

Title: Claims Management Rules Review - Phase One Proposal to prohibit the offering of inducements or similar rewards as an inducement to make a claim – Amendment of Client Specific Rule 6 (b) of the Conduct of Authorised Persons Rules 2007	Impact Assessment (IA)
	IA No: MoJ 89
	Date: 12/12/2011
	Stage: Final
	Source intervention: Domestic
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Lead department or agency: Ministry Of Justice	
Other departments or agencies:	

Summary: Intervention and Options

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

Financial inducements are offered to potential claimants by some regulated Claims Management Companies (CMCs). This may incentivise potential claimants to pursue weaker claims when they otherwise would not do so, which may contribute to the high overall costs and volumes of personal injury litigation. The payment of financial inducements may encourage excessive litigation for low value claims and fuel a compensation culture or perception of one. Indeed in his report ‘Common Sense – Common Safety’ published in October 2010¹ Lord Young identifies such inducements as contributing to a perceived compensation culture. The Government considers that this is not in the public interest. Claims management regulation is delivered by the MoJ and so Government intervention may be required to address this issue.

What are the policy objectives and the intended effects?

The objectives and intended effects are:

- to prohibit CMCs regulated under the Compensation (Claims Management Services) Regulations 2006 from offering potential claimants a financial reward or similar benefit as an inducement for making a claim.
- to reduce incentives for excessive litigation, especially weak or unnecessary claims.
- to reduce the overall level of legal costs involved in personal injury cases.
- to reduce the perception of a compensation culture.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Option 0 – Do Nothing. The current rules would remain in place.
Option 1 – Amend the relevant rules to state that a financial inducement could not be offered at any stage.
Option 2 – Write to businesses asking that they refrain from offering financial inducements at any stage on a voluntary basis.

Option 1 is the preferred option at this stage and will be pursued. Option 2 was considered by a consultation exercise and it is unclear whether it would work effectively in practice.

Will the policy be reviewed? Yes If applicable, set review date: n/a

What is the basis for this review? To monitor compliance If applicable, set sunset clause date: Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes
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Minister’s Sign-off For Final stage Impact Assessments:

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:.....

¹ www.number10.gov.uk/wp-content/uploads/402906_CommonSense_acc.pdf

Summary: Analysis and Evidence

Policy Option 1

Description: Amend Client Specific Rule 6 (b) of the Conduct of Authorised Persons Rules 2007

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: NQ
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised costs by 'main affected groups'					
Costs are not quantifiable					
Other key non-monetised costs by 'main affected groups'					
CMCs and lawyers experience reduced income from reduced case volumes					
CMCs pay more on advertising instead of relying upon inducements					
Claimants no longer receive inducement payments					
Claimants pursue fewer cases and hence receive less overall compensation					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate	NQ		NQ		NQ
Description and scale of key monetised benefits by 'main affected groups'					
Benefits are not quantifiable					
Other key non-monetised benefits by 'main affected groups'					
CMCs save from no longer paying inducements					
Defendants gain from fewer cases, with reduced overall legal costs (including CMC costs) and reduced overall levels of compensation paid					
Media owners, media planners, advertising agencies and CMCs operating as advertisers gain from increased levels of business					
Reduced perception of a compensation culture					
Key assumptions/sensitivities/risks					
Assume no significant shift of business from CMCs to lawyers who are still able to offer financial inducements					
Assume no significant difference in regulatory costs of implementing the reform					
Assume inducements are more effective than advertising at attracting claims, and that inducements incentivise claimants to pursue claims when they would not otherwise have done so					
Assume CMC costs are passed on to lawyers and that lawyers' costs under 'no win no fee' arrangements are ultimately passed to defendants					
Assume that the payment of inducements contributes to the perception of a compensation culture					
Assume neutral overall financial impacts on HM Court and Tribunal Service					
Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as	
Costs:	Benefits:	Net: 0	Yes	IN	

What is the geographic coverage of the policy/option?			England and Wales		
From what date will the policy be implemented?			April 2013		
Which organisation(s) will enforce the policy?			MoJ		
What is the total annual cost (£m) of enforcement for these organisations?			Unchanged		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: 0	Non-traded:0	
Does the proposal have an impact on competition?			Yes		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	Yes	No	No	No	No

Specific Impact Tests: Checklist

	Impact	Page ref within IA
Statutory equality duties	No	15
Economic impacts		
Competition	Yes	15
Small firms	Yes	15
Environmental impacts		
Carbon emissions	No	16
Wider environmental issues	No	16
Social impacts		16
Health and well-being	No	16
Human rights	No	16
Justice	No	16
Rural proofing	No	16
Sustainability	Yes	16

Evidence Base (for summary sheets) – Notes

References

No.	Legislation or publication
1	PIR Plan (Annex 1)
2	Common Sense, Common Safety – <i>A report by Lord Young of Graffham to the Prime Minister following a Whitehall-wide review of the operation of health and safety laws and the growth of the compensation culture – Published 15th October 2010</i>
3	Consultation Paper No. CP19/10
4	Response to Consultation Paper CP (R) 19/10

Evidence Base (for summary sheets)

1. Introduction

- 1.1 The Ministry of Justice (MoJ) is responsible for the delivery of claims management regulation under the Compensation (Claims Management Services) Regulations 2006. The MoJ's direct regulatory responsibilities remain a unique function for a Government department to hold and in October 2009 the Better Regulation Executive concluded in its report entitled 'Better Regulation, Better Benefits: Getting the Balance Right'², that claims management regulation was a good example of efficient and low cost regulation.
- 1.2 The claims management market is volatile, being subject to changes in the wider economy as well as to legal judgments on types of claims allowed, reforms to the personal injury claims process and new regulations being introduced in respect of legal costs and funding. As such, the number of claims management businesses trading and level of business conducted is subject to large swings that are difficult to predict.
- 1.3 Businesses providing claims management services in the following sectors must be authorised and regulated by the MoJ: personal injury, financial services, criminal injuries compensation, industrial injuries disablement benefit, employment and the housing disrepair service. In 2010-11 there were around 3,200 authorised Claims Management Companies (CMCs), of which about 2,600 operated in the personal injury sector. The overall turnover of the claims management sector during the 2010/11 financial year was a reported £581m. This is an increase of around £210m on the previous year's reported turnover of around £370m. The significantly higher figure for 2010/11 is mostly due to increased reported turnover in the personal injury sector of approximately £380 million in 2010-11 compared to around £250 million the previous year, representing around 65% of total CMC industry turnover in 2010-11. There are more than twice the numbers of CMCs operating in that sector than there are CMCs providing financial claims management services. The financial claims management sector is the second largest sector in the claims management industry. In summary the CMC sector has grown significantly in recent years.
- 1.4 In 2010/11 the Compensation Recovery Unit recorded almost 990,000 claims. The proportion of these that would have made a claim through a CMC and received an inducement is not recorded. Road Traffic Accidents (RTAs) account for the significant majority of all personal injury claims³. In relation to these types of claims, the total volume of road accidents has been falling, by around 25% between 2000 and 2007, and by around a further 15% between 2007 and 2010⁴. However, the volume of motor-related cases registered for compensation increased by around 45% between 2007/08 and 2010/11⁵, reaching almost 800,000. Anecdotal evidence suggests that a substantial increase in claims might relate to small injuries. Furthermore, the litigation cost in relation to each accident appears to be high, and possibly growing, relative to the actual compensation claim. An ABI report⁶ indicates that, in motor claims under £5,000, for every £1 paid by insurers in personal injury compensation an additional 88p is paid to claimant lawyers. The ABI reports that a significant volume, over 430,000 in 2007, of motor accidents claim whiplash, which represents around 1 person in every 140 of the UK population. Most whiplash claims fall below £5,000 and the incidence of whiplash claims has increased by 25% from 2002 to 2008. This might be reflected in higher insurance premiums, driving insurance costs up for policyholders including the general public and businesses.
- 1.5 Aside from motor claims personal injury claims might also relate to injuries arising at work, in public places, whilst engaged in activities, and injuries associated with faulty products. Public liability claims, product liability claims and employer liability claims account for the remaining 195,000 claims recorded with the Compensation Recovery Unit. These claims increased by around 15,000 or 10% between 2007 and 2010. The main increases were in public liability claims (around 15,000 or 20% rise) and clinical negligence (around 4,000 or 50% rise). Employer liability claims fell over the period by around 6,000 (over 5% fall).

² www.bis.gov.uk/files/file53251.pdf

³ ABI Research Paper no. 15, Marketing Costs for Personal Injury Claims, Evidence of market Failure. Report from Oxera Consulting Ltd. 2009.

⁴ Department for Transport Statistics, all reported casualties by road.

⁵ Department for Work and Pensions, Compensation Recovery Unit Performance Statistics.

⁶ ABI, Tackling whiplash Prevention, Care, Compensation. November 2008

Regulations and Rules

- 1.6 Regulation 22 of the Compensation (Claims Management Services) Regulations 2006 states that the Regulator must prescribe, in writing, rules for the professional conduct of authorised persons. Regulation 25 states that the Regulator may amend or revoke rules or a code of practice, and any amendment or revocation may include transitional, incidental or consequential provisions. The proposals presented in this Impact Assessment (IA) relate to the amendment of a current rule that is contained within the Conduct of Authorised Persons Rules, which were initially prescribed under the provision of Regulation 22. The proposals therefore do not affect any statutory legislation but rather the rules created and prescribed underneath it.
- 1.7 The rule that is being proposed for amendment is “Client Specific Rule 6 of the Conduct of Authorised Persons Rules 2007”. This currently permits the offering of inducements as long as they are not given immediately. In most instances this means that inducements are paid to clients upon acceptance of a claim by a solicitor. In some cases inducements are paid once the defendant admits liability. The rule states:
- 6.** In soliciting business through advertising, marketing and other means a business must –
- a) Clearly identify the name of the advertiser.
 - b) Not offer an immediate cash payment or similar benefit as an inducement for making a claim.**
 - c) Not promote the idea that it is appropriate that compensation may be used in a way that is not consistent with the cause of the claim.
 - d) Not imply that the business is approved by the Government or is connected with any Government agency or any regulator. (If a business wishes to mention in advertising and marketing material that it is authorised it may use only the following words which must be used in their entirety: “Regulated by the Ministry of Justice in respect of regulated claims management activities”.
- 1.8 Regulation 12 (b) of The Compensation (Claims Management Services) Regulations 2006 states that it is a condition of authorisation that regulated businesses must comply with the rules prescribed. If a business were to breach Client Specific Rule 6 (b) by offering an immediate inducement they would therefore also breach a condition of authorisation. Regulation 46 gives provision for the Regulator to vary, suspend or cancel a business’s authorisation to provide regulated claims management services if it is satisfied after investigation of the alleged or suspected failure that the authorised person has failed to comply with the condition. Authorisations may be suspended and cancelled for a variety of reasons related to the non compliance of businesses with their conditions of authorisation. In 2010 the MoJ cancelled over 250 businesses’ authorisations as a result of malpractice or non-compliance with the conditions of authorisation.
- 1.9 The current restrictions in relation to inducements are, in spirit, intended to rule out the practice of paying inducements. However, these do not prevent inducements from being paid by regulated CMCs in all circumstances. Given this apparent loophole some CMCs therefore still choose to pay inducements. The MoJ has limited data on which CMCs may be offering inducements, and how much these may be. Although it is difficult to quantify accurately, informal research (including that obtained during a recent consultation exercise) suggests that inducements are currently offered mainly within the personal injury sector and are typically between £20 and £500 in cash or retail vouchers. Such inducements are usually non-returnable and paid upon acceptance of a claim by a solicitor. This is not a breach of Client Specific Rule 6 (b) as presently worded as the inducement is not paid immediately. Many of the responses to the consultation indicated that many CMCs do not widely advertise the fact that they offer inducements and therefore we accept and acknowledge that more CMCs than initially thought may currently offer inducements.

Problem under consideration

- 1.10 Inducement payments may encourage or proactively persuade people to make a claim when they might otherwise not do so. If a claimant has a weak and low value claim then they might not be willing to expend much time or effort in pursuing it or might not think it is appropriate to do so. The activities of CMCs including the payment of inducements may reduce these initial claimant search costs or enable them to be recovered more quickly, and as a result encourage such claims to surface when otherwise they might not. Claimants would also receive a greater return for making a

claim if the underlying damages award remains the same and in effect is topped up by the early payment of an inducement. Inducements may encourage unmeritorious cases that would not otherwise seek compensation, while claimants with meritorious cases may not necessarily need to be induced through an inducement payment in order to decide to make a claim through a CMC. For example with a meritorious claim the claimant might believe they have a strong case, and hence may wish to pursue the case even if an inducement was not offered.

- 1.11 Inducements may be driving up the volume of such weaker cases, which may also be lower value cases where the litigation costs may be disproportionately high compared to the damages awarded. Where the resources used to resolve a case are disproportionately high compared to the value of the claim it may not be in society's interests for such cases to be pursued, as the resources could be used more productively on other economic activities.
- 1.12 The payment of inducements may influence claimants' choice of CMCs or solicitors as claimants may select the highest inducement offered rather than considering more broadly who the best provider might be. The extent of any such consumer choice failure is unclear (although RBS Insurance considered that the practice of CMCs offering inducements has a distorting effect on the market and that banning inducements would improve the environment in which personal injury claims are brought without reducing access to justice). Even if there were no such consumer choice failures, if all other factors were equal a claimant may choose the CMC which offers the largest financial inducement, and CMCs may have an incentive to offer the highest inducement necessary in order to win business.
- 1.13 This can be a problem because inducement payments might be contributing to higher overall legal costs. Claimants are not always exposed to the costs they generate as these are recoverable from the losing defendant. As such claimants may have a limited incentive to control costs. This would include the costs to CMCs of making inducement payments (which effectively are payments to buy cases). As such inducement payments might collectively rise with limited control. In the 'no win no fee' market the costs of making a claim currently are met by the defendants, as 'no win no fee' lawyers recoup the costs of cases they lose from the cases they win (and are allowed to do so by charging additional 'success fees').
- 1.14 A report commissioned by the LSB finds that some of the larger firms in the CMC industry see their primary role as marketing, and it was estimated that CMC marketing expenditure during 2005-08 was around £35 million to £40 million. Financial inducements may be viewed as a form of marketing. The Law Society considers that the value added by claim handlers does not match the overall increase in costs associated with them, and that the solicitors' profession is capable of providing information to potential claimants without incurring such high costs, which in successful cases are recoverable from the losing defendant.
- 1.15 The NHS Litigation Authority (NHSLA) states that, from the defendant's perspective, there is little or no transparency in the activities of CMCs. It considered that the practice of CMCs offering inducements increases the number of claims overall and adds to the costs of defendants and their indemnifiers. It commented that CMCs pass on the cost of cash inducements to solicitors who purchase claims from them, which in turn means that those solicitors need to bill the unsuccessful defendant at a higher level than would be necessary if no cash inducement had been paid. The NHSLA also stated that all payments made by them come directly out of the NHS budget, so the present system of CMCs giving cash inducements to claimants means that sums which would otherwise be spent on NHS care are instead used to meet charges by claimants' solicitors (which have been elevated by meeting the cost of paying inducements).
- 1.16 In summary, various aspects of market dynamics as outlined above indicate that inducements might be generating increased overall legal costs and might be associated with an increased volume of less meritorious claims. (The extent to which costs per case are higher would depend upon how the cost to the CMC of providing inducements compares to the costs of providing alternative additional advertising as a means of attracting claims).
- 1.17 In addition to the above indications, Lord Young identified the payment of inducements as contributing to a perceived 'compensation culture', which may be damaging for society. Industry representatives, such as Keoghs LLP, the Association of British Insurers (ABI) and Groupama Insurances have also outlined in their responses to consultation that there is a perception of a compensation culture that needs to be addressed.
- 1.18 The ABI firmly considers that a compensation culture exists, which encourages people to believe the personal injury system can be exploited, resulting in claimants possibly behaving in a more risk

averse way and making claims even when the associated loss is minimal. The ABI commented that CMCs pass on considerable costs to businesses, and therefore to consumers as a whole. The Institute and Faculty of Actuaries (IFA) concluded from its work that there has been an increase in the costs insurers have faced over recent years, primarily driven by the increase in both the number and average cost of third-party injury claims rather than from damage claims. The IFA demonstrates a correlation between the existence and activities of CMCs and the increase in third-party injury claims, and it considers that a prohibition on CMCs from offering inducements is likely to lead to a reduction in the cost of third-party injury claims. That should, over time, lead to lower insurance premiums.

Policy Background

- 1.19 In 2010 the Prime Minister commissioned Lord Young of Graffham to review the operation of health and safety laws and to investigate the growth of a compensation culture. His terms of reference were: ‘To investigate and report back to the Prime Minister on the rise of the compensation culture over the last decade coupled with the current low standing that health and safety legislation now enjoys and to suggest solutions. Following the agreement of the report, to work with appropriate departments across Government to bring the proposals into effect’.
- 1.20 In his report entitled ‘Common Sense – Common Safety’⁷ published in October 2010 Lord Young considered that personal injury advertising by regulated CMCs and lawyers is at least partially responsible for fuelling the perception of a compensation culture. Lord Young recommended that greater controls be introduced to restrict the volume and type of advertising by CMCs, and stated:
- “...in my view the regulations do not go far enough: they allow companies and personal injury lawyers to advertise in such a way that encourages individuals to believe that they can easily claim compensation for the most minor of incidents and even be financially rewarded once a claim is accepted... I particularly feel that the system needs to go further and do more to control both the volume of advertising that such companies produce and also the content of these adverts.”*
- 1.21 Lord Young focused particularly on the promotion of cash or other inducements to consumers to make a claim. In his report, he stated: “...many adverts entice potential claimants with promises of an instant cheque as a non-returnable bonus once their claim is accepted – a high pressure inducement to bring a claim if ever there was one”.
- 1.22 Separately the Government has decided to ban the payment of case referral fees to CMCs. This proposal is subject to a separate Impact Assessment (on www.justice.gsi.gov.uk). These are fees paid to CMCs by lawyers in return for CMCs passing cases to lawyers – or in other words, payments made by lawyers to obtain case details held by CMCs. Referral fees are also considered to foster increasing overall legal costs and an increasing volume of weaker cases that are brought into the legal system. While the ban on referral fees is expected to reduce the volume of unmeritorious cases, it is not expected to completely eradicate the problem under consideration in this Impact Assessment.
- 1.23 The ban on referral fees does not prevent CMCs from offering financial inducements to claimants. Once the ban on referral fees is in place CMCs may operate under different business models compared to now, but may continue to offer financial inducements as a means of encouraging people to make claims. The ban on referral fees does not, therefore, render the ban on financial inducements unnecessary and the two reforms are complementary.

Economic rationale

- 1.24 The conventional economic approach to Government intervention is based on efficiency or equity arguments. The Government may consider intervening if there are strong enough failures in the way markets operate, e.g. monopolies overcharging debtors, or if there are strong enough failures in existing Government interventions, e.g. outdated regulations generating inefficiencies. In all cases the proposed intervention should avoid generating a further set of disproportionate costs and distortions. The Government may also intervene for reasons of equity or fairness and for redistributive reasons (e.g. reallocating resources from one group in society to another).

⁷ www.number10.gov.uk/wp-content/uploads/402906_CommonSense_acc.pdf

- 1.25 It is possible that banning inducement payments might lead to a reduction in low value and less meritorious cases being pursued in future. Where the value of damages claimed is much lower than the resource costs used in resolving a claim this might constitute the inefficient use of resources. Resolving such claims still might be justified if society places a high value in justice being provided, but this might not be so for frivolous or lower value claims.
- 1.26 It is also possible that inducements might be adding to the overall legal costs of resolving a case, without making a material difference to case outcomes. If so then any reduction in overall legal costs associated with banning inducement payments would generate an improvement in overall resource efficiency.
- 1.27 Finally if a ban on inducements led to a reduction in successful claims then there would be distributional implications. In particular those who would have made successful claims would lose out and defendants would gain. The claimants might be individuals and the defendants might be insurers, funded by insurance premiums paid by policy holders. The overall economic rationale of the reforms assumes that, in the absence of strong evidence to the contrary, the value placed by society on the distributional implications of the reforms is neutral.

Policy Proposal

- 1.28 Client Specific Rule 6(b) of the Conduct of Authorised Persons Rules 2007 would be amended to prevent businesses from offering inducements at any stage of a claim, even after the case has been accepted by the solicitor.
- 1.29 Some responses to the consultation asked whether 'refer-a-friend' schemes – in which a CMC gives a typically low-value gift or payment to an existing client who recommends its services to a friend – would be affected by the proposed amendment to Client Specific Rule 6 (b). For the avoidance of doubt, refer-a-friend schemes would not be affected by the proposals.
- 1.30 This proposal and the scope of this policy apply only to CMCs. Lawyers would still be able to offer inducements to clients directly. Solicitors are regulated by the Solicitors' Regulatory Authority (SRA), with the Legal Services Board (LSB) as its oversight regulator. Any decision about whether to impose a comparable ban on solicitors from offering inducements would fall within the remit of those bodies, and would be subject to a separate Impact Assessment. This would need to consider the extent of the problem associated with solicitors offering inducements, including how the banning of inducements for CMCs has affected solicitors' behaviour, and whether the regulatory framework applying to solicitors (which differs to that applying to CMCs) presents a viable alternative to a ban.
- 1.31 No evidence has been presented to suggest that, following the ban on inducements as applied to CMCs, solicitors themselves would as a response start to offer increased financial inducements, either in number or in amount, and hence that the reforms will have no aggregate effect. This may be a potential behavioural response but it is also possible that the ban on inducements paid by CMCs might send a clear signal to solicitors that the Government considers this practice not to be in the public interest and is prepared to take action to stop it. This signal may lead to a reduction, either in number or amount, in financial inducements paid by solicitors.

Alternative Proposal

- 1.32 A formal consultation exercise was conducted between 23 December 2010 and 10 February 2011. The consultation sought views on proposed amendments to Client Specific Rule 6 (b) that would see the banning of any financial or similar rewards being used as inducements to make a claim by regulated CMCs. The consultation also sought views on an alternative option which proposed a voluntary code of practice to limit or stop offering inducements as a method of advertising. Views were sought from the claims management industry as well as from any other parties with an interest in claims management. There were 39 responses to the consultation with the majority of those respondents in agreement with the proposal to amend the rule rather than rely on voluntary measures.
- 1.33 The Government considered that the alternative option of a voluntary ban would not directly tackle the objectives. In particular those CMCs offering inducements would still have little incentive not to offer them and a voluntary code would provide a competitive advantage to those CMCs that would continue to offer inducements as this would attract clients from other CMCs that choose to stop paying them. There may be a reduction in overall litigation costs associated with firms that choose

not to offer inducements, however this would be to a lesser extent and the aggregate impact would depend on the substitution effects mentioned. The extent to which CMCs would comply with a voluntary code is unclear and as such, the level of any reduction in the overall cost of litigation is also unclear. The extent to which litigation costs would be reduced in this instance depends on the level of voluntary compliance undertaken by CMCs. This would be to a lesser extent than the effects of a comprehensive ban on the offering of inducements by all CMCs.

1.34 We accept that the issue of a compensation culture may be a perception problem; however inducements have been identified as partly leading to that problem and the Government considers that they should, therefore, be addressed. Consultation responses did not indicate that using voluntary measures was a feasible option as doing so would not guarantee that the issue would be resolved and could create further distortions to the market. Despite the public policy arguments raised with the claims management industry via the consultation exercise, in Lord Young's report and in related coverage expressing the political imperative to ban inducements, there is no evidence to suggest CMCs have voluntarily stopped offering inducements.

Main affected stakeholder groups, organisations and sectors

1.35 The following individuals/sectors are likely to be affected by the proposals:

- Regulated CMCs in England & Wales.
- Claimants wishing to contract with a regulated CMC.
- Defendants in those cases that may be pursued.
- Other sectors that derive income from civil litigation, including solicitors, after the event (ATE) insurers, and experts.
- HM Courts and Tribunal Service.
- Ministry of Justice, as the Claims Management Regulator.

2. Costs and Benefits

2.1 This Impact Assessment attempts to identify both monetised and non-monetised impacts on individuals, groups and businesses in the UK, with the aim of understanding what the overall impact to society might be from implementing these options. The costs and benefits of each option are compared to the do nothing option. Impact Assessments place a strong emphasis on valuing the costs and benefits in monetary terms (including estimating the value of goods and services that are not traded). However there are important aspects that cannot sensibly be monetised. These might include how the proposal impacts differently on particular groups of society or changes in equity and fairness, either positive or negative.

2.2 It has not been possible to monetise the identified impacts in this Impact Assessment as the data here is limited, however a qualitative assessment is provided. A quantitative assessment would require obtaining specific details such as how many cases receive inducement payments, what the value of each payment is, and which cases are likely to be unmeritorious. This information is commercially sensitive and not available to Government. Even where such information had been shared, there may have been issues with the data not being statistically representative enough of the whole industry, and self-reported commercial data might also be associated with issues of statistical bias. Generally, the banning of inducements is expected to reduce the volume of litigation as it is anticipated that the activity of claims management companies that encourage claims, including those deemed as frivolous, via the offering of inducements would be reduced. As a result of less litigation, it is assumed that the overall sum of damages paid to individuals would be lower as would overall costs paid by defendants. It has been assumed that the overall costs of litigation per case would fall as a result of banning inducements.

Option 0: Base case (do nothing)

2.3 Under this option, no intervention would be made. This means the current regime would remain in its current form, and inducements to encourage consumers to make a claim would continue to be offered and paid. This would also mean that the recommendation to ban inducements made in Lord Young's report would not be taken up.

2.4 The do nothing option is included for comparative purposes. As its costs and benefits are compared against themselves, they are necessarily zero, as is its net present value.

Option 1: Amend Client Specific Rule 6 (b) of Conduct of Authorised Persons Rules 2007

Description

- 2.5 Under this option, the relevant part of the Conduct of Authorised Persons Rules 2007 concerning inducements would be amended to prevent businesses from offering inducements at any stage.
- 2.6 The amended rule would read:
- 6.** In soliciting business through advertising, marketing and other means a business must –
- a) *(Unchanged)*
 - b) Not offer any cash payments or similar benefits as an inducement for making a claim.**
 - c) *(Unchanged)*
 - d) *(Unchanged)*

Costs of Option 1

Costs to Ministry of Justice

- 2.7 The Claims Management Regulator is a unit based within MoJ, which monitors and enforces the Compensation (Claims Management Services) Regulations 2006 and the relevant rules prescribed under them. The proposal could be interpreted as moving to a tighter form of regulation that could involve additional monitoring and enforcement costs for MoJ. However, the proposal is an amendment of an existing rule, rather than introducing a new rule. Therefore, any additional costs are not expected to be significantly higher than those of monitoring the existing rule. Furthermore the costs of the Claims Management Regulator are met by CMCs through licensing fees.

Costs to CMCs

- 2.8 A ban on inducements may reduce income for CMCs if this results in a lower volume of cases coming forward. The volume of case reductions depends on unknown behavioural responses to the reform.
- 2.9 CMCs that currently offer inducements may incur one-off adjustment costs from meeting the regulatory changes, and additional ongoing costs from finding alternative methods of attracting cases (e.g. advertising) to replace inducement payments. These alternative methods might not be as effective, which could result in a lower volume of cases, as mentioned above.
- 2.10 CMCs would also be liable to meet (via licensing fees) any increased regulatory costs associated with banning inducements, these being costs incurred by the Claims Management Regulator.

Costs to claimants

- 2.11 It has been assumed that the overall volume of cases might fall as a result of inducements being banned. This may represent a direct cost to those claimants (individuals) who do not pursue their case. The extent of any reduction in case volumes is unknown, as is the size of compensation payments involved, although these are expected to be less meritorious cases.
- 2.12 Claimants would lose out from no longer receiving inducements, assuming that the cost of inducements is passed to defendants (in successful cases) rather than indirectly coming from the damages award.

Costs to defendants

- 2.13 There are no expected additional costs to defendants if inducement payments are banned.

Costs to lawyers

- 2.14 Lawyers may experience reduced income if banning inducements results in an overall reduction in the volume of claims pursued, which would represent a reduction in demand for lawyers' services. Lawyers might incur additional advertising and promotional costs to attract claimants.

Costs to other affected groups

- 2.15 Any overall reduction in the volume of claims pursued as a result of the proposal would represent a cost to any sector that derives income from civil litigation. This may include after the event (ATE) insurers and experts.

Costs to HM Courts and Tribunal Service (HMCTS)

- 2.16 It has been assumed that overall case volumes may fall as a result of banning inducements. If so HMCTS might experience costs in the form of reduced court fee income. On the other hand HMCTS might benefit from lower operating costs. HMCTS operates on a cost recovery basis, including by adjusting court fees when required, and it has been assumed that the proposals have a neutral financial impact on HMCTS.

Costs to wider economy and society

- 2.17 Removing the ability of CMCs to offer inducements could restrict one dimension of competition within the claims management market, the ability to compete by paying an inducement.
- 2.18 There may be some costs to society if cases that were previously pursued are no longer pursued in future. This would apply if society placed a benefit on such cases being pursued, even if they were less meritorious and if the size of damages was low compared to the legal costs of resolving the case. However there would be nothing to prevent such claimants contacting lawyers or CMCs to get access to justice and pursue their claim.

Benefits of Option 1

Benefits to CMCs

- 2.19 CMCs are not expected to benefit from the proposals.

Benefits to claimants

- 2.20 Claimants are not expected to benefit from the proposals.

Benefits to defendants

- 2.21 There may be benefits to defendants from lower overall legal costs to the extent that the cost of inducements feeds through to legal costs and that there may be a reduction in the number of cases.
- 2.22 Defendants may include individuals and businesses, in particular insurers. Where insurers benefit from lower costs this might feed through to lower insurance premiums.
- 2.23 Defendants are not expected to incur any further benefits. Defendants are not expected to change their behaviour towards personal injury cases in response to this measure.

Benefits to lawyers

- 2.24 Lawyers are not expected to benefit overall from the proposals. There may be benefits to individual lawyers, at the expense of other lawyers, if a ban on inducements results in clients making different decisions about which CMCs, or lawyers, to choose.

Benefits to media owners and the advertising industry

2.25 Media owners, media planners and advertising agencies would gain if the ban on inducements leads to CMCs and lawyers spending more money on advertising as a means of attracting cases. As discussed above, some CMCs see their primary role as marketing, and inducements may form part of their promotional activity. The reforms, therefore, might benefit CMCs which act as advertisers.

Benefits to HM Courts and Tribunal Service (HMCTS)

2.26 As explained in the costs section, HMCTS might benefit from lower operating costs as a result of any reduction in court case volumes, but this would be matched by reduced court fee income. Overall it is assumed that there would be a neutral impact on HMCTS.

Benefits to wider economy and society

2.27 Some cases are currently pursued where the overall cost of reaching case resolution could be disproportionately high compared to the value being disputed in the case itself. This may generate efficiency costs for society, given the resources (e.g. legal, court and judicial resources) used in such cases could more productively have been used elsewhere. If the proposal leads to some of these cases not being pursued this might generate efficiency gains for society.

2.28 Lord Young suggested that the payment of inducements contributes to the perception of a compensation culture. If this is the case, and if the perception of a compensation culture is valued negatively by society, the proposal could deliver benefits for society.

Overall summary and One-In One-Out position

2.29 The proposals are regarded in principle as an IN because they are regulatory in nature.

2.30 The proposals are considered to generate ZERO NET COST for business for the reasons outlined in more detail below. In summary the losses to CMCs and lawyers through a lower volume of business from reduced claims volumes would be balanced by corresponding gains to defendants (mostly insurance businesses) from not paying legal costs in such cases (which include CMC costs) and in addition from not paying compensation (to individuals, not businesses) in these cases. The lower volume in overall claims would also drive legal costs for remaining claims down, where businesses (as defendants) would benefit. In addition businesses would gain as the losses to claimants (who are individuals, not businesses) from no longer receiving inducement payments would be balanced to some extent by gains to media owners, media planners and advertising agencies (as CMCs divert spending on inducement payments to spending on advertising).

CMCs offering inducements

2.31 CMCs that currently offer inducement payments would lose out from a reduced volume of business. Whilst CMCs might gain from no longer paying inducements they might lose from paying advertising costs to secure cases. It is unclear whether total CMC spending would be higher or lower, but it has been assumed that for a given level of spending fewer cases are likely to surface and this would count as an IN. (The CMC picture is complicated to some extent as some CMCs also act as advertisers. The position for these CMCs is captured below in the section on the advertising industry). Furthermore, CMCs costs of managing individual claims are assumed to be passed on to lawyers, so some of the change in overall CMC costs would be met by lawyers and must not be double counted here.

Lawyers

2.32 Lawyers would lose out if a ban on inducements results in a lower volume of business. Overall, this would count as an IN for lawyers.

Media owners and the advertising industry

2.33 Media owners, media planners and advertising agencies would gain as CMCs would be expected to shift their current expenditure on inducement payments towards spending it on advertising in

future. The cost to claimants (individuals) from no longer receiving inducement payments would be balanced to some extent by the gain to media owners and advertising agencies (businesses, including some CMCs). This would therefore generate a net gain for business and would count as an OUT.

Defendants

2.34 Defendants, mainly businesses such as insurers, would gain from a lower volume of litigation cases. Firstly, there would be savings from a lower level of compensation paid associated with claimants no longer taking their case forward as CMCs become less effective at attracting cases. Secondly, defendants would gain from lower overall legal costs resulting from a lower volume of cases. This would count as an OUT.

Claimants

2.35 Claimants (individuals) would lose out from no longer receiving inducements and from pursuing fewer cases. As discussed above, this is expected to be offset by a higher volume of business for media owners and the advertising industry.

HMCTS

2.36 Overall there are no expected additional costs to HMCTS. HMCTS operates a full cost recovery regime hence any change in court fee income would reflect a change in operating costs and vice versa.

Option 1: Micro Business Exemption Waiver

2.37 An exemption is being sought from the moratorium on new regulation on micro-businesses on the basis that, without such an exemption, the intended effect of its proposal would be unduly limited. Of the 3,270 CMCs currently authorised to provide regulated claims management services, 2,907 declared that they employed, or were due to employ, fewer than 10 members of staff to deal with claims management matters over the forthcoming year. Of those, 1,333 CMCs declared that they were sole traders who did not employ any staff.

2.38 The high volume of firms operating in this industry indicates that the current regulations encourage a competitive environment, in particular amongst smaller firms and sole traders, which make up approximately 89% of CMCs. The possible detriment identified by Lord Young is not principally caused by CMCs that employ ten members of staff or more. Conversely, it is typically smaller CMCs that offer inducements to encourage consumers to make a claim. Furthermore, most CMCs that are the subject of the Regulator's enforcement action are smaller businesses.

2.39 The Claims Management Regulation Unit is different from most other regulators – such as the Solicitors Regulation Authority and the Financial Services Authority – as it operates from within central Government. It is because of where the regulatory function sits, rather than the nature of those functions that its proposal is subject to the moratorium on new regulations for micro-businesses and start-up businesses. In addition, Regulation 25 of the Compensation (Claims Management Services) Regulations 2006 gives provision for the Regulator to amend or revoke rules or codes of practice with any such amendments containing transitional, incidental or consequential provisions.

2.40 The proposed rule would be inadequate if the majority of regulated CMCs were exempt from the obligation to comply. We would therefore consider withdrawing the proposed changes if no waiver from the moratorium is granted.

Option 1: Overall Risks and Assumptions

2.41 It is assumed that the costs of inducements are largely passed onto defendants (in successful cases) through litigation costs.

2.42 It is assumed that the volume of litigation cases and hence overall litigation costs will decline following a ban on inducement payments.

- 2.43 It is assumed that the saving to CMCs from not paying inducements would be offset to some extent by additional spending on advertising, which for a given level of spending is less successful at attracting cases than are inducements.
- 2.44 This IA assumes that claimants will not shift from CMCs and go directly to lawyers. However, there is a risk that in future claimants may seek lawyers directly, especially if lawyers start to offer financial inducements.

3. Enforcement and Implementation

- 3.1 The MoJ intends to implement the proposals in April 2013. Monitoring and enforcement will be carried out as part of the existing regulatory regime already in operation.

4. Specific Impact Tests

Equality Impact Assessment

- 4.1 An Equality Impact Assessment screening has been completed as a separate document.

Competition Assessment

- 4.2 Some consultation responses suggested many businesses currently offer inducements and do not widely advertise this but promote their inducement schemes via word of mouth instead. It is therefore difficult to provide an accurate number of the amount of businesses that would directly be affected by any proposed change to Client Specific Rule 6 (b); they are, however, considered to be in the minority compared with the overall size of the sector.
- 4.3 The proposed amendment to the existing rule may produce an adverse effect on competition by removing a dimension of competition by competing through offering financial inducements. The extent of this is unknown. All remaining marketing options would remain untouched. CMCs' advertisements are subject to compliance with the Committee of Advertising Practice and Broadcast Committee of Advertising Practice's Codes in any event.
- 4.4 Responses to the consultation raised an issue of disparity between the regulation of CMCs and solicitors, which are regulated by the Solicitors Regulation Authority (SRA). Solicitors are not subject to any restriction regarding the offer of inducements, and many solicitors' firms provide assistance with personal injury claims.
- 4.5 A concern highlighted via the consultation and its responses is that there would not be an even playing field between CMCs and solicitors under the proposal because CMCs would be prohibited from offering inducements and solicitors firms would not. Many respondents, including those in favour of the proposed changes, stated that if there is not a cross-sector approach to the problem, with other regulators implementing similar changes, then any proposed restriction on the offer of inducements would be unfair. The MoJ has had preliminary discussions with the SRA, which also responded to the consultation on the proposals. In their response they acknowledge the steps that the MoJ is taking but they are not in a position to indicate whether or not, in the course of their own review of their conduct framework, there would be steps taken to directly compliment the MoJ's proposed amendment to the rules. It should be noted that there is already a difference between the Claims Management Regulator's current rules, which currently prohibit the offer of immediate inducements to make a claim, and the SRA's, which currently do not.

Small Firms Impact Test

- 4.6 As part of the 2010/11 annual authorisation renewal exercise, 2,907 out of a total of 3,270 currently regulated CMCs declared that they employed or were due to employ between 0 to 10 staff over the forthcoming year. CMCs range in size from large national companies to smaller local firms that employ small numbers of people and operate within a more localised community. Anecdotal evidence suggests that some small CMCs, however, consistently declare annual turnovers in excess of £500,000 despite employing few or no staff. In some cases, CMCs with fewer than 10 members of staff are operating with a turnover in excess of £1m and appear in the top 50 grossing personal injury CMCs. This is an indication that the current regulatory regime promotes high business volumes to smaller firms, in particular operating the area of personal injury CMCs. The high volume of firms operating in this industry indicates that the current

regulations encourage a competitive environment, in particular amongst smaller firms and sole traders, which make up approximately 89% of CMCs (2,907 out of 3,270 CMCs in total).

- 4.7 It is not envisaged that the proposals considered would have a disproportionate impact on small businesses. As it appears that most CMCs would be classed as micro businesses, approval is being sought for the proposed rule change to be exempt from the micro business moratorium in order to maintain uniformity and to uphold the integrity of the overall regime. The proposed change could not feasibly be applied without a waiver being granted.

Carbon Assessment

- 4.8 There are no anticipated major carbon impacts as a consequence of these proposals.

Other Environment

- 4.9 There are no anticipated major environmental impacts as a consequence of these proposals.

Health Impact Assessment

- 4.10 There are no anticipated major health impacts as a consequence of these proposals.

Human Rights

- 4.11 The reforms are considered to be compatible with Convention Rights.

Justice Impact Test

- 4.12 Impacts on the Justice system are taken into account in the impact assessment presented here.

Rural Proofing

- 4.13 There are no anticipated major rural impacts as a consequence of these proposals.

Sustainable Development

- 4.14 There are no anticipated major sustainable development impacts as a consequence of these proposals.

Annex 1: Post Implementation Review (PIR) Plan

Basis of the review:

To monitor levels of compliance throughout the industry on a continual basis and in line with the current enforcement policy. All CMCs must adhere to the Conduct of Authorised Persons Rules as a condition of authorisation. Monitoring and enforcement procedures in relation to the conduct rule framework are ongoing in line with the regulatory objectives to protect consumers and the wider public interest.

Review objective:

To ensure compliance and take action against businesses that do not adhere to the conduct rules in line with the regulatory framework already in place.

Review approach and rationale:

Monitoring and enforcement is currently in place with regards to the Compensation Act & Compensation (Claims Management Services) Regulations 2006, the current enforcement structure will remain overall unchanged, however will adopt the amendments made to the existing regulation.

Baseline:

The baseline for the review is the current position.

Success criteria:

Success will be based on the level of compliance seen in regards to the regulatory regime already in operation.

Monitoring information arrangements:

The Regulator's monitoring and enforcement team currently monitor all regulated businesses to ensure compliance with the rules and regulations.

Reasons for not planning a PIR:

Current monitoring and enforcement arrangements provide the regulatory framework under which the claims management industry operates under statutory law.