



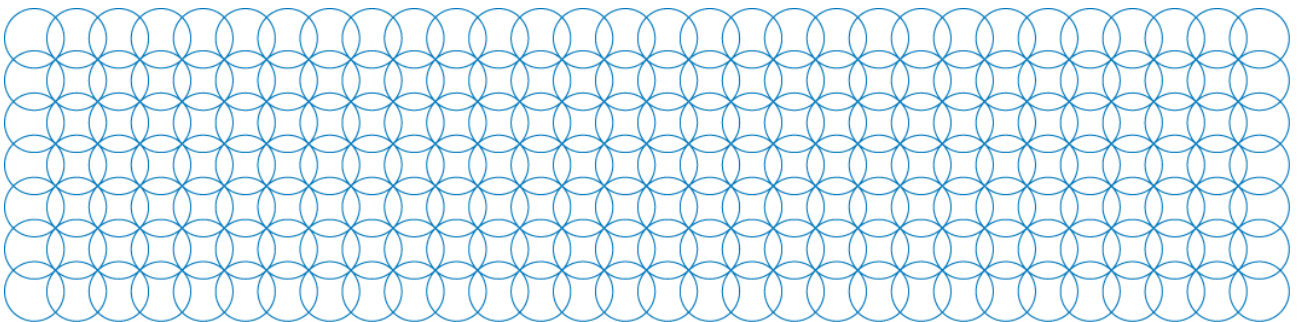
Ministry  
of Justice

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

## Consultation on the fee framework

This consultation begins on 7 May 2014

This consultation ends on 6 June 2014







Ministry  
of Justice

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

Consultation on the fee framework

**A consultation produced by the Ministry of Justice. It is also available on the Ministry of Justice website at [www.gov.uk/justice](http://www.gov.uk/justice)**

## About this consultation

- To:** All those required to be authorised to provide claims management services in England and Wales under the Compensation Act 2006
- Duration:** From 07/05/14 to 06/06/14
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John Russell  
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102 Petty France  
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Email: John.Russell2@justice.gsi.gov.uk
- Response paper:** A response to this consultation exercise is due to be published by 04/07/14 at: <http://www.gov.uk/justice>

## Contents

Executive summary	3
Consultation overview	4
Introduction	5
Proposal	8
Background	11
Questionnaire	13
About you	14
Contact details/How to respond	15
Cost Benefit Analysis	17
Consultation principles	23

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**The Legal Ombudsman and complaints about claims management companies**  
- Consultation on the fee framework

## Executive summary

1. In August 2012 the Government announced its intention for customers' complaints about poor service provided by authorised claims management companies to be dealt with by the Legal Ombudsman. 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.
2. Implementation of this policy was delayed when a difficulty arose around the mechanism for funding it, as provided for in the Legal Services Act 2007. 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.
3. The issue was resolved through primary legislation in the form of clauses in the Financial Services (Banking Reform) Act 2013, which amended the Legal Services Act 2007 to provide the Lord Chancellor with a new fee raising power to recover the costs incurred in covering the Legal Ombudsman's costs in relation to handling complaints about authorised claims management companies, from the authorised claims management industry.
4. Between November and December 2012, an initial consultation was undertaken on the fees that might be charged to authorised claims management companies in respect of the Legal Ombudsman dealing with complaints about the industry. That consultation assumed that the costs would be recovered as part of the Claims Management Regulator's annual regulation fee, in line with the original levy mechanism in the Legal Services Act 2007. This further consultation is therefore being undertaken as the fees will now be imposed under the new Lord Chancellor's fee raising power and will be a separate fee from the Claims Management Regulator's annual regulation fee.
5. This consultation therefore sets out proposals for how the costs related to complaint handling by the Legal Ombudsman are intended to be recovered from authorised claims management companies. It also takes account of changes in the claims management market and the Legal Ombudsman's scheme rules since the last consultation, as well as anticipated trends in complaints volumes and complexity, to set out a revised fee framework.
6. Set out from paragraph 29 are the estimated costs that the Legal Ombudsman believes it will incur in providing a complaints handling and redress mechanism for the customers of authorised claims management companies, and the fees that it is proposed to charge authorised claims management companies to recover those costs.

## **Consultation overview**

7. This paper sets out for consultation proposals as to how the costs incurred by the Legal Ombudsman in dealing with complaints about authorised claims management companies may be recovered from the claims management industry. The consultation is aimed at persons authorised to provide claims management services in England and Wales under the Compensation Act 2006 and those claims management companies and individuals considering making an application for authorisation.
8. A Welsh language version of this consultation paper is available on request.
9. Copies of the consultation paper are being sent to:
  - All authorised claims management companies and organisations, and
  - The Claims Management Regulatory Consultative Group.

However, this list is not meant to be exhaustive or exclusive and responses are welcomed from anyone with an interest in or views on the subject covered by this paper.



## Introduction

10. In 2012, the Government announced its intention to widen the Legal Ombudsman's jurisdiction to include complaints about authorised claims management companies, thereby providing consumers with an independent complaints resolution service. The Legal Ombudsman has wider powers to award redress than those available to the Claims Management Regulator. This will provide added benefits to consumers and should contribute towards reducing poor practice within the authorised claims industry.
11. It is intended that the Legal Ombudsman will begin taking complaints about claims management companies towards the end of 2014. Once the Legal Ombudsman's jurisdiction is extended, all authorised claims management companies will automatically be covered by the scheme and will have certain obligations towards it. This is in line with the regulated legal services sector currently covered by the Legal Ombudsman.
12. Under the new funding arrangements, the cost of the service provided by the Legal Ombudsman will be met by the Lord Chancellor. The Lord Chancellor will recover these costs from authorised claims management companies, through a new fee raising power derived from provisions in section 140 of the Financial Services (Banking Reform) Act 2013. Section 140 of the Financial Services (Banking Reform) Act 2013 amends the Legal Services Act 2007 by inserting a new section 174A, which contains the Lord Chancellor's new fee raising power.
13. This Lord Chancellor's 'complaints fee' will be separate from, and charged in addition to, the Claims Management Regulator's annual regulation fee. However, for ease of administration, the Claims Management Regulation Unit, within the Ministry of Justice, will administer the fee collection on the Lord Chancellor's behalf.
14. Failure to pay the Lord Chancellor's 'complaints fee', once invoiced, may result in enforcement action. This might include suspension or cancellation of authorisation. Potential sanctions as a result of failure to pay the Lord Chancellor's complaints fee are out of the scope of this consultation, which seeks views on the fee structure and levels.

## Timescales and process

15. It is intended that authorised claims management companies will be invoiced for the Lord Chancellor's 'complaints fee' annually, prior to the beginning of a new financial year.
16. As the aim is for the Legal Ombudsman to begin taking complaints about claims management companies towards the end of this year, this may only constitute 4 full months of expenditure in the 2014/2015 financial year. Therefore, for this first partial year only, it is intended that the 2014/15 fees be collected retrospectively alongside the collection of the fees for the 2015/16 financial year, in February/ March 2015.
17. Fee levels may change each year as a result of the Legal Ombudsman's estimates of expected complaints volumes, associated costs and anticipated case fee income (see paragraph 22 for more information on the Legal Ombudsman's case fee) and changes

to the claims management market. In very exceptional circumstances, it may be necessary to change fee levels 'in year'. This may be as a result of the Legal Ombudsman receiving substantially more complaints about claims management companies than anticipated, for example.

18. In order for the Lord Chancellor's complaints fee to be charged to authorised claims management companies, the fees must be set out in Regulations. Therefore, following this consultation and once the fee levels have been set, the draft complaints fee Regulations will be laid before Parliament for approval. Should the fee levels change subsequently, this change will need to be reflected in the complaints fee Regulations and would be subject to Parliamentary approval.

### **Cost estimates**

19. The Legal Ombudsman has estimated that in a full year it would expect to receive in the region of 3000 cases about claims management companies. Based on this complaint volume, it expects its costs in relation to claims management companies will be approximately £2.9<sup>1</sup>m for a full financial year.
20. 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 authorised claims management companies as part of the Lord Chancellor's 'complaints fee' over the course of three years, divided into approximately a third per year. Based on these estimates, total costs for a full year, including approximately a third of set up costs, would be around £3.2m
21. Assuming the Legal Ombudsman begins taking complaints towards the end of 2014, and therefore assuming 4 full months of expenditure in the 2014/2015 financial year, on a pro-rata basis the expected costs for the 2014/15 financial year will be approximately £1.1m including a proportion of the set up costs.

### **Case fees**

22. The costs quoted above are the Legal Ombudsman's estimates of the costs of complaint handling, based on receipt of around 3000 complaints requiring investigation about claims management companies, and set up of the scheme in respect of authorised claims management companies. These costs **do not** take into consideration the value of case fees paid by those claims management companies who have complaints investigated, which will reduce the amount to be recovered through the Lord Chancellor's complaints fee.
23. The Legal Ombudsman can currently charge a case fee of £400 for each case it considers against a respondent business. However, where a case that is investigated turns out not to be within the Legal Ombudsman's jurisdiction then no case fee is charged, nor is a case fee charged if the case is dismissed or discontinued under the Legal Ombudsman's scheme rules (paragraph 5.7 Grounds for dismissing or

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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.

discontinuing a complaint), for example, because the complaint is vexatious or the Legal Ombudsman has already considered the complaint and there is no new evidence.

24. There are also some circumstances where the Legal Ombudsman will waive the case fee. The Legal Services Act 2007 specifies that the Legal Ombudsman's scheme rules must provide for the case fee to be waived where the complaint is resolved in favour of the respondent 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 can also be waived if the complaint is withdrawn or abandoned by the complainant during the course of the investigation.
25. Once the Legal Ombudsman takes on complaints handling, when charged, this case fee will be directly payable by the authorised claims management company against whom the case is considered, as is currently the case for the legal sector.
26. Based on an assumption of 3000 complaints requiring investigation, and, with the Legal Ombudsman charging a case fee in 70% of these cases, the Legal Ombudsman estimates that it will receive case fee income in the region of £0.8m for a full financial year.
27. This anticipated income would be deducted from the Legal Ombudsman's estimated expenditure before the Lord Chancellor's complaints fees are calculated. Therefore, net costs to be recovered through the Lord Chancellor's complaints fee would be in the region of **£2.3m** for a full financial year.
28. Assuming the Legal Ombudsman begins taking complaints towards the end of 2014, and therefore assuming 4 full months of expenditure in the 2014/2015 financial year, on a pro-rata basis the expected case fee income would be around £0.3m. Therefore, net costs to be recovered through the Lord Chancellor's complaints fee would be in the region of £0.8m, for the 2014/2015 financial year.

## Proposal

29. Based on the Legal Ombudsman’s cost and case fee income estimates, we are consulting on how the net costs should be recovered from authorised claims management companies, specifically in relation to the fee structure and levels.
30. We have considered a number of options on the fee structure, including do nothing (so the Legal Ombudsman’s costs would fall to the Ministry of Justice and, ultimately, the taxpayer), charge a flat fee or charge a sliding scale of fees. To do nothing is not a viable option, as it would not be appropriate for the tax payer to pay for the costs of the scheme. Charging on a flat fee basis would also be inappropriate, as this would have a disproportionate effect on small and medium sized entities, as for many the charge would work out at around half of their relevant turnover.
31. We therefore propose that the Lord Chancellor’s complaints fee should be charged as a sliding scale of fees based on authorised claims management companies’ relevant turnover. Turnover appears to be the most fair and proportionate method of calculation and a system with which the industry is already familiar.
32. Turnover would mean claims management companies’ last declared turnover (in respect of authorised claims management services) to the Claims Management Regulation Unit at authorisation renewal or, should renewal information not be provided, their turnover estimated by the Claims Management Regulation Unit.
33. Based on the Legal Ombudsman’s costs and case fee income estimates set out above, the following tables set out the proposed fee structure and levels:

**TABLE 1 – Cost recovery target and fee levels based on a full financial year**

Operating Expenditure	£2.9m
Implementation Costs (to be spread over 3 years)	£0.3m
LESS expected Case Fee Income	(£0.8m)
 Cost to be recovered for example year	 £2.3m

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

<b>Turnover band £</b>	<b>Annual Fee</b>
£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 would 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.

**TABLE 2 - Cost recovery target and fee levels based on commencement at the end of 2014**

Operating Expenditure (4 months)	£1m
Implementation Costs (to be spread over 3 years)	£0.1m
LESS expected Case Fee Income	(£0.3m)
Cost to be recovered for partial year 1	£0.8m

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

Turnover band £	Annual Fee
£0-£4,999	£25
£5,000- £14,999	£45
£15,000- £24,999	£90
£25,000- £74,999	£120
£75,000- £163,636	£180

Where the annual turnover of an authorised claims management company is over £163,636 then authorised businesses would pay an amount equal to 0.110% of annual turnover up to £1 million, plus 0.075% of annual turnover between £1 million and £5 million, plus 0.060% of annual turnover above £5 million.

\* These fees will be subject to a cap of £15,000

34. Having taken into account potential market exits and a reduction in entrants following the ban on referral fees and inducements to make a claim, the proposal would recover the full estimated costs of complaints handling over a full financial year. Please also note that the figures for the starting part way through the financial year are calculated on a pro-rata basis.

35. *Managing Public Money*<sup>2</sup> stipulates that charges should normally be set at no more than the full cost of the service provided to the user or customer. It sets out that creating cross-subsidies between different groups of customers of the same service is

<sup>2</sup> *Managing Public Money* is a HM Treasury document that offers guidance on how public funds should be handled. It can be found at: <https://www.gov.uk/government/publications/managing-public-money>

not normal practice. The fee structure proposed here would be an exception to the *Managing Public Money* norm because it creates a planned cross-subsidy whereby firms with a larger turnover will pay higher fees to subsidise lower fees for smaller firms. There will also be cross-subsidisation within the proposed turnover bands, although this is limited through keeping the bands relatively narrow.

36. However, we believe the proposed fee structure is justified because the Government is committed to recovering the whole of the Legal Ombudsman's claims management costs (less the Legal Ombudsman's case fee income) from the authorised claims management industry. It was clear about that when it legislated for the new charging provision in the Financial Services (Banking Reform) Act 2013. We consider that any other way of structuring the fee, including a flat fee, would not be justified in these circumstances as it would have a disproportionate effect on small and medium entities, potentially forcing some firms from the authorised market because the fees would be unaffordable. Currently, 40% of the industry comprises of firms with an annual authorised claims management turnover of less than £25,000. While paying a larger share of the costs, larger firms will still benefit from being able to sell their services as being within the remit of the Legal Ombudsman, and from improvements in the reputation of the industry as regulation and complaints handling improves the experience of consumers in the industry, in addition to the benefits in having complaints against them dealt with by the Legal Ombudsman.
37. The structure we propose also allows for simplicity of fee levels, rather than determining individual fee levels for each firm based on their specific turnover, which would be significantly more complex. As set out above, the upper bands are also set at a percentage of turnover, to ensure fairness where turnover levels are much higher. The band widths are structured to ensure that those paying fixed fees do not pay more than businesses paying a fee based on a calculation of percentages of turnover.

## Background

38. The Legal Ombudsman, set up by the Office for Legal Complaints (their board) under the Legal Services Act 2007, is an independent ombudsman scheme to resolve complaints about lawyers, in an impartial, fair and effective way. It currently has the power to consider complaints about the service provided by authorised legal professionals and firms in England and Wales, regulated under the Legal Services Act 2007. Where the Legal Ombudsman finds that the service provided by an authorised legal professional is unsatisfactory, they have the power to ask that it be put right and where appropriate they can award redress, payable by the lawyer, up to a current maximum of £50,000.
39. 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. However, the professional conduct of the authorised person remains a matter for the relevant approved regulator. For example, conduct matters relating to solicitors are dealt with by the Solicitors Regulation Authority, the independent regulatory arm of the Law Society.
40. In 2013/14, the Legal Ombudsman dealt with just over 69,500 contacts (calls, letters and emails), of which 20,000 were complaints from consumers about the service provided by their lawyer. Of these, 8055 cases required an investigation. Of these, approximately 37% of cases were referred to an Ombudsman for a decision. The Legal Ombudsman's total operating expenditure for 2013-14 was 15.7 million (2012-13: £16.6 million), against a budget expenditure of £17.0 million (2012-13: £17.0 million). In March 2014 the Office for Legal Complaints was funded through £14.5 million in levy funding relating to the financial year 2013-14 (2012-13 £16.3 million) and £1.2 million in case fee income (2012-13: 0.3million). Case fee income increased significantly in 2013-14 due to changes to the scheme's rules which, for case fees, took effect on 1 April 2013.
41. In August 2012 the Government announced its intention to enable consumers that had received a poor service from an authorised claims management company, to have their complaint considered by the Legal Ombudsman. This will be done by extending the Legal Ombudsman's jurisdiction to include claims management companies by commencing the powers provided for by section 161 of the Legal Services Act 2007.
42. The Legal Ombudsman is a free service to consumers, with its costs being met by regulated businesses that fall within its jurisdiction. The Legal Services Act 2007 provides for a levy to be imposed on the Regulators of services covered by the scheme, who then, in turn, recover the costs from the businesses they regulate. Under the Legal Services Act 2007, therefore, it was expected that the levy would be imposed on the Claims Management Regulator, and the Claims Management Regulator would recover the costs through the regulatory fees it imposes.
43. However, in practice, the levy mechanism set out in the Legal Services Act 2007 could not be used because, in current circumstances, the Justice Secretary fulfils the function of Claims Management Regulator (a function which is undertaken on the Justice Secretary's behalf by the Claims Management Regulation Unit located in the Ministry of Justice).

44. As a result, there was a need for new primary legislation to make provision for alternative funding arrangements, which still met the original intention that the authorised claims management industry should meet the costs of the Legal Ombudsman related to handling complaints about authorised claims management companies.
45. The necessary legislation was put in place late last year through provisions in the Financial Services (Banking Reform) Act 2013. These provisions amended the Legal Services Act 2007, to provide the Lord Chancellor with a new fee raising power to recover the costs of the Legal Ombudsman in relation to handling complaints about authorised claims management companies, from the authorised industry.
46. Therefore, following the commencement of section 161 of the Legal Services Act 2007, all authorised claims management companies will be required to pay this fee to contribute to the costs of the Legal Ombudsman in considering complaints about claims management companies. The Lord Chancellor's fee will be a separate fee from, and charged in addition to, the Claims Management Regulator's regulation fee.
47. The Claims Management Regulation Unit will continue to be responsible for directly regulating the activities of businesses providing claims management services under Part 2 of the Compensation Act 2006. This includes ensuring compliance with the Conduct Rules. Any businesses that do not comply with the conditions of authorisation (including the Conduct Rules) will continue to be subject to appropriate enforcement action.
48. An initial consultation was undertaken on the fee framework for the Legal Ombudsman dealing with complaints about claims management companies between November and December 2012. That consultation assumed that the costs would be recovered as part of the Claims Management Regulator's annual regulation fee.
49. This consultation is therefore being undertaken as fees will now be imposed under the Lord Chancellor's new fee raising power. The revised fee estimates take into account changes in the claims management market and the Legal Ombudsman's scheme rules since the last consultation, as well as anticipated trends in complaints volumes and complexity. It also takes into account the anticipated income to the Legal Ombudsman of case fees, which will be set against anticipated expenditure.



## Questionnaire

We would welcome responses to the following question set out in this consultation paper.

**Do you have any comments in relation to the fees framework proposed to meet the costs of handling complaints about claims management companies by the Legal Ombudsman?**

**Thank you for participating in this consultation exercise.**

## About you

Please use this section to tell us about yourself

<b>Full name</b>	
<b>Job title</b> or capacity in which you are responding to this consultation exercise (e.g. member of the public etc.)	
<b>Date</b>	
<b>Company name/organisation</b> (if applicable):	
<b>Address</b>	
<b>Postcode</b>	
If you would like us to acknowledge receipt of your response, please tick this box	<input type="checkbox"/> (please tick box)
Address to which the acknowledgement should be sent, if different from above	

**If you are a representative of a group**, please tell us the name of the group and give a summary of the people or organisations that you represent.

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## Contact details/How to respond

Please send your response by 6 June 2014 to:

**John Russell**  
**Ministry of Justice**  
**Legal Services Policy**  
**Post point 4-41**  
**102 Petty France**  
**London SW1H 9AJ**  
**Tel: 020 3334 3626**  
**Fax: 020 3334 4455**  
**Email: [John.Russell2@justice.gsi.gov.uk](mailto:John.Russell2@justice.gsi.gov.uk)**

### Complaints or comments

If you have any complaints or comments about the consultation process you should contact the Ministry of Justice at the above address.

### Extra copies

Further paper copies of this consultation can be obtained from this address and it is also available on-line at <http://www.justice.gov.uk/index.htm>.

Alternative format versions of this publication can be requested from:  
[John.Russell2@justice.gsi.gov.uk](mailto:John.Russell2@justice.gsi.gov.uk) Tel: 020 3334 3626.

### Publication of response

A paper summarising the responses to this consultation will be published one month after the closure of this consultation. The response paper will be available on-line at <http://www.justice.gov.uk/index.htm>.

### Representative groups

Representative groups are asked to give a summary of the people and organisations they represent when they respond.

### Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information

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

- Consultation on the fee framework

we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Ministry.

The Ministry will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

## Cost Benefit Analysis

### Introduction

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

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.

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 claims management companies, regulated by the Claims Management Regulation Unit in the Ministry of Justice.

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

In August 2012 the Government announced its intention for customers' complaints about poor service provided by authorised claims management companies to be dealt with by the Legal Ombudsman. 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.

Implementation of this policy was delayed when a difficulty arose around the mechanism for funding it as provided for in the Legal Services Act 2007. 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.

The issue was resolved through primary legislation in the form of clauses in the Financial Services (Banking Reform) Act 2013, which amended the Legal Services Act 2007 to provide the Lord Chancellor with a new fee raising power to recover the costs incurred in covering the Legal Ombudsman's costs in relation to handling complaints about authorised claims management companies, from the authorised claims management industry.

#### **Problem under consideration**

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 authorised 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**

The Legal Ombudsman estimates that in a full year it would expect to receive in the region of 3000 cases about claims management companies. Based on this case volume, it expects its running costs will be approximately £2.9m<sup>3</sup> per year.

### **Implementation Cost**

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 authorised claims management companies over the course of three years, divided into approximately a third per year.

### **Case Fee Income**

The Legal Ombudsman can currently charge a case fee of £400 for each case it considers against a respondent business. However, in certain circumstances the case fee is waived. For example, 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 is also 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 can also be waived if the complaint is withdrawn or abandoned by the complainant during the course of the investigation.

Based on an assumption of 3000 cases, with the Legal Ombudsman charging a case fee in 70% of cases, the Legal Ombudsman estimates that it will receive case fee income in the region of £0.8m.

### **Cost Recovery Target**

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.

This cost estimate does not take into consideration the value of case fees paid by those claims management companies against whom complaints are considered. 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**

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.

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<sup>3</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.

## Policy Objective

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 authorised claims sector in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller claims management companies.

## Options

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

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.

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

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.

## Costs and Benefits

The monetised costs of each option are largely similar. The question under consideration is where those costs should fall and how they should be apportioned.

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

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 claims management sector, beyond the existing fees paid in relation to the wider regulation of the sector.

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

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 authorised claims management companies in order to recover those costs. This would result in an estimated additional cost of around £2.3m a year falling on the authorised claims management sector, 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 Lord Chancellor's 'complaints fee' would be in addition to the fees paid by the regulated claims management industry with regard to their authorisation to practise and wider regulation. There may also be an additional unquantifiable administrative burden for companies to process payment of the complaints handling fee.

The complaints handling costs would be apportioned across the sector 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 authorised claims businesses are familiar, as their annual regulation fee is based on turnover.

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 that end of 2014, 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 –

<b>Turnover band £</b>	<b>Annual Fee</b>
£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 risk and assumption section below]

**Part Year Fees (assuming 4 months of operation in 2014/2015)**

The intention at present is for the Legal Ombudsman to start taking complaints about claims management companies towards the end of 2014. Should the scheme commence at this time there would be costs for the last 4 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 4 months of the year, giving operating costs of around £1m. Implementation cost would still be spread over 3 full years; in this case they would be applied pro-rata for 4 months of that 3 year period, giving implementation costs of around £0.1m. 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 4 months of the year, giving case fee income of around £0.3m. A total cost of around £0.8m 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 –

Turnover band £	Annual Fee
£0-£4,999	£25
£5,000- £14,999	£45
£15,000- £24,999	£90
£25,000- £74,999	£120
£75,000- £163,636	£180

Where the annual turnover of an authorised claims management company is over £163,636 then authorised businesses shall pay an amount equal to 0.110% of annual turnover up to £1 million, plus 0.075% of annual turnover between £1 million and £5 million, plus 0.060% of annual turnover above £5 million.

\* These fees will be subject to a cap of £15,000

Under option 1 there are also some additional unquantifiable administrative burdens for the Ministry of Justice to process invoices received in relation to the Legal Ombudsman’s costs. However, the vast majority of the costs do not fall on the department, or, ultimately, the taxpayer.

This option also means that the regulated claims sector is treated equitably with the legal services sector, which meets the costs of the Legal Ombudsman under the Ombudsman’s current legal service complaints remit.

## 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 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 year which is stated by them on application. It is assumed that the turnover of newly authorised claims management companies is distributed according to predictions made by new claims companies in the previous year. The large majority of claims companies (over 80%) predicted turnover of less than £75k when they entered the industry.

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 sector, through a sliding scale of fees based on turnover, 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 sector.

Following this consultation, the approach to charging the fee will be confirmed and the necessary fee Regulations laid before Parliament for approval.

## Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf>





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