

Title: Recovering the costs the Lord Chancellor incurs to cover the costs of the Legal Ombudsman in hearing complaints about Claims Management Companies. IA No: MoJ029/2016 Lead department or agency: Ministry of Justice Other departments or agencies:	Impact Assessment (IA)		
	Date: 24 October 2016		
	Stage: Final		
	Source of intervention: Domestic		
			Type of measure: Secondary legislation
			Contact for enquiries: Martin Marston-Paterson, Legal Services Policy, Ministry of Justice, martin.marston-paterson@justice.gsi.gov.uk
Summary: Intervention and Options			RPC Opinion: N/A

Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year	In scope of One-In, Measure qualifies as Two-Out?	
£0m	£4.3m	-£0.5m	No	N/A

What is the problem under consideration? Why is government intervention necessary?
The problem under consideration is how the fees charged to authorised claims management companies (CMCs) should be adjusted to ensure that the costs the Lord Chancellor incurs in relation to the Legal Ombudsman (LeO) dealing with complaints about authorised CMCs are recovered from the authorised claims industry rather than the taxpayer. As we have previously over-recovered fees, the fees are being reduced this year in order to match income to expenditure as closely as possible.

What are the policy objectives and the intended effects?
The main policy aim is to match the fee income to LeO expenditure as closely as possible. For 2017-18 the fees need to be reduced due to previous over-recovery and to reflect changes in the market, expected complaints volumes and associated LeO expenditure. An associated policy objective is to ensure that the total costs incurred by the Lord Chancellor in relation to meeting LeO expenditure, incurred in dealing with complaints about CMCs, are recovered from authorised 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/Do nothing: Retain the current fees (as specified in The Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014)
- Option 1: Adjust the fee levels to achieve more accurate cost recovery.

Option 1 is the preferred option. Adjusting the fee levels will ensure that the costs the Lord Chancellor incurs, in relation to the LeO dealing with complaints about CMCs, can be fully recovered from the authorised claims industry and will not have to be met by the taxpayer, while addressing the previous over-recovery and expected market changes and LeO complaints volumes during 2017-18.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 09/2017

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.		Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)				Traded: N/A		Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister

Sir Oliver Heald QC

Date: 16th November 2016

Summary: Analysis & Evidence

Policy Option 1

Description: Adjust the existing fees to ensure full cost recovery

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2017-18	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: 0

COSTS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Cost
Low						
High						
Best Estimate	0		-0.5		4.3	

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

CMCs would meet the Lord Chancellor's outstanding costs, incurred in relation to LeO dealing with complaints about CMCs. Adjusting the existing fees to ensure full cost recovery would mean a total cost of approximately £1.6m to the CMC industry for 2017-18.

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

The Ministry of Justice (MoJ) will incur some 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 (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Benefit
Low						
High						
Best Estimate	0		0.5		4.3	

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

The MoJ will benefit from not having to meet the LeO's cost in relation to dealing with complaints about CMCs. This will provide a saving to the taxpayer of approximately £1.6m in 2017-18.

In aggregate, the saving to the CMC industry in 2017-18 is the difference between the total fee income generated under this option (around £1.6m) and that generated assuming no change in the fees (around £2.1m). This is estimated to be around £0.5m in 2017-18. (Figures may not sum due to rounding.) The industry will still have to pay fees, albeit reduced. The decrease for individual firms would depend on their turnover.

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 latter meets the LeO's costs incurred in dealing with complaints about regulated legal services providers.

Key assumptions/sensitivities/risks

Discount rate (%) 3.50

It is assumed that the LeO will receive approximately 27,000 initial contacts from consumers (letters, phone calls, emails) resulting in around 3,400 complaints cases for investigation in 2017-18.

It is estimated that a total of around 1,450 CMCs will be authorised at the time of renewal of authorisation in February 2017, and that around 20% of them will exit the market before paying their regulatory fees and fees related to the complaints handling function of the LeO. It is also assumed that there will be no change in CMCs' nominal turnover compared to the previous year.

Any changes to the above assumptions may result in higher or lower costs to the MoJ and, therefore, the taxpayer.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m, 2014 prices:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0.5	Net: 0.5	No	NA

Evidence Base (for summary sheets)

A. Background

1. The Legal Services Act 2007 (the 2007 Act) established an 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' (LeO), which became operational in October 2010. Since October 2010, the LeO has been 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. In January 2015, the LeO's remit was expanded to include consideration of complaints about claims management companies (CMCs) authorised by the Claims Management Regulator (CMR).
2. The Secretary of State for Justice exercises the function of the CMR under the provisions of the Compensation Act 2006 (although it is intended that the regulation of CMCs will move to the Financial Conduct Authority when Parliamentary times allows). The Claims Management Regulation Unit (CMRU) within the Ministry of Justice (MoJ) is responsible for directly regulating the activities of businesses providing claims management services. Regulation covers six claims sectors: personal injury, financial products/services, criminal injuries, industrial injuries, employment and housing disrepair. There are currently around 1,500 authorised CMCs.
3. In relation to its claims management remit, the LeO is funded through a combination of grant-in-aid from the MoJ and fees the LeO charges directly (predominantly case fees which are charged by the LeO directly to respondent firms against whom there is a complaint).
4. The cost of the grant-in-aid is recovered through a separate 'cost recovery' fee charged to authorised CMCs by the MoJ. The fees are set out in the Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014 (the 'Fee Regulations') a statutory instrument agreed by Parliament. The fee is a cost recovery measure for the Lord Chancellor and is separate from the CMR's regulatory fees and activities. The cost recovery fees will usually be invoiced in the February before the financial year to which the fee relates.
5. This Impact Assessment (IA) therefore considers the specific issue of how the current Fee Regulations should be adjusted to make sure the costs incurred by the Lord Chancellor, in relation to the LeO dealing with complaints about authorised CMCs, are recovered from the authorised claims industry. In particular the total outstanding cost for 2017-18 around £1.6m, which remains after the LeO's case fee income and an over-collection in fees to date is taken into account.

The LeO's Costs

6. *Operating Costs:* The LeO estimates that around 27,000 initial contacts from consumers (letters, phone calls, emails etc) resulting in around 3,400 complaints cases for investigation would generate running costs of approximately £3m¹ per year.
7. *Set-up Costs:* In preparation for taking complaints about CMCs, the LeO incurred set up costs, including recruitment, training, marketing and IT, of around £0.4m. It was intended to recover these costs over 3 years. Set up costs of around £0.3m were recovered as part of the fee collection for 2014-15 and 2015-16, around £50k were charged for 2016-17 and set-up costs will be around £50k for 2017-18, after which the set-up costs will have been recovered.
8. *Total Costs:* Taking into account the LeO's estimated operating costs and the proportion of set-up costs to be recovered, the total costs to be recovered for 2017-18 will be in the region of £3m.

The LeO's Income

9. *Case Fees:* Under the 2007 Act, the LeO can charge a case fee for each case it considers against a respondent business. The Lord Chancellor's cost recovery fee therefore has to cover the shortfall

¹ 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.

between the LeO's costs of dealing with complaints about CMCs (as detailed above) and the fee income from the LeO's case fees.

10. Case fees are paid directly to the LeO on closure of a case by the respondent business. This cost falls on non-compliant businesses. Rather than cover the total costs of dealing with complaints, the case fee is 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 if a complaint is resolved in favour of the respondent business and if the LeO is satisfied that the respondent took all reasonable steps to try and resolve the complaint under their in-house complaint procedure.
11. Under the LeO's scheme rules, the case fee is also waived if a case turns out not to be within the LeO's jurisdiction, or if the case is dismissed or discontinued under the LeO'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 LeO considers it important that its mere presence does not unduly encourage lawyers or CMCs to settle complaints, even those without merit, in order to avoid the risk of incurring a case fee. Currently, the LeO's case fee is £400.
12. The LeO expects to charge case fees in 2017-18 of around £1.074m.

Over-recovery to date

13. For 2016-17 fees were increased to address under collection of fees in previous years of around £0.5m, which was due to greater market exits than anticipated. In 2016-17 we sought to recover around £2.3m, comprised of approximately £1.8m LeO costs for 2016-17 (taking into account the LeO's separate case fee income) and a predicted £0.5m under collection from previous years.
14. However, slightly fewer market exits than anticipated in 2016-17 and an under-spend by the LeO at the end of the 2015-16 financial year, has resulted in an approximate £0.4m over-recovery to date. It is intended to carry this over-recovery forward to meet part of the LeO's costs for 2017-18.

Income required from the fees

15. The annual cost to the LeO of dealing with complaints about CMCs equates to the relevant annual operating costs (around £3m) plus a proportion of the outstanding set-up costs (around £45k). If around £1m case fee income is generated by the LeO's case fees and the over recovery of around £0.4m is taken into account, then the Lord Chancellor's fee needs to generate around £1.6m in order for the LeO's costs to be recovered (figures have been rounded).

B. Rationale and Policy Objectives

16. The rationale for this policy is that authorised CMCs pay the full costs associated with the LeO investigating and resolving any complaints about the manner in which they conduct their business.
17. The main policy objective is to secure full cost recovery from authorised CMCs to cover the LeO's costs as, without full cost-recovery, some of these costs would need to be met by the MoJ, and therefore, by the taxpayer. An associated policy objective is to ensure that the costs incurred by the Lord Chancellor in relation to the LeO dealing with complaints about CMCs are recovered from authorised CMCs in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller CMCs.
18. Intervention via secondary legislation is required to meet this objective in order to amend the existing Fee Regulations (The Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014). This fee income is to be used in addition to the current case fees which the LeO charge and are already provided for under the 2007 Act.

C. Affected Stakeholder Groups, Organisations and Sectors

19. The following individuals/sectors are likely to be most affected by these proposals:

- Authorised CMCs – who pay fees to cover the costs of the LeO.
- Customers of authorised CMCs – who ultimately pay for the costs of the LeO via the prices CMCs charge them for the services they supply.
- The MoJ: The MoJ, and ultimately the taxpayer, who would need to make up any shortfall in the funding of the LeO should the fees charged were insufficient.

D. Description of Options Considered

20. This IA identifies both monetised and non-monetised impacts on individuals and groups in the UK with the aim of understanding what the overall impact on society might be from implementing the preferred option.

Option 0 - Retain the existing fees

21. Under this option the fees would remain unchanged, and therefore there would be no increase or decrease in costs for the authorised claims management industry.
22. Under this option, the fees set out in the existing Fee Regulations would be charged to CMCs. The LeO would also charge their case fee (although this is waived in some circumstances: see paragraph 10) in the usual way. Under the assumptions listed above, the fees set out in the existing Fee Regulations would raise approximately £2.1m. The LeO's case fee would raise around £1m which would leave an over-recovery of around £0.5m (figures may not sum due to rounding).
23. The MoJ 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 CMR's annual regulation fee.

Option 1 - Adjust the existing fees to ensure accurate cost recovery

24. Under this option, the fees set out in the existing Fee Regulations would be amended to ensure more accurate cost recovery, in relation to the LeO's costs of dealing with complaints about CMCs. The updated fee levels would be designed so that further over-recovery could be avoided. As explained above, the total cost to be recovered through the cost recovery fee is estimated to be around £1.6m for 2017-18.
25. Fees are based on the LeO's current expectations about complaints volumes, costs and case fee income and the claims management market. The number of authorised CMCs has declined from around 2,000 when the 2016-17 financial year's fees were set at the end of 2015, to around 1,500 in September 2016. It is expected that there will be further market exits prior to the fees for 2017-18 being charged.
26. The overall structure of the Lord Chancellor's 'cost recovery' fee would not change: it would remain a sliding scale of fees, based on business turnover in relation to regulated claims management activities. This ensures that disproportionate cost does not fall on smaller CMCs, which may result in a number of businesses leaving the market and negatively impact on competition. Basing fee levels on turnover is also the method with which the regulated CMCs are familiar, as their existing annual regulation fee is based on turnover. Details of the fee structure are provided at Annex A.

E. Cost and Benefit Analysis

27. This section provides an overview of the likely costs and benefits of our proposals. All figures are rounded to the nearest 0.1m. As Option 0 is the baseline, or 'do nothing' option, is being compared to itself its costs and benefits are, by definition, zero as is its Net Present Value (NPV).

Costs of Option 1

CMCs

28. In aggregate, the annual cost to the CMC industry if no changes were made, is the difference between the total fee income generated under this option (around £1.6m) and that generated assuming no change in the fees (around £2.1m). This is estimated to be around £0.5m in 2017-18. (Figures may not sum due to rounding.) The precise impact on individual firms would depend on their revenue. The large majority (over 85%) of the fee income generated would be recovered from the largest firms (i.e. those with a turnover of £1m or above).

MoJ

29. The MoJ 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.

30. £0.5m less is being recovered under the new fee regime, which represents a cost to the MoJ when comparing to the baseline scenario. In absolute terms, due to the over collection last year, the slight under collection for next year will make the option neutral in terms of covering the LeO's costs.

Benefits of Option 1

CMCs

31. Under this option CMCs will pay lower fees than under the previous fee year's fee schedule.

MoJ

32. The MoJ will recover its costs in paying grant-in-aid to the LeO to cover its costs in handling complaints on the CMC sector. It will not over-recover as it would if the current fee regulations remained in place.

CMC Customers

33. Any reduction in CMCs' costs following the decrease in the fees can potentially be passed on to the consumer through a reduction in the prices CMC's charge. Due to the uncertainty over CMCs' behavioural responses, it has not been possible to monetise this impact.

Preferred option

34. The preferred option is Option 1. Adjusting the existing fees to take account of changes to the LeO's expectations about complaints volumes, costs and case fee income and changes in the claims management market, as well as taking into account over recovery to date, means that more accurate cost recovery can be achieved. This will also ensure a reasonable apportionment of the total costs across regulated CMCs and mean that regulated CMCs are treated equitably with regulated legal services providers.

35. Regulations, amending the existing Fee Regulations, to put in place updated fees will be laid before Parliament for debate and approval.

F. Key Assumptions and Risks

36. The following key data and assumptions have been made in order to monetise the impacts of the reforms (a more detailed discussion on data and assumptions is provided in Annex A):

- The LeO estimates that it will deal with 27,000 consumer contacts and 3,400 complaint cases in 2017-18. There is a risk that baseline complaints volumes may be significantly higher than

anticipated. This will result in increased costs for the LeO 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.

- Based on the latest data from the CMRU, it is estimated that a total of around 1,450 CMCs will be authorised at the time of renewal of authorisation in February 2017, and that around 20% of them will exit the market before paying their regulatory fees, and fees related to the complaints handling function of the LeO. There is a risk that the Lord Chancellor will be unable to recover the full costs he incurs if additional CMCs fail to pay the annual fee. If this occurs, the Lord Chancellor would have to meet the shortfall. CMCs that do not pay the annual fee will face the having their authorisation suspended or cancelled.
- It is assumed that there will be no change in CMCs' nominal turnover compared to the previous year. As the fee firms pay is dependent on their level of turnover, any changes to overall industry turnover is likely to affect the total fee income collected.
- The fee structure for 16-17 was estimated to generate around £2.3m. However, when this fee structure is applied using the most recent market data, it is estimated it would generate an income of £2.1m. £2.1m is used as the baseline for the do nothing option to compare the new fee schedule against.

Impact on Micro businesses

37. Micro businesses are included within the proposal as they are subject to regulation by the CMR and therefore, under the 2007 Act, will fall within the remit of the LeO. Further information on the small and micro business impact test is at Annex B.

Annex A: Fee Setting Model

38. The fees are modelled based on the cost target to be recovered by the Lord Chancellor, to meet the costs of the LeO in relation to dealing with complaints about CMCs.
39. Scenario 1 sets out an example of the fee levels for the 2017-18 financial year, based on the LeO's expectations about complaints volumes, costs and case fee income, and the current claims management market.
40. The intention is that fees will be adjusted, usually annually, to reflect changes to the LeO's expectations about complaints volumes, costs and case fee income and changes in the claims management market. The claims management market is fluid, with the number of CMCs and annual turnover subject to variation. As a result, we have not modelled long run fees in this analysis. Instead fees will be modelled and set each year using the latest annual revenue data from the CMR.

Assumptions

41. 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:

No. of firms at start of renewal in Feb 2017	1,450
No. CMCs expected to pay	1,150
Firms exiting	300

	<i>Exit profile</i>	Number of CMCs exiting
Turnover less than £5000	27%	80
Turnover £5000 -£14999	18%	53
Turnover £15000 - £24999	8%	23
Turnover £25000 - £74999	18%	53
Turnover £75000 - threshold	8%	23
1st Percentage	13%	40
2nd Percentage	8%	23
3rd Percentage	2%	6
<i>Total</i>	100%	300

42. It has been assumed that in 2017-18 there will be around 15 new CMCs authorised per month. Each newly authorised CMC pays the LeO 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 CMRU. It is assumed that the turnover of newly authorised CMCs is distributed according to predictions made by newly authorised claims companies in the previous year.

Full Financial Year Fees

43. Under scenario 1, the Lord Chancellor charges fees to recover his costs in relation to LeO complaints handling for the 2017-18 financial year.
44. The annual cost is calculated from the LeO's yearly operating cost, plus a proportion of set-up costs and the deduction of the over-recovery from the invoicing for the 2016-17 fee collection.
45. Applying these, the annual cost to the LeO is around £3m plus £45k of the outstanding set-up costs (to be charged back over three years from January 2015). Deducted from this can be £400k over-

recovery in the invoiced total from the 2016-17 financial year, making a total cost of around £1.6m, plus a £1.074m recovery from the case fees charged by the LeO.

Scenario 1: Fees for 2016-17 financial year (based on current expectations of complaints volumes, costs and the claims management market.)

46. Where the annual turnover of an authorised CMC is £157,143 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	£260
£25,000- £74,999	£340
£75,000- £157,143	£550

47. Where the annual turnover of an authorised CMC is over £157,143 then authorised businesses shall pay an amount equal to 0.35% of annual turnover up to £1 million, plus 0.25% of annual turnover between £1 million and £5 million, plus 0.20% of annual turnover above £5 million.^{2 3}

² These fees would be subject to a cap of £50,000.

³ This fee scale assumes a number of market exits and entrances across the year (see above).

Annex B: Small & Micro Business Test

48. For the purposes of this assessment the parameter used to define micro businesses is up to 10 employees.
49. Small and micro businesses are included within the proposal as they are subject to regulation by the CMR and therefore, under the 2007 Act, fall within the remit of the LeO.

Number of firms impacted

50. 1,301 out of a total of around 1,497 regulated CMCs have declared that they employed or were due to employ between 0 and 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. Information provided by the monitoring and compliance unit suggests that some small CMCs however, do declare annual turnovers in excess of £500,000 despite employing little or no additional staff. For example, some CMCs in the personal injury and financial claims sectors 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 CMCs. 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 Fee Regulations encourage a competitive environment, in particular amongst micro businesses, which make up the majority of CMCs. 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

51. 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
52. Following from the evidence above, allowing any exemptions targeted at small and micro business would negate the ability of the Lord Chancellor to achieve cost recovery as around 89% of CMCs 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

53. The proposal to update the existing fee levels includes retention of the existing fee structure, this mitigates 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). CMCs with low annual turnovers of £0 to £157,143 per year will pay £75 to £550 per annum. The majority of the LeO's costs (around 88%) will be recovered from the largest firms. CMCs with turnovers greater than £1 million will pay the majority of the annual cost recovery target of the LeO. The fee cap, however, is intended to ensure that no firm will pay in excess of £50,000.