

<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. Case Fee structure as it will apply to authorised claims management companies <b>IA No:</b> <b>Lead department or agency:</b> Ministry of Justice <b>Other departments or agencies:</b> Office for Legal Complaints (OLC) Legla Ombudsman (LeO)	<b>Impact Assessment (IA)</b>			
	<b>Date:</b> 05/11/2014			
	<b>Stage:</b> Final			
	<b>Source of intervention:</b> Domestic			
	<b>Type of measure:</b> Other			
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<b>Summary: Intervention and Options</b>	<b>RPC Opinion:</b> Not Applicable
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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
£0m	-£19.7m	-£1.9m	No   NA

**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 imposed on 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 industry. Intervention is required to ensure that the relevant costs, arising from poor services and complaints handling by claims management companies, do not have to be met by the taxpayer. The Legal Ombudsman will also be applying their current case fee system to CMC firms as consulted on between March and June 2012.

**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 dealing with claims management complaints, are recovered from the regulated claims industry in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller claims management companies. In applying the case fee it is to provide a case fee structure which is fair to all areas of the profession. Putting in place a structure which continues to encourage good complaints handling at the first tier which promotes dealing effectively with consumer complaints with the minimum formality, fuss and cost to all parties. Minimise the administrative complexity of recovering case fees.

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

Option 0: Fees not imposed and all costs falls to Ministry of Justice (Do nothing)

Option 1: Fees are imposed on a sliding scale based on companies' relevant turnover and case fees are applied as current scheme rules indicate.

Option 1 is the preferred option. Recovering the costs the Lord Chancellor incurs, in relation to the Legal Ombudsman dealing with claims management complaints, through a sliding scale of fees based on turnover, ensures that fees are not overly burdensom on smaller companies, allows a reasonable apportionment of the total costs across the regulated claims sector and means that regulated claims management companies are treated equitably with regulated legal services providers. Claims Management Regulator took part in last scheme rules consultation, scheme rules will be reviewed by LeO next year.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 04/2015					
Does implementation go beyond minimum EU requirements?				N/A	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes
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 Chair: \_\_\_\_\_ Date: \_\_\_\_\_

# Summary: Analysis & Evidence

# Policy Option 1

## Description:

### 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: £0m

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	£2.3m	£19.7m

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

Claims management companies would meet the Lord Chancellor's 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. Profession: Certain parts of the profession will incur costs as a result of case fees. In addition the administrative costs will be passed on to the profession via either a case fee or Lord Chancellor's fee charge.

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

Regulated claims management companies may also incur additional administrative burdens to process payment of the Lord Chancellor's fee and case fee.  
The Ministry of Justice will incur some additional administrative costs in processing invoices relating to the Lord Chancellor's cost recovery 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	£2.3	£19.7m

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

The Ministry of Justice will benefit from no longer meeting the Legal Ombudsman's cost in relation to dealing with complaints about claims management companies. This will provide annual savings of £2.3m. Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving. Legal Ombudsman: The impact of the change will be to increase the amount of the Legal Ombudsman costs being drawn from case fees.

#### 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.  
Consumers: Complaints are dealt with effectively at the first tier, saving time and inconvenience to the consumer. Legal Ombudsman: is able to recover case fee's directly.

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	3.5
A- The LeO's current jurisdiction (assuming the extension to CMCs) will apply, as will its current Scheme Rules. LeO will receive approx 8,000 contacts resulting in approx 3,000 ombudsman cases. R- Case volumes may be significantly higher resulting in increased costs. R- The Lord Chancellor will be unable to recover the full costs he incurs in relation to LeO CMC complaints handling from regulated CMCs, resulting in the MoJ meeting the shortfall.		

### BUSINESS ASSESSMENT (Option 1)

<b>Direct impact on business (Equivalent Annual) £m:</b>	<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
<b>Costs:</b> £2.3M	<b>Benefits:</b> NQ	<b>Net:</b> -£2.3m
	No	NA

# 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 £15.7m.

### **Claims Management Regulation**

- 1.3. The Secretary of State 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 2,008 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, 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 when a difficulty arose around the mechanism for funding it as provided for in the 2007 Act. 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, as the Justice Secretary carries out the function of the Claims Management Regulator the provided for levy could not be imposed.
- 1.8. An alternative process was developed, whereby the Lord Chancellor will meet the Legal Ombudsman's costs 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, which 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 claims management, from the regulated claims management industry. The 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.

- 1.9. The OLC must set a structure for a case fee that authorised persons who use the Legal Ombudsman will be charged. The Legal Services Act requires us to do this and the Act is also specific about when it does and does not apply. A case fee is payable unless a complaint is resolved in favour of an authorised person and if the Ombudsman is satisfied that the authorised person took all reasonable steps to try and resolve the complaint.
- 1.10. Case fees are a charge to be paid by firms whose customers file a complaint about them with the Legal Ombudsman, following an unsuccessful attempt to resolve their dispute in-house. The fees, which will be charged at the end of the process, may be waived in line with the provisions in the Act
- 1.11. Two periods of consultation have taken place regarding the case fee, in 2009 prior to the Legal Ombudsman setting up and again in 2012. A further period of consultation on the scheme rules is planned for 2015 and case fees may again be considered in this. Responses to these consultations are posted on the OLC website. A discussion group, attended by a range of stakeholders, were also held to help develop OLC thinking in relation to setting a fair case fee.
- 1.12. Before the Legal Ombudsman can investigate a case a consumer must first take their complaint to the authorised person and have it considered through their internal complaints procedure (first tier complaint). Therefore the scheme rules also set out the conditions in which the Legal Ombudsman will decide to waive the case fees for authorised persons who have dealt with the case reasonably at the first tier. The case fee becomes chargeable when the Legal Ombudsman has finalised an investigation into a case and decided there is no basis for waiving the fee.
- 1.13. It should be noted that the case fee is a contribution to the cost of investigation and is not intended to be a full cost recovery mechanism. The current case fee is £400.
- 1.14. The Legal Ombudsman proposes to apply the same scheme rules and associated case fee to the claims management industry to enable a cautious beginning and use the start up period to evaluate the evidence and increase the proportion of income drawn from the case fees.
- 1.15. It is useful to note that at the Financial Ombudsman Service their costs are drawn from five parts case fee and one part levy. Increasing the proportion of the Legal Ombudsman's costs which are drawn from case fees would therefore seem to be in line with Ombudsman best practice.
- 1.16. In addition to the assumptions set out above the Legal Ombudsman had always intended to set up an administratively straightforward system.

## **Note on the scope of this Impact Assessment**

- 1.17. This impact assessment is focused on the structure of the fee framework to recover the Lord Chancellor's costs, in relation to meeting the costs of the Legal Ombudsman in dealing with complaints about claims management companies. It covers the specific issue of how the costs should be apportioned across the regulated claims industry. This is because the wider policy in relation to extending the Legal Ombudsman's jurisdiction and the intention for the costs to be recovered from the regulated claims industry was agreed and encompassed with the passage of the Legal Services Act 2007. The case fee has previously been considered for the legal jurisdiction and underwent consultation in 2012 and in 2009. The case fee system will need to be reviewed and the intention is to review this for claims management companies in 2015 after a number of months of operation.

## **Problem under consideration**

1.18. The problem under consideration is how the Lord Chancellor's new fee raising power under the Financial Services (Banking Reform) Act 2013 should be imposed on regulated claims management companies, to recover the costs the Lord Chancellor incurs in relation to the Legal Ombudsman dealing with complaints about claims management companies.

## **Estimated costs to the Legal Ombudsman**

### **Operating cost**

1.19. From an analysis of the Claims Management Regulator's 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 3000 cases about claims management companies. This refers to complaints which require investigation, as opposed to initial contacts with the Ombudsman which are expected to be much higher.

1.20. Assuming a volume of 3000 cases, it expects its running costs will be approximately £2.9m<sup>1</sup> per year.

### **Implementation cost**

1.21. 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.

### **Case fee income**

1.22. Under the Legal Services Act 2007, the Legal Ombudsman can charge a case fee for each case it considers against a respondent business. Case fees are paid directly to the Legal Ombudsman on closure of a case by the respondent business. Rather than cover the total costs of dealing with complaints, the case fee is instead intended to encourage good 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 the ombudsman is satisfied that the respondent took all reasonable steps to try and resolve the complaint under their in-house complaint procedure. 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 firms to settle complaints, even those without merit, in order to mitigate the risk of incurring a case fee. Currently, the Legal Ombudsman's case fee is £400.

1.23. Based on an assumption of 3000 cases, the Legal Ombudsman estimates it will waiver 30% of case fees and will therefore receive case fee income in the region of £0.8m. This is higher than the previous jurisdiction and is based on evidence gathered from the regulator and the potentially higher number of complaints which will not be able to progress due to the company no longer existing.

1.24.

### **Cost recovery target**

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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.

- 1.25. 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.
- 1.26. The Legal Ombudsman's assumption that a case fee could be charged in 70% of cases, suggests that the Legal Ombudsman would receive case fee income of around £0.8m, as such the Legal Ombudsman cost recovery target is around £2.3m.

## **Rationale for intervention**

- 1.27. Intervention is required to ensure that the costs the Legal Ombudsman incurs in dealing with complaints about claims management companies, arising from poor service by claims management companies, do not have to be met by the taxpayer nor fall on the legal jurisdiction already operated by the Legal Ombudsman.

## **Policy Objective**

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

## **Note on the options**

- 1.29. As this impact assessment is focused on the structure of the Lord Chancellor's cost recovery fee, and not the wider policy with regard to extending the Legal Ombudsman's jurisdiction, we do not have a base case option that equates to zero net present value. Instead the comparison is to not recovering the costs incurred from the regulated claims industry.
- 1.30. Prior to consultation, other fee structures were looked at but were not considered to be feasible models for development. This included recovering costs on a pure 'polluter pays' basis, where companies would be charged per complaint against them. Such an approach was not feasible as the cost per complaint would place a disproportionate burden on smaller claims companies. This is because, in addition to the cost of investigating the complaint, the cost per complaint fee would need to encompass the Legal Ombudsman's standing costs, including staffing and infrastructure, (incurred regardless of the number of complaints received), the costs the 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 Regulator. Currently 40% of the industry comprises firms with an annual authorised claims management turnover of less than £25,000. It is therefore likely that to charge at direct cost to CMCs a significant number of them would be forced out of the market with the costs being too high, which would mean that the scheme would cease to be of public benefit. On a pure 'polluter pays' basis, an estimate of the fee charged per complaint would be around £1,100.
- 1.31. Similarly, recouping the costs through a flat fee (essentially dividing the total cost equally among the number of regulated companies) would have a disproportionate effect on smaller entities, as for many the cost would work out at around half their relevant turnover. An estimate of a flat fee charged to all CMC would be around £1,200

## **Options**

### **Option 0: Fees not imposed (cost falls to Ministry of Justice)**

- 1.32. Under this option the Lord Chancellor would meet the Legal Ombudsman's costs in relation to dealing with claims management complaints, but would not recover those costs from the authorised claims sector.

1.33. This is against the original intention of the Legal Services Act 2007 that the sector should meet the costs of the Legal Ombudsman, as the need for the Ombudsman to deal with complaints derives from the existence of poor services in the sector and poor practice in dealing with consumer complaints. It would also mean treating the regulated claims sector differently from the regulated legal services sector, which falls under the Legal Ombudsman's current 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); the regulators in turn recover those costs from the legal firms and professionals they regulate.

### **Option 1: Fees are imposed on a sliding scale and case fees are applied as current scheme rules indicate.**

1.34. Under this option the Lord Chancellor would recover the costs he has incurred in meeting the Legal Ombudsman's 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 fees imposed would be on a sliding scale, based on businesses' turnover in relation to regulated claims management activities.

1.35. Claims Management firms would also have to abide by the scheme rules of the Legal Ombudsman including the payment of £400 case fee.

## **2. Costs and Benefits**

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 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) have not been considered as the policy has already been adopted in legislation. The question under consideration is to whom the costs should fall and how they should be apportioned.

### **Option 0: Fees not imposed (cost falls to Ministry of Justice)**

#### **Description**

Under this option the Lord Chancellor would meet the Legal Ombudsman's costs in relation to dealing with claims management complaints, but would not recover those costs. This would result in an additional cost of £2.3m on the Ministry of Justice and ultimately the taxpayer. This option would result in no additional costs for the regulated claims management industry.

### **Option 1: Fees are imposed on a sliding scale**

#### **Description**

Under this option, the Lord Chancellor would meet the Legal Ombudsman's costs in relation to dealing with claims management complaints, but would impose fees on regulated claims management companies in order to recover those costs. These costs are based on the Legal Ombudsman's current expectations about complaints volumes, costs and case fee income and the claims management market. 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.

The costs would be apportioned across the industry in a sliding scale of fees, based on firms' turnover in relation to relevant regulated activities. Turnover appears to be the most appropriate basis for charging the fee for the claims industry. 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 impacting on competition. Turnover is also the method with which the regulated claims businesses are familiar, as their 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***

Claims management companies would meet the Lord Chancellor's 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.

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. This cost has not been monetised.

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

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 (tax payers)***

The Ministry of Justice will benefit from no longer meeting the Legal Ombudsman's cost in relation to dealing with complaints about claims management companies. This will provide annual savings of £2.3m. Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving.

### **Risks and assumptions**

The following assumptions have been made in developing this impact assessment:

- That the Legal Ombudsman's current Scheme Rules will apply.
- That approximately 3000 cases a year, arising from contacts with the Legal Ombudsman about claims management companies, will be investigated.
- That there will be a number of firms who 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%

- 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 management companies in the previous year. The large majority of claims companies (over 80%) predicted turnover of less than £75k when they entered the industry.

The following risks have been identified in developing this cost/benefit analysis:

- There is a risk that 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 in relation to the Legal Ombudsman dealing the complaints about claims management companies. If this occurs, the Ministry of Justice will have to meet the shortfall.

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

The preferred option is Option 1. Recovering the costs the Lord Chancellor incurs in relation to the Legal Ombudsman dealing with claims management complaints from the regulated claims industry, through a sliding scale of fees based on turnover alongside a case fee of £400, means that regulated claims management companies are treated equitably with regulated legal services providers and ensures a reasonable apportionment of the total costs across the regulated claims industry.

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 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**

The proposal in this Impact Assessment is out of scope of the One In Two Out rule as the reforms do not relate to new regulation.

### **Inclusion of Micro businesses**

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

Outlined below, 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.

### 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 Risks and Assumptions section on page 7]

### 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**

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.

As part of the 2014/2015 annual authorisation renewal exercise 1857 out of a total of around 2008 regulated CMC 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 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 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 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 CMC industry.