary of State’s oversight	<p>Similar expected benefits as in the authority model (option 2).</p> <p>In addition, compared to option 2:</p> <ul style="list-style-type: none"> i. Lower set-up (£1M) and operational costs (£2.1M - £3.2M less per year) incurred, plus lower estimated license fees for CMCs (£4,200 - £6,400 less per year). ii. Smaller, less bureaucratic 	<ul style="list-style-type: none"> i. Risk of adding regulatory burdens on CMCs, such as new licence fees and other compliance costs (circa. £1.25M per year), though this is smaller compared to option 2. ii. May lead to the closure of some inefficient suppliers, though their elimination from the market should reduce the number of vexatious and/or frivolous claims being made. iii. Risk of the claims management

	<p>and more efficient than the regulatory authority model, as day-to-day regulatory functions would be performed at the FLR level, consistent with Hampton principles.</p> <p>iii. Provide a clear channel to consumers to seek redress against the poor services they received.</p> <p>iv. Regulatory expertise more likely to be retained, as the specialist knowledge of the claims management industry body, the infrastructure and the staff of the existing body would be utilised. This would reduce risk of regulations being set inappropriately.</p> <p>v. Take less time for this regulatory framework for claims managers' activities to be fully operational.</p>	<p>sector formulating regulations that put the sectors' interests above those of consumers. Risk minimised by the Secretary of State's power to remove the regulatory power from the failing FLR and bring it under his direct control.</p> <p>iv. Possibility that extra financing from the Government would be required to cover parts of the start-up costs (circa. £1M). Extra time and resources may also be required to strengthen the infrastructure of the fledging FLR and to employ enough staff (5 management, 30 caseworkers and 5 support staff) with the required competence to perform the day-to-day regulatory functions.</p>
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Conclusion

- 12.3 This proposal intends to provide better safeguards for consumers of claims management services and to offer them with a clear route to redress. It aims to build consumer confidence and promote effective competition within the claims management sector. It also intends to improve the effectiveness and efficiency of the system for those who have a genuine claim to compensation, and to tackle practices that have helped to spread the misperceptions and false expectations of compensation claims amongst consumers.
- 12.4 Continuing with the existing arrangements (Option 1 – 'do nothing') will mean that consumers of claims management services will remain unprotected against poor sales practices such as aggressive advertising, high-pressure selling tactics and mis-selling of CFAs, as demonstrated by evidence produced by Citizens Advice in its report *No win, no fee, no chance*, and by Better Regulation Task Force in its report *Better Routes to Redress*. Claims managers would continue to be in the position to provide poor quality services and misleading advice to their customers. Vulnerable groups of consumers would continue to be targeted by unscrupulous CMCs. A complaint handling mechanism will remain absent for consumers to lodge a complaint. In addition, the harm done to consumers is expected to increase if claims management activities remain unregulated. This is because CMCs tend to move swiftly into other areas of claims management activities by targeting areas where potential claims can be made.
- 12.5 Consumers of claims management services will be protected against malpractice if the provision of such services is statutorily regulated. Regulation of claims management services will lead to an increase in the quality of advice and standard of services provided by claims managers. A clear route to redress will also be available to consumers. Outcome for consumers and claims managers will also be more certain, enhancing access to justice and increasing consumer confidence in the sector. Vexatious or frivolous claims being made against businesses and local authorities will also be reduced, as consumers will be less likely to be advised to lodge such claims by

quality claims managers, enabling more accurate risk assessments for business. Workload of courts and the cost to businesses and local authorities in dealing with frivolous claims will also be lowered. Regulatory inconsistencies in the claims management sector will be reduced, which will help to promote effective competition in the sector and encourage innovations in the provision of claims management services.

- 12.6 However, statutory regulation via a new regulatory authority (Option 2) will not be the best option. It will incur substantial set-up and operational costs incurred by the authority. It will have the potential to be overly bureaucratic and inefficient, and will risk adding sizeable regulatory burdens on CMCs, potentially being passed onto consumers. Furthermore, this option will not be in line with the Hampton principles. The potential for substantial delays in making the authority fully operational and the inherent inflexibility of the authority will risk leaving consumers to remain unprotected against malpractice.
- 12.7 Therefore, the Government favours statutory regulation via a front-line regulator (FLR), subject to the Secretary of State's oversight (Option 3). It is estimated that the set-up and operational costs incurred by this system will be lower (by £1 million and £2.1 - £3.2 million respectively). As the day-to-day regulatory functions will be performed at the FLR level, this system will be smaller, less bureaucratic and more efficient, consistent with the Hampton principles. The regulatory burden for CMCs will be less compared to option 2. License fees for CMCs under this option are estimated to be between £4,200 - £6,400 lower per year and aggregate compliance cost for business is estimated to be around £1.25 million less per year. The risk of regulations being set inappropriately will also be reduced. It will also take a shorter period of time for this regulatory framework for claims managers' activities to be fully operational, ensuring that consumers will be protected without delay.

13. Declaration and publication

13.1 I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed:

**Baroness Ashton of Upholland
Parliamentary Under Secretary of State
Department for Constitutional Affairs**

Date:

19 October 2005

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