

<b>Title:</b> Recovering the costs the Lord Chancellor will incur in meeting the costs of the Legal Ombudsman, dealing with complaints about claims management companies, from the authorised claims industry.  <b>IA No:</b>  <b>Lead department or agency:</b> Ministry of Justice  <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>			
	<b>Date:</b> 02/07/2014			
	<b>Stage:</b> Final			
	<b>Source of intervention:</b> Domestic			
	<b>Type of measure:</b> Secondary legislation			
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<b>Summary: Intervention and Options</b>	<b>RPC Opinion:</b> Awaiting Scrutiny
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Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
£0.9m	£19m	£1.7m	Yes   IN

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

The problem under consideration is how the Lord Chancellor's new fee raising power under the Financial Services (Banking Reform) Act 2013 should be exercised in relation to regulated claims management companies (CMCs), to recover the costs the Lord Chancellor incurs in relation to the Legal Ombudsman (LeO) dealing with complaints about the regulated claims industry. Intervention is required to ensure that the relevant costs arising from poor services and complaints handling by CMCs do not have to be met by the taxpayer.

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

The policy objective is to ensure that the costs incurred by the Lord Chancellor in relation to the Legal Ombudsman expenditure in dealing with CMCs are recovered from regulated CMCs in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller CMCs.

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

Option 0: An individual case fee for complaints and outstanding costs fall to the Ministry of Justice (Do nothing)

Option 1: An annual fee, based on a sliding scale linked to turnover, to be paid by all regulated claims management companies. The individual case fee will also be maintained.

Option 1 is the preferred option. Recovering the costs the Lord Chancellor incurs, in relation to the Legal Ombudsman dealing with complaints about CMCs, through a sliding scale of fees based on turnover, ensures that fees are not overly burdensome on smaller CMCs, allows a reasonable apportionment of the total costs across regulated CMCs and means that regulated CMCs are treated equitably with regulated legal services providers.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 04/2018					
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> No	<b>Small</b> Yes	<b>Medium</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>	
				<b>Non-traded:</b>	

***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 Minister: \_\_\_\_\_ Date: \_\_\_\_\_

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** An annual fee, based on a sliding scale linked to turnover, to be paid by all claims management companies.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: NQ	High: NQ	Best Estimate: -£0.9m

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A	NQ	NQ
High	N/A	NQ	NQ
Best Estimate	N/A	£2.2m	£19m

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

Claims management companies would meet the Lord Chancellor's outstanding costs, incurred in relation to the Legal Ombudsman's dealing with complaints about claims management companies. This would result in additional costs of £2.3m a year for the regulated claims management industry (over the first three years, then around £2.0m per year afterwards). Claims management companies would incur annual familiarisation costs of around £100,000.

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

The Ministry of Justice will incur some additional administrative costs in processing invoices relating to the Lord Chancellor's cost recovery fee. These costs are likely to be minimal as the intention is to align the collection of the Lord Chancellor's cost recovery fee with the collection of the Claims Management Regulator's annual regulation fee.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A	NQ	NQ
High	N/A	NQ	NQ
Best Estimate	N/A	£2.1m	£18.1m

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

The Ministry of Justice will benefit from not meeting the Legal Ombudsman's cost in relation to dealing with complaints about claims management companies. This will provide annual savings of £2.3m (over the first three years, then around £2.0m per year afterwards). Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving.

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

The regulated claims management sector and the regulated legal sector will be treated equitably, in the respect that the regulated legal sector meets the Legal Ombudsman's costs incurred in dealing with complaints about regulated legal services providers.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

It has been assumed that the Legal Ombudsman will receive approx 8,000 contacts resulting in approx 3,000 ombudsman cases, and that case volumes and case outcomes will not be affected by the reforms, which relate narrowly to cost recovery. This impact assessment assumes that all claims management companies are compliant businesses.

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OITO?	Measure qualifies as
Costs: £1.7	Yes	IN
Benefits: NQ		
Net: -£1.7		

# Evidence Base (for summary sheets)

## 1. Introduction

### **The Legal Services Act 2007: The Office for Legal Complaints and the Legal Ombudsman**

- 1.1. The Legal Services Act 2007 established a new, independent complaints handling body for legal services in England and Wales, the Office for Legal Complaints. The Office for Legal Complaints, in turn, established an ombudsman scheme, 'the Legal Ombudsman', which became operational in October 2010. The Legal Ombudsman is the single point of contact for consumers wishing to complain about the service provided by authorised legal professionals such as solicitors, barristers and legal executives.
- 1.2. The Legal Ombudsman is funded through a combination of a levy on the approved regulators of the legal profession and fees (predominantly case fees which are charged by the Legal Ombudsman directly to respondent firms against whom there is a complaint). The majority of the Legal Ombudsman's costs are paid for by the levy. The Legal Ombudsman's total operating expenditure for 2013/14 was around £15.7m.

### **The Claims Management Regulator**

- 1.3. The Secretary of State for Justice exercises the function of the Claims Management Regulator under the provisions of the Compensation Act 2006. The Claims Management Regulation Unit (CMRU) within the Ministry of Justice has been responsible for directly regulating the activities of businesses providing claims management services since April 2007. Regulation covers six claims sectors: personal injury, financial products/services, criminal injuries, industrial injuries, employment and housing disrepair. There are currently around 2,000 regulated claims management companies.

### **The Legal Ombudsman and claims management complaints**

- 1.4. Section 161 of the Legal Services Act 2007, which has not yet been commenced, makes provision for the Legal Ombudsman's remit to be extended to include complaints about authorised claims management companies. Such companies are regulated by the Claims Management Regulation Unit in the Ministry of Justice.
- 1.5. The Legal Ombudsman will provide a new avenue of redress for clients of claims management companies and will assist the Claims Management Regulator in driving out poor standards and practices in the market. The Legal Ombudsman has a wider remit than the Claims Management Regulator in the types of complaints it can consider and a greater range of redress powers. The intention is to provide better protection for consumers against poor service received from regulated claims management companies, including the potential for awards of compensation which are not currently available.
- 1.6. In August 2012 the Government announced its intention to commence section 161 of the Legal Services Act 2007 to enable customers' complaints about poor service provided by regulated claims management companies to be dealt with by the Legal Ombudsman. This was expected to be achieved through simple Commencement Order.
- 1.7. However, implementation of this policy was delayed due to difficulties presented by some of the features of the mechanism for funding it in the 2007 Act. In particular the independent complaint resolution service provided by the Legal Ombudsman is free to consumers, with the costs incurred met by the legal profession via a levy imposed on the Regulators of the sector. However, legally it is the Secretary of State that carries out the function of the Claims Management Regulator, hence the levy provided for in the 2007 Act could not be imposed.
- 1.8. An alternative process was developed whereby the Lord Chancellor will meet the Legal Ombudsman's costs, through an existing grant in aid power, and then recover those costs from

regulated claims management companies. The necessary legislation was put in place in the form of clauses in the Financial Services (Banking Reform) Act 2013. This amended the 2007 Act to provide the Lord Chancellor with a new fee raising power to recover the costs he incurs (in meeting the expenditure of the Legal Ombudsman in dealing with complaints about regulated claims management companies) from regulated claims management companies. This fee raising power is therefore a cost recovery measure for the Lord Chancellor and is separate from the Claims Management Regulator's regulatory fees and activities.

### **The extent of cost recovery – total costs to be recovered**

- 1.9. From an analysis of the Claims Management Regulator's current complaints data, and taking into account the Legal Ombudsman's broader remit to consider general complaints about the service customers receive, its retrospective jurisdiction enabling it to consider complaints that occurred since October 2010 and its wider powers of redress, including awards of compensation, the Legal Ombudsman estimates that in a full year it would expect to receive in the region of around 3,000 cases about claims management companies. This refers to complaints which require investigation, as opposed to initial contacts with the Legal Ombudsman, of which there are expected to be many more. A volume of 3,000 cases per year would generate running costs for the Legal Ombudsman of approximately £2.9m<sup>1</sup> per year.
- 1.10. In preparation for taking complaints about claims management companies, the Legal Ombudsman will also incur set up costs, which will consist of recruitment, training, marketing, IT and other costs. The Legal Ombudsman estimates that set up costs will be in the region of £0.8m. It is intended that these set up costs be charged back to regulated claims management companies over the course of three years, divided into approximately a third per year.

### **The extent of cost recovery – income required from the new fee**

- 1.11. Under the Legal Services Act 2007, the Legal Ombudsman can already charge a case fee for each case it considers against a respondent business. The proposed new fee therefore needs to cover the shortfall between the Legal Ombudsman's costs of dealing with claims management company complaints (as detailed above) and the fee income from case fees which already exist in law.
- 1.12. Case fees are paid directly to the Legal Ombudsman on closure of a case by the respondent business. This cost falls on non-compliant business. Rather than cover the total costs of dealing with complaints, the case fee is instead intended to encourage good in-house complaints handling within businesses. In certain circumstances the case fee is waived. The 2007 Act requires the case fee to be waived (or refunded) if a complaint is resolved in favour of the respondent business and if the Legal Ombudsman is satisfied that the respondent took all reasonable steps to try and resolve the complaint under their in-house complaint procedure. Under the Legal Ombudsman's scheme rules, the case fee is also waived if a case turns out not to be within the Legal Ombudsman's jurisdiction, or if the case is dismissed or discontinued under the Legal Ombudsman's scheme rules, for example because the complaint is vexatious. The case fee can also be waived if the complaint is withdrawn or abandoned by the complainant during the course of the investigation. When setting the case fee the Legal Ombudsman considers it important that its mere presence does not unduly encourage lawyers or claims management companies to settle complaints, even those without merit, in order to avoid the risk of incurring a case fee. Currently, the Legal Ombudsman's case fee is £400. The Legal Ombudsman estimates that 70% of complaints about claims management companies will attract a case fee. Therefore, based on an assumption of around 3,000 claims management complaints cases per year and an assumption that the Legal Ombudsman will charge a case fee in 70% of cases, the Legal Ombudsman will therefore receive case fee income in the region of £0.8m per year.
- 1.13. Over the first three years the annual cost to the Legal Ombudsman of dealing with claims management company complaints equates to the relevant annual operating costs (of around £2.9m) plus one third of the initial implementation costs, i.e. a total of around £3.2m. If around

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<sup>1</sup> All Legal Ombudsman cost figures have been rounded to the nearest £0.1m. Cost figures are calculated using unrounded numbers so may not sum using the rounded figure in the text.

£0.8m case fee income is generated by the Legal Ombudsman's case fees then the new Lord Chancellor's fee needs to generate around £2.3m in order for the Legal Ombudsman's costs to be recovered. (figures have been rounded).

## 2. Rationale and objectives

- 1.14. The policy objective is to ensure that the costs incurred by the Lord Chancellor in relation to the Legal Ombudsman dealing with claims management company complaints are recovered from regulated claims management companies in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller claims management companies. The objective is to secure full cost recovery from regulated claims management companies to cover the Legal Ombudsman's costs. Without full cost recovery some of these costs would be met by the taxpayer.
- 1.15. Intervention via secondary legislation is required to meet this objective in order to implement the Lord Chancellor's new fee raising power (provided in the Financial Services (Banking Reform) Act 2013), to be used in addition to the current case fees which the Legal Ombudsman can charge and are already provided for under the Legal Services Act 2007.
- 1.16. The problem under consideration is how the Lord Chancellor's new fee raising power under the Financial Services (Banking Reform) Act 2013 should be exercised in relation to regulated claims management companies. The Legal Ombudsman already has the power to charge case fees, and the proposals do not encompass any changes to the way case fees are currently applied.
- 1.17. This Impact Assessment covers the specific issue of how the Legal Ombudsman's costs should be apportioned across regulated claims management companies, in particular (over the first three years) the total outstanding annual cost of around £2.3m which remains after the Legal Ombudsman's case fee income is taken into account.

## Options

### **Option 0: An individual case fee for complaints (outstanding costs fall to Ministry of Justice)**

- 1.18. In the base case the Legal Ombudsman would charge a complaint handling fee, although this could be waived in some circumstances (see paragraph 1.12). The complaint fee would raise around £0.8m per annum which would leave a shortfall of around £2.3 in the first three years and £2m in subsequent years. The Legal Ombudsman's case fees must already be applied under the 2007 Act, therefore are included in the base case of this impact assessment. The Lord Chancellor would need to meet the outstanding costs relating to the Legal Ombudsman dealing with claims management complaints.
- 1.19. This position would go against the original intention of the Legal Services Act 2007, notably that businesses should meet the costs of the Legal Ombudsman, as the need for the Legal Ombudsman to deal with complaints derives from the existence of poor services from businesses and their poor in-house practices in dealing with consumer complaints. Option 0 would also involve treating regulated claims management companies differently from the regulated legal services providers, which already fall under the Legal Ombudsman's remit. The costs the Legal Ombudsman incurs in dealing with legal services complaints are met by a levy on the 'approved regulators' of legal services (such as the Law Society); these approved regulators in turn recover those costs from the legal firms and professionals they regulate.

### **Option 1: An annual fee, based on a sliding scale linked to turnover, to be paid by all regulated claims management companies.**

- 1.20. Under this option an individual case fee for complaints against claims management companies would be charged although this will not achieve full cost recovery for the Legal Ombudsman. The Lord Chancellor would recover the outstanding costs incurred in meeting the Legal Ombudsman's

operating costs in relation to dealing with complaints about claims management companies, through imposing the fees provided for in section 140 of the Financial Services (Banking Reform) Act 2013 (which amends the Legal Services Act 2007). The new fees would be imposed on a sliding scale, based on business turnover in relation to regulated claims management activities. The new fees would complement the Legal Ombudsman's case fees which must already be applied under the 2007 Act.

## **Other options considered**

- 1.21. Instead of introducing secondary legislation to provide for a new type of fee, the possibility of expanding the Legal Ombudsman's case fees which can already be applied under the 2007 Act was considered.
- 1.22. Under a pure 'polluter pays' basis, claims management companies would be charged per complaint against them and in no circumstances would the complaint fee be waived. Such an approach was considered not to be feasible as the cost per complaint would place a disproportionate burden on smaller claims management companies. This is because, in addition to the cost of investigating the complaint, the cost per complaint fee would need to cover the Legal Ombudsman's relevant wider costs. These wider costs include staffing and infrastructure, (incurred regardless of the number of complaints received), the costs the Legal Ombudsman incurs in responding to general consumer contacts and complaints that are abandoned prior to resolution and the wider work undertaken by the Legal Ombudsman which extends beyond complaint handling, such as providing consumer information services, working with consumer groups and stakeholders, engagement with the industry as a whole, data publication and sharing intelligence with the Claims Management Regulator. On a pure 'polluter pays' basis, an estimate of the fee charged per complaint would be around £1,100. Currently around 40% of the industry comprises claims management companies with an annual turnover of less than £25,000. A fee of £1,100 per complaint was considered to be disproportionate.
- 1.23. Similarly, recouping the costs through a flat fee (essentially dividing the total cost equally among the number of regulated claims management companies) would have a disproportionate effect on smaller entities. An estimate of a flat fee charged to all regulated claims management companies would be around £1,200.

## **2. Costs and Benefits**

- 1.24. This Impact Assessment identifies, where possible, the monetised and non-monetised costs and benefits for individuals, groups and businesses in the UK. The scope of this Impact Assessment is restricted to the Lord Chancellor's new fee framework in relation to recovering the Legal Ombudsman's costs. The costs and benefits to consumers and businesses of the wider policy (related to extending the Legal Ombudsman's jurisdiction) and of the application of the Legal Ombudsman's existing case fee powers have not been considered as the policy has already been adopted in legislation.

## **Assumptions**

- 1.25. The following key data and assumptions have been made in order to monetise the impacts of the reforms:
  - To assess the financial impact on businesses we use the ASHE 2013 data on the average wage of "business, finance and related associate professionals" (£20.41 per hour), with an additional 30% added to account for overheads. Including the 30% uplift for overheads it is £26.53.
  - Data from the Claims Management Regulation Unit shows that there were around 9000 complaints between April 2013 and March 2014. However the data does not provide information on the outcome of the complaint, further the way complaints are handled by the Legal Ombudsman will inevitable differ from that of the Claims Management Regulation

Unit. Therefore we are unable to assess the number of non-compliant businesses. As such, we make the assumption that all claims management companies are compliant businesses. Therefore the total costs to claims management companies in this impact assessment falls on compliant business. In practice some companies will be non-compliant as they will have complaints upheld against them, however we are unable to assess the proportion of non-compliant business hence the EANCB figure will be higher than may otherwise be the case.

## **Option 0: An individual case fee for complaints (outstanding costs fall to Ministry of Justice)**

### **Description**

1.26. Under this option the Legal Ombudsman would charge a complaint handling fee, although this could be waived in some circumstances (see paragraph 1.12). The complaint fee would be paid by claims management companies and would raise around £0.8m per annum. This would leave a shortfall of around £2.3 in the first three years and £2m in subsequent years. The Lord Chancellor would need to meet the outstanding costs relating to the Legal Ombudsman dealing with claims management complaints. This option would result in no additional costs for the regulated claims management industry.

## **Option 1: An annual fee, based on a sliding scale linked to turnover, to be paid by all claims management companies.**

### **Description**

1.27. The Lord Chancellor would recover the Legal Ombudsman's outstanding costs in relation to dealing with claims management complaints by imposing annual fees on regulated claims management companies in order to recover those outstanding costs fully. These costs are based on the Legal Ombudsman's current expectations about complaints volumes, costs and case fee income and the claims management market. As explained above they have been estimated at around £2.3m over the first three years. These costs would be recovered from the authorised claims management companies by the Lord Chancellor through the imposition of fees, usually collected on an annual basis.

1.28. The costs would be apportioned across the industry in a sliding scale of fees, based on claims management companies' turnover in relation to relevant regulated activities. Turnover appears to be the most appropriate basis for charging the fee for claims management companies. It would ensure that disproportionate cost did not fall on smaller businesses, which may result in a number of businesses leaving the market and negatively impact on competition. Turnover is also the method with which the regulated claims management companies are familiar, as their existing annual regulation fee is based on turnover. Details of the fee structure are provided at Annex A.

### **Costs of Option 1**

#### **Costs to claims management companies**

1.29. Claims management companies would then meet the Lord Chancellor's outstanding costs, incurred in relation to the Legal Ombudsman dealing with complaints about claims management companies, via an annual fee based on annual turnover. This would result in additional costs of around £2.3m a year for the regulated claims management industry in the first three years, and around £2.0m per year after the first three years. This cost falls on compliant business. Annex A outlines the proposed fee schedule.

1.30. Claims management companies may also face additional administrative costs in complying and processing the payment of the complaints handling fee. These costs are likely to be minimal as the intention is to align the collection of the Lord Chancellor's cost recovery fee with the collection of the Claims Management Regulator's annual regulation fee and claims management companies are already required to provide their turnover figures to the Claims Management Regulator. We estimate that claims management companies may have to spend around 2 hours a year familiarising themselves with annual changing of the charge level based on turnover. Applying the £26.53 hourly wage rate, set out in the assumptions above, to around 2000 claims management companies this generates costs of around £100,000.

1.31. The total cost for claims management companies will be £2.4m in the first three years and £2.1m per year thereafter.

### ***Costs to the Ministry of Justice***

1.32. Under Option 1 there are also some additional administrative burdens for the Ministry of Justice to process invoices in relation to the Lord Chancellor's cost recovery fee. These costs are likely to be minimal as the intention is to align the collection of the Lord Chancellor's cost recovery fee with the collection of the Claims Management Regulator's annual regulation fee. This cost has not been monetised.

### **Benefits of Option 1**

#### ***Benefits to Ministry of Justice***

1.33. The Ministry of Justice will benefit from not having to meet the Legal Ombudsman's cost in relation to dealing with complaints about claims management companies. This will provide annual savings of £2.3m (in the first three years, then £2m afterwards). Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving.

### **Risks**

1.34. The following risks have been identified:

- There is a risk that baseline complaints volumes may be significantly higher than anticipated. This will result in increased costs for the Legal Ombudsman and, subsequently, the Lord Chancellor. As a result, fee levels may have to be revised. Changes to fee levels will be subject to Parliamentary approval.
- There is a risk that the Lord Chancellor will be unable to recover the full costs he incurs if some claims management companies fail to pay the annual fee. If this occurs, the Lord Chancellor would have to meet the shortfall. Claims management companies that do not pay the annual fee will face the having their authorisation suspended or cancelled.

### **Preferred option – summary and implementation**



- 1.35. The preferred option is Option 1. Recovering the costs the Lord Chancellor incurs in relation to the Legal Ombudsman dealing with complaints about regulated claims management companies, through a sliding scale of fees based on turnover. This means that full cost recovery can be achieved and ensure a reasonable apportionment of the total costs across regulated claims management companies. It will also mean that regulated claims management companies are treated equitably with regulated legal services providers.
- 1.36. The Regulations setting out the fees will be laid before Parliament for debate and approval. Following this a Commencement Order will be laid before Parliament to commence section 161 of the 2007 Act, extending the Legal Ombudsman's jurisdiction with the aim that the Legal Ombudsman will begin dealing with complaints about claims management companies at the beginning of 2015.

### **One-in-two-out Assessment for Option 1**

- 1.37. The proposal in this Impact Assessment is in scope of the One In Two Out rule. The reforms relate to changes in the levels of fees relating to an expansion in scope of regulatory activity. The costs arising from the result of the Legal Ombudsman's wider remit have been scored as an IN for 'One-in- Two-out purpose.

### **EANCB**

- 1.38. The aggregate net cost to claims management companies of the Lord Chancellor recovering the costs incurred in meeting the costs of the Legal Ombudsman from the authorised claims industry is expected to be around £2.4m per annum for the first 3 years and £2m for subsequent years. The policy has an overall NPV of -£913,000 and a business NPV of -£18,998,000 over ten years or -£0.9m and -£19m when rounded to the nearest £0.1m. The overall EANCB figure (in 2009 prices) is expected to be around -£1,744,000 or around -£1.7m when rounded to the nearest £0.1m.

### **Inclusion of Micro businesses**

- 1.39. Micro businesses are included within the proposal as they are subject to regulation by the Claims Management Regulator and therefore, under the Legal Services Act 2007, will fall within the remit of the Legal Ombudsman once the Ombudsman's jurisdiction is extended. Further information on the small and micro business impact test is at Annex B.

## Annex A: Fee Setting Model

The fees are modelled based on the cost target to be recovered by the Legal Ombudsman. The target differs in each scenario based on whether the scheme is running for the full year or introduced part way through the year.

Scenario 1 sets out an example of the fee levels for a full financial year, based on the Legal Ombudsman's current expectations about complaints volumes, costs and case fee income, and the current claims management market.

As the intention is that the Legal Ombudsman will begin taking complaints about claims management companies at the beginning of 2015 the fees to be charged in relation to the 2014/2015 financial year are outlined under scenario 2.

We have not modelled long run fees in this analysis as the annual turnover of claims management companies can fluctuate significantly. For example, the total turnover declared (for the 12 months to 30 November 2012) was £1.01 billion, up £240 million on the previous year. The number of claims management companies registered can also vary each year. In March 2013 there were 2,693 claims management companies registered with the claims management regulator compared to around 2,000 in 2014. Instead fees will be modelled and set each year using the latest annual revenue data from the claims management regulator.

### Assumptions

It has been assumed that a number of firms will leave the market during the year. We have modelled the following exit profile dependent upon firm revenue:

<b>Claims management company market exits</b>	
<b>Turnover upper bound £</b>	<b>% of Claims management companies exiting the market</b>
4,999	30%
14,999	25%
24,999	20%
74,999	15%
163,636	10%
Above 163,636	1%

It has been assumed that there will be 16 new claims management companies authorised per month. Each newly authorised claims management company pays the Legal Ombudsman fees for the part year, which is calculated on a pro-rata basis (i.e. if a firm starts halfway through the year it will pay half an annual fee). The applicable pro-rata fee depends on the predicted turnover of the company for the coming financial year which is stated by them on application for authorisation to the Claims Management Regulation Unit. It is assumed that the turnover of newly authorised claims management companies is distributed according to predictions made by newly authorised claims companies in the previous year. The large majority of claims companies (over 80%) predicted turnover of less than £75k when they entered the industry.

## Full Financial Year Fees

Under scenario 1, the Lord Chancellor charges fees to recover his costs in relation to Legal Ombudsman complaints handling for a full financial year.

The annual cost to the Legal Ombudsman is calculated from the yearly operating costs plus one third of implementation costs. Applying these, the annual cost to the Legal Ombudsman is around £3.2m. The Legal Ombudsman's expected case fee income (around £0.8m) is then deducted from the annual cost. As such, a total cost of around £2.3m is to be recovered from the claims management industry. The fees to recover this amount would be:

### Scenario 1: Fees for full financial year (based on current expectations of complaints volumes, costs and the claims management market.)

Where the annual turnover of an authorised claims management company is £163,636 or less, then the amount payable will be a fixed fee of –

Turnover band £	Annual Fee
£0-£4,999	£75
£5,000- £14,999	£150
£15,000- £24,999	£250
£25,000- £74,999	£340
£75,000- £163,636	£540

Where the annual turnover of an authorised claims management company is over £163,636 then authorised businesses shall pay an amount equal to 0.33% of annual turnover up to £1 million, plus 0.22% of annual turnover between £1 million and £5 million, plus 0.18% of annual turnover above £5 million.

\* These fees would be subject to a cap of £40,000

\* This fee scale assumes a number of market exits and entrances across the year. [See Assumptions below]

### Part Year Fees (assuming 2 months of operation in 2014/2015)

The intention at present is for the Legal Ombudsman to start taking complaints about claims management companies at the beginning of 2015. Should the scheme commence at this time there would be costs for the last 2 months of this financial year, including a proportion of the start up costs. The Lord Chancellor would charge fees to recover his costs in relation to Legal Ombudsman complaints handling for a part financial year.

In scenario 2, the operating costs are applied pro-rata for 2 months of the year, giving operating costs of around £0.5m. Implementation cost would still be spread over 3 full years; in this case they would be applied pro-rata for 2 months of that 3 year period, giving implementation costs of around £50k. The Legal Ombudsman has estimated case fee income for a full year on a volume of 3000 cases per annum, would be around £0.8m. This is applied pro-rata for 2 months of the year, giving case fee income of around £0.1m. A total cost of around £0.4m is therefore to be recovered from the claims management industry. The fees to recover this amount would be:

## Scenario 2: Fees for part year

Where the annual turnover of an authorised claims management company is £163,636 or less, then the amount payable will be a fixed fee of:

<b>Turnover band £</b>	<b>Annual Fee</b>
£0-£4,999	£13
£5,000- £14,999	£25
£15,000- £24,999	£42
£25,000- £74,999	£57
£75,000- £163,636	£90

Where the annual turnover of an authorised claims management company is over £163,636 then authorised businesses shall pay an amount equal to 0.055% of annual turnover up to £1 million, plus 0.037% of annual turnover between £1 million and £5 million, plus 0.030% of annual turnover above £5 million.

\* These fees will be subject to a cap of £6,667

## **Annex B: Small & Micro Business Test**

For the purposes of this assessment the parameter used to define micro businesses is up to 10 employees.

Section 161 of the Legal Services Act 2007, which has not yet been commenced, makes provision for the Legal Ombudsman's remit to be extended to include complaints about authorised claims management companies which are regulated by the CMRU. Small and micro businesses are included within the proposal as they are subject to regulation by the Claims Management Regulator and therefore, under the Legal Services Act 2007, will fall within the remit of the Legal Ombudsman once the Ombudsman's jurisdiction is extended.

### **Number of firms impacted**

As part of the 2014/2015 annual authorisation renewal exercise 1857 out of a total of around 2008 regulated claims management companies declared that they employed or were due to employ between 0 and 10 staff over the forthcoming year. Claims management companies range in size from large national companies to smaller local firms that employ small numbers of people and operate within a more localised community. Information provided by the monitoring and compliance unit suggests that some small claims management companies however, do declare annual turnovers in excess of £500,000 despite employing little or no additional staff. For example, some claims management companies in the personal injury sector with fewer than 10 members of staff are operating with a turnover in excess of £1m and have appeared in the top 50 grossing personal injury claims management companies. This is an indication that the current regulatory regime promotes high business volumes to smaller firms. The high volume of firms operating in this industry indicates that the current regulations encourage a competitive environment, in particular amongst micro businesses, which make up the majority of claims management companies. The proposed changes could not feasibly be applied without impacting small and micro businesses due to the large proportion that make up the claims management industry.

### **Exemptions**

For the purpose of the small and micro assessment, the following exemptions were considered:

- Full Exemption
- Partial exemption
- Extended transition period
- Temporary exemption
- Varying requirements by type and/or size of business

Following from the evidence above, allowing any exemptions targeted at small and micro business would negate the ability of the Legal Ombudsman to achieve cost recovery as around 90% of claims management companies are micro businesses. Full exemptions, partial exemptions or a temporary exemption are therefore not possible. An extended transition period would not allow for cost recovery.

### **Mitigations**

The fee structure proposed does however mitigate the impact on the smallest firms by varying the size of payment required depending upon the size on annual turnover. The fees are levied based upon annual turnover and on a sliding scale (see annex A). Claims management companies with low annual turnovers of £0 to £163,000 per year will pay £75 to £540 per annum. The majority of the Legal Ombudsman's costs will be recovered from the largest firms. Claims management companies with turnovers greater than £1 million will pay the majority of the annual cost recovery target of the Legal Ombudsman. As such this proposal places less of a burden on smaller firms than the alternative of an identical flat fee charged to all claims management companies. As indicated above, we are unable to assess the relationship between size of firm, turnover and the volume of complaints due to lack of data on upheld complaints. If larger firms attract fewer meritorious complaints relative to their turnover than smaller firms do, this would result in a cross subsidisation from businesses with higher turnover.