

# Summary: Analysis and Evidence

# Policy Option 1

**Description:** Amend rules affecting PPI and PBA claims only – 15 per cent cap

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
	Years			
Low			250	2,200
High			510	4,400
Best Estimate	NK		390	3,300

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

The annual costs to CMCs from capping completion fees and banning up-front fees has been estimated at £390m.

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

Due to data limitations, we have not been able to calculate all of the potential costs of this option. However, we expect there to be other potential costs to CMCs from: capping cancellation fees, if the current average fee charged is above £300; the proposed ban on fees being charged if no PPI/ PBA exists for the client or where there is no relationship to the lender but where CMCs have undertaken an investigation into this; and the proposed ban on making and receiving financial payments to a third party for PPI / PBA claims. There is also a potential cost to consumers if the current average cancellation fee is below £300 and CMCs start charging at the level of the proposed cap.

BENEFITS (£m)	Total Transition (Constant Price)		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
	Years			
Low	0		250	2,200
High	0		510	4,400
Best Estimate	0		390	3,300

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

The annual benefit to consumers by the cap on completion fees for PPI/PBA claims and banning up-front fees has been estimated at £390m.

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

There is a potential benefit to consumers, businesses and the Financial Ombudsman if the number of speculative claims and 'nuisance' calls reduces.

### Key assumptions/sensitivities/risks

The costs and benefits of this option are based on the following information and assumptions: the total volume of PPI/ PBA claims has been estimated using data from the Financial Conduct Authority (FCA) consultation, the number of claims reaching the Financial Ombudsman and the proportion of claims upheld by the Financial Ombudsman; the average redress to consumers is calculated using the total amount of compensation paid out since 2007 and the total number of claims over this period from the FCA consultation; it is assumed that all CMCs will charge completion fees at the cap.

There are various risks associated with this option. These include: that the decrease in profits for CMCs will reduce what the regulator collects to finance its operations, meaning it will need extra funding from the MoJ; uncertainty around the volumes of successful claims may mean our estimates of the costs to CMCs and benefits to consumers may be higher or lower than what has been presented in this impact assessment.

The consultation process will seek further information on these issues.

<b>Direct impact on business (Equivalent Annual) £m):</b>			<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
Costs: £382m	Benefits: £0m	Net: -£382m	Yes	N/A

# Summary: Analysis and Evidence

# Policy Option 2

**Description:** Amend rules affecting PPI and PBA claims only – 10 per cent cap

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			340	2,900
High			600	5,100
Best Estimate	<b>NK</b>		<b>470</b>	<b>4,100</b>

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

The annual costs to CMCs from capping completion fees and banning up-front fees has been estimated at £470m.

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

Due to data limitations, we have not been able to calculate all of the potential costs of this option. However, we expect there to be other potential costs to CMCs from: capping cancellation fees, if the current average fee charged is above £200; the proposed ban on fees being charged if no PPI/ PBA exists for the client or where there is no relationship to the lender but where CMCs have undertaken an investigation into this; and the proposed ban on making and receiving financial payments to a third party for PPI / PBA claims. There is also a potential cost to consumers if the current average cancellation fee is below £200 and CMCs start charging at the level of the proposed cap.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	<b>0</b>		340	2,900
High	<b>0</b>		600	5,100
Best Estimate	<b>0</b>		<b>470</b>	<b>4,100</b>

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

The annual benefit to consumers by the cap on completion fees for PPI/PBA claims and banning up-front fees has been estimated at £470m.

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

There is a potential benefit to consumers, businesses and the Financial Ombudsman if the number of speculative claims and 'nuisance' calls reduces.

### Key assumptions/sensitivities/risks

The costs and benefits of this option are based on the following information and assumptions: the total volume of PPI/ PBA claims has been estimated using data from the Financial Conduct Authority (FCA) consultation, the number of claims reaching the Financial Ombudsman and the proportion of claims upheld by the Financial Ombudsman; the average redress to consumers is calculated using the total amount of compensation paid out since 2007 and the total number of claims over this period from the FCA consultation; it is assumed that all CMCs will charge completion fees at the cap.

There are various risks associated with this option. These include: that the decrease in profits for CMCs will reduce what the regulator collects to finance its operations, meaning it will need extra funding from the MoJ; uncertainty around the volumes of successful claims may mean our estimates of the costs to CMCs and benefits to consumers may be higher or lower than what has been presented in this impact assessment.

The consultation process will seek further information on these issues.

<b>Direct impact on business (Equivalent Annual) £m):</b>			<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
Costs: £464m	Benefits: £0m	Net: -£464m	Yes	IN

# Summary: Analysis and Evidence

# Policy Option 3

**Description:** Amend rules affecting other financial claims

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
	Years			
Low			0.2	1
High			0.3	3
Best Estimate	NK		0.2	2

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

We estimate that there will be an annual cost to CMCs from the ban on upfront fees of £0.2 million, and a cost of £0.0 million from introducing a completion fee cap of 25 per cent.

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

Due to data limitations we have been unable to estimate all of the potential costs associated with this option. The main one is that the potential costs to CMCs if the average completion fee cap is lower than 25 per cent after the regulations have been introduced. There is a potential cost to consumers if the fall in profitability of CMCs means they are less likely to pursue complex claims.

BENEFITS (£m)	Total Transition (Constant Price)		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
	Years			
Low	0		0.2	1
High	0		0.3	3
Best Estimate	0		0.2	2

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

Consumers are estimated to benefit £0.2 million per annum from the ban on upfront fees

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

There is a potential benefit to consumers, businesses and the Financial Ombudsman if the number of speculative claims and 'nuisance' calls reduces.

### Key assumptions/sensitivities/risks

The costs and benefits of this option are based on the following information and assumptions: the total volume of non-PPI/ PBA claims has been estimated using the number of claims reaching the Financial Ombudsman and the proportion of claims upheld by the Financial Ombudsman; we have assumed that all CMCs will charge completion fees at the cap of 25 per cent, which is equivalent to the average completion fee at the moment. Therefore, the net cost of the cap is zero.

There are various risks associated with this option. The main one concerns the uncertainty around the volumes of successful claims which may mean our estimates of the costs to CMCs and benefits to consumers may be higher or lower than what has been presented in this impact assessment.

The consultation process will seek further information on these issues.

<b>Direct impact on business (Equivalent Annual) £m):</b>			<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
Costs: £0.2m	Benefits: £0m	Net: -£0.2m	Yes	IN

# Summary: Analysis and Evidence

# Policy Option 4

**Description:** Request that CMCs voluntarily adhere to Options 1 or 2 and 3

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: NK	High: NK	Best Estimate: NK

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

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

We expect a proportion of CMCs to voluntarily adhere to the rules. For those who are compliant there will be a cost from charging a lower completion fee and from choosing not to charge upfront fees:

- If all the rules are complied with, the costs will be the same as those described in Option 1 or 2 and 3.
- If compliance is 50 per cent, then there will be a cost to the CMC industry of around £190 million.
- If there is 0 per cent compliance, there is no cost to CMCs.

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

Due to data limitations we have been unable to estimate all of the potential costs associated with this option. If CMCs voluntarily adhere to the proposed rules then we expect there to be other potential costs to CMCs from: capping cancellation fees, if the current average fee charged is above £200; the proposed ban on fees being charged if no PPI/PBA exists for the client or where there is no relationship to the lender but where CMCs have undertaken an investigation into this; and the proposed ban on making and receiving financial payments to a third party for PPI / PBA claims. There is also a potential cost to consumers if the current average cancellation fee is below £200 and CMCs start charging at the level of the proposed cap.

BENEFITS (£m)	Total Transition (Constant Price)		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
	Years			
Low				
High				
Best Estimate	NK		NK	NK

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

If CMCs are compliant with the voluntary code then consumers would benefit from keeping more of their redress from lenders. This would be equal to the additional costs to CMCs described above.

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

There is a potential benefit to consumers, businesses and the Financial Ombudsman if the number of speculative claims and 'nuisance' calls reduces.

### Key assumptions/sensitivities/risks

The costs and benefits of this option are unknown as the expected level of compliance amongst CMCs is not known. Instead various scenarios looking at different levels of compliance is used to assess the costs and benefits. Alongside, this the costs and benefits are based on the same assumptions used under Option 1 or 2 and 3.

The consultation process will seek further information on these issues.

Direct impact on business (Equivalent Annual) £m):			In scope of OITO?	Measure qualifies as
Costs: NK	Benefits: NK	Net: NK		

# Summary: Analysis and Evidence

# Policy Option 5

**Description:** Improve consumer awareness and advertising around free alternatives for bringing a claim.

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: NK	High: NK	Best Estimate: NK

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate	NK		4	41

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

There will be a cost to whoever finances the consumer awareness campaign. We assume that a campaign will cost the equivalent of the FCA campaign described in their consultation. This would be £21 million annually for two years, costing a total of £42 million.

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

If the consumer campaign is effective then consumers may switch away from lodging complaints with CMCs to lodging complaints on behalf of themselves. Therefore, there may be costs to CMCs from lost business. Due to data limitations we do not know what proportion of individuals would switch and therefore what the cost to CMCs would be.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate	NK		NK	NK

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

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

Consumers will have more awareness and information of how to claim redress without contracting with a CMC. If consumers switch away from claiming mis-sold PPI/ PBA with a CMC they will benefit from retaining 100 per cent of their redress. We do not know the proportion of consumers that will switch, but will attempt to quantify this during the consultation process.

**Key assumptions/sensitivities/risks**

The main costs and benefits of this option are unknown as the expected number of consumers who will switch away from contracting their claim through CMCs is not known. Instead various scenarios looking at different levels of compliance is used to assess the costs and benefits. Alongside, this the costs and benefits are based on the same assumptions used under Option 1, and the cost of the consumer awareness campaign is assumed to be the same as in the FCA consultation.

There is a risk with this option, in that the CMRU may not be in a position to conduct a consumer awareness campaign. Their remit is to protect both consumers and the claims management companies so warning consumers not to use CMCs goes against their directive.

<b>Direct impact on business (Equivalent Annual) £m):</b>			<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
Costs: NK	Benefits: NK	Net: NK	Yes	N/A

# Evidence Base

## 1. Problem Under Consideration

- 1.1 Payment Protection Insurance (PPI) claims were designed to cover loan, mortgage, credit card or other credit repayments in the event of an accident, sickness or unemployment. Over a number of years lenders mis-sold PPI policies on a mass scale, and in recent years consumers have been able to claim redress from their lenders for being mis-sold these policies.
- 1.2 As with PPI claims, Packaged Bank Accounts (PBAs), which are accounts that offer benefits such as insurance policies and preferential interest rates on borrowing, and other financial claims, such as pensions and interest rate hedge funds, were also mis-sold by lenders and consumers can also claim redress from being mis-sold these products.

### Claims Management Companies

- 1.3 If they believe they have been mis-sold a product, consumers are able to pursue a claim against the lender in the Financial Products and Services (“financial claims”) sector in a number of ways. They may pursue it by filling out a questionnaire and sending this to the lender or, if they are unhappy with their lender’s initial decision, to the Financial Ombudsman Service (“Financial Ombudsman”). The Financial Ombudsman will then make an independent assessment on the case free of charge. Consumers can also contract with a Claims Management Company (CMC) to pursue matters on their behalf.
- 1.4 After a period of self-regulation, during which the claims management industry was unable to demonstrate it could govern itself appropriately, the Government introduced formal regulation of the industry via statutory legislation in the Compensation Act 2006. This came into force in April 2007.
- 1.5 Since the introduction of regulation, CMCs operating in the following sectors must be authorised and regulated by the Claims Management Regulation Unit (CMRU) within the Ministry of Justice (MoJ): personal injury, financial services, criminal injuries compensation, industrial injuries disablement benefits, employment and housing disrepair. During this time the CMRU have taken a number of steps to improve the regulation of CMCs and to help continue ensuring the right behaviours and practices of CMCs. These measures to date have not proved sufficient in protecting consumers from high fees and so further action is required.
- 1.6 At present there are around 1,700 authorised CMCs in operation. The CMRU Annual Report<sup>1</sup> for the 2014/15 regulatory year indicates that the overall turnover of the claims management sector during the 2014/15 financial year was a reported £772m. This is an increase of £74 million on the previous year’s reported turnover of £698m.
- 1.7 This impact assessment (IA) relates to proposals affecting the financial claims sector only in which there are currently around 850 CMCs in operation. The CMRU Annual Report indicates that the turnover of the financial claims sector during the 2014/15 financial year was a reported £458m, an increase of £5 million on the reported turnover for the sector for the 2013/14 financial year.

### Conduct Rules relating to fees

- 1.8 Regulated CMCs must comply with the Conduct of Authorised Rules 2014 (“CAPR”) as a condition of authorisation. The CAPR do not contain any restrictions on how much a CMC can charge a consumer in up-front fees, although there are requirements around the manner in

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<sup>1</sup> [www.gov.uk/government/publications/claims-management-regulator-annual-report-2014-to-2015](http://www.gov.uk/government/publications/claims-management-regulator-annual-report-2014-to-2015)

which charges are imposed and the information that should be given to consumers prior to the agreement of a contract.

- 1.9 CMCs are required to provide consumers with information regarding any applicable charges and also examples of how any charges would be calculated based on the amount of any final compensation. In addition, CMCs must provide consumers with information about how a client may cancel their contract and the consequences of doing so.
- 1.10 The rules in this area focus on the transparency of fees and ensuring that consumers are aware of any charges they may face before entering into a contract. However, in certain instances, the rules do not prevent CMCs from imposing high charges either in advance or upon the conclusion of a claim. Many consumers do not appear to understand the information that they are presented with and have reported that they feel the final charges imposed can be unnecessarily high. This is often seen in particular instances where a consumer has been required to undertake a level of work themselves, such as completing the Financial Ombudsman questionnaire, or providing relevant documentation to a CMC that they could have provided either directly to the lender or the Financial Ombudsman.

### **Rules regarding fairness and transparency**

- 1.11 The CAPR also contain rules around transparency in dealing with clients. This is to help ensure that consumers are aware of their options, as well as the potential implications and outcomes before they make a decision on whether to use a CMC.
- 1.12 CMCs must act fairly and reasonably in all dealings with consumers. Before a contract with a consumer can be agreed, CMCs must make reasonable enquiries as to whether a consumer has alternative options for pursuing a claim and must advise the consumer of ombudsman schemes or other official means of redress. CMCs are also obliged to make explicit to consumers their right to seek further advice or to shop around.
- 1.13 Although CMCs must also take reasonable steps to ensure that the client is able to understand the contract that they are being asked to agree, consumers do not appear to be understanding the information that they are presented with in many cases.

## **2. Rationale for Intervention**

- 2.1 Conventional economic approaches to government intervention are based on efficiency or equity arguments. In terms of the former, the government may consider intervening if there are strong enough failures in the way markets operate (e.g. the existence of monopoly) or if there are significant failures in existing government interventions (e.g. outdated or costly regulations). In all cases the proposed intervention should avoid generating a further set of disproportionate costs and distortions. The government may also intervene for reasons of equity or fairness and for re-distributional reasons (e.g. reallocating resources from one group in society to another).
- 2.2 The main rationale for the proposed reforms is efficiency. In particular, it relates to asymmetries of information which may exist between consumers and CMCs.
- 2.3 We have identified two forms of information asymmetry in the current financial claims sector, which CMCs have been able to exploit. Firstly, consumers may not fully understand the nature of the free alternatives for pursuing their claim or the real charges that they may be subject to. This has meant that CMCs are likely to be able to agree contracts with consumers that may potentially have opted for free alternative methods, if they were able to better understand their options at the outset.

- 2.4 Even if consumers are aware of the free alternatives they may still wish to instruct a CMC to pursue matters on their behalf. In this instance, the information asymmetry arises because consumers are unaware of the level of work required to investigate claims in the financial claims sector. This work can vary greatly, from mass PPI and PBA claims, which involve relatively little work, to mis-sold pensions and mortgage claims, which are more complex. Because consumers are unaware of the amount of work CMCs undertake, CMCs are able to charge fees above the market efficient level and do not represent the true value of the CMCs contribution in many cases.
- 2.5 Also, there is evidence that because of this information asymmetry, CMCs have, in certain circumstances, been providing a quality of service which makes it less likely for a consumer to obtain compensation than if the consumer had undertaken the process themselves – this is a problem of ‘adverse selection’. For example, data from the Financial Ombudsman shows the uphold rate (i.e. the business has done something wrong and needs to put things right) to be 61 per cent in 2014-15 for claims submitted by CMCs and 65 per cent for claims submitted by a consumer.
- 2.6 In addition to these asymmetries, CMCs appear to make a large number of speculative claims, without an appropriate level of investigation taking place to ascertain whether or not a particular policy does in fact exist. In many cases, no policy or relationship between a consumer and lender is ever found and this places additional administrative and financial burdens on lenders and other organisations such as the Financial Ombudsman. This excessive risk being taken on by CMCs is because they do not bear the burden of rejecting the speculative complaints and is a form of ‘moral hazard’.
- 2.7 These market failures justify the need for government intervention, and the options presented below are aimed at addressing the failures in the current financial claims market.

### **3. Objectives**

- 3.1 This policy has three broad objectives outlined below:
- 3.2 One of the aims is to protect consumers that wish to use the services of a financial claims CMC by ensuring that they are charged a fair and proportionate amount for the work undertaken on their behalf. Many consumers do not appear to fully understand the scope of their options, particularly the free alternatives that are available, or shop around for the best deal should they wish to use a CMC. The policy options discussed in this IA aim to provide more clarity to consumers and better protect consumers from being exploited.
- 3.3 Changes in this area should result in CMCs becoming inclined to be more efficient in the manner in which they conduct financial claims matters, whether dealing directly with lenders or the Financial Ombudsman on behalf of their clients. Through this we expect that improved operations more widely would be of benefit not only to the claims management industry in terms of reputation and output but also to consumers that wish to use a CMC regardless of whether they have been able to gain a full understanding of the scope of their options.
- 3.4 In addition to increased consumer protection, the proposals are designed to reduce the number of speculative claims lodged with lenders and, ultimately, the Financial Ombudsman. At present, CMCs can pursue speculative claims for relatively little risk and can take hundreds of pounds from consumers before any potential mis-selling is identified or any claim is settled.



- 3.5 Finally, the proposals outlined below aim to also reduce the level of nuisance calls and texts by CMCs and encourage CMCs to target their marketing more precisely than has been the case to date under existing requirements.
- 3.6 We believe the proposals outlined below will seek to address all or some of these objectives. If this is the case, then the market that emerges should be one in which consumers are better protected and better informed about how they can lodge financial claims against lenders. The proposals should encourage the market to operate more efficiently, whilst still encouraging a good deal of competition amongst CMCs.

## 4. Groups Affected

- 4.1 The main stakeholder groups, organisations and sectors affected by this proposal are:
- MoJ and the CMRU;
  - CMCs providing regulated services in England and Wales;
  - Consumers wishing to contract with a regulated CMC;
  - Lenders in those cases that may be pursued;
  - Other dispute resolution services e.g. the Financial Ombudsman;
  - Wider economy and society.

## 5. Policy Proposals

- 5.1 In the 2015 Summer Budget, the Chancellor announced that proposals were to be brought forward to cap the fees that regulated CMCs can charge their consumers. These proposals involve adding to the existing CAPR to address the issues outlined above. This IA identifies both monetised and non-monetised impacts of understanding what the net social impact might be from implementing the following options:
- **Option 0: Do Nothing.** Maintain the existing arrangements relating to CMC fees.
  - **Option 1: Amend rules affecting PPI and PBA claims only – 15 per cent cap**
  - **Option 2: Amend rules affecting PPI and PBA claims only – 10 per cent cap**
  - **Option 3: Amend rules affecting other financial claims**
  - **Option 4: Request that CMCs voluntarily adhere to Options 1 or 2 and 3**
  - **Option 5: Improve consumer awareness and advertising around free alternatives for bringing a claim.**
- 5.2 The Government's preferred option is to implement Options 1 and 3 concurrently. In the rest of this section, each of these options is described in more detail. The costs and benefits associated with each of these options are then presented in section 6.

## **Option 1: Amend rules affecting PPI and PBA claims only ('Bulk' claims) – 15 per cent cap.**

5.3 Under this option the following rule changes are proposed:

- A completion fee cap of 15 per cent (Inc. VAT) of the net amount of the final compensation awarded, for one or more PPI or PBA claims with a lender, where the total net value of all relevant claims equals £2,000 or less;
- An overall total charge cap of £300 (Inc. VAT), for one or more PPI or PBA claims with a lender where the total net value of all relevant claims totals more than £2,000;
- A maximum 'cancellation' fee of £300 (Inc. VAT) where a consumer cancels their contract with a CMC after the initial 14 day 'cooling off' period. To support this, CMCs would be required to ensure that all charges are reasonable and will be required to provide consumers with an itemised bill setting out details of what the charges relate to;
- A ban on any charges to a consumer where it is identified that the consumer does not have a relationship or relevant policy with the lender;
- A ban on CMCs receiving or making any financial payment for referring or introducing a client to a third party.

5.4 The proposed cap has been set at 15 per cent (Inc. VAT) as it provides a better reflection of the level of work typically required to pursue a claim. A recent comparison website<sup>2</sup> shows that out of 80 CMCs charging completion fees for PPI claims, 9 charged completion fees at or below the proposed cap. For CMCs dealing with PBA claims, the website showed 2 firms out of 19 charged at or below the proposed cap. This shows that completion fees in this range are viable and would enable the most efficient CMCs to operate and make a profit. Based on subject matter expertise the CMRU also believe this level of completion fee is more aligned to the relatively simplistic nature of most PPI and PBA claims.

5.5 This option proposes a ban on up-front fees, which is expected to incentivise CMCs to reduce the level of nuisance calls made in order to gain a fee before any work is undertaken. This would provide better conditions for consumers, who will only be required to pay reasonable charges once it has been ascertained whether or not they have a claim and are successful in making that claim.

## **Option 2: Amend rules affecting PPI and PBA claims only ('Bulk' claims) – 10 per cent cap.**

5.6 Under this option the following rule changes are proposed:

- A completion fee cap of 10 per cent (Inc. VAT) of the net amount of the final compensation awarded, for one or more PPI or PBA claims with a lender, where the total net value of all relevant claims equals £2,000 or less.
- An overall total charge cap of £200 (Inc. VAT), for one or more PPI or PBA claims with a lender where the total net value of all relevant claims totals more than £2,000;
- A maximum 'cancellation' fee of £200 (Inc. VAT) where a consumer cancels their contract with a CMC after the initial 14 day 'cooling off' period. To support this, CMCs would be required to ensure that all charges are reasonable and will be required to provide consumers with an itemised bill setting out details of what the charges relate to;

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<sup>2</sup> <http://lbcompare.co.uk/compare-claims-management-companies/payment-protection-insurance-ppi-reclaim>

- A ban on any charges to a consumer where it is identified that the consumer does not have a relationship or relevant policy with the lender;
- A ban on CMCs receiving or making any financial payment for referring or introducing a client to a third party.

5.7 A cap at this level would bring the maximum completion fee down to the lowest known level of charges currently seen within the industry. Although resources for price comparison information of CMCs offering financial claims services has traditionally been non-existent, the recent launch of the Legal Beagles' Compare site provides an initial indicative insight into the range of charges currently seen in the financial claims sector. The new comparison site suggests that some CMCs currently charge a 10 per cent completion fee for PPI claims specifically, which indicates that fee levels as low as this are viable for some CMCs. A fee limit at this lower level would ensure that consumers receive no less than 90 per cent of any compensation and would protect consumers even further. A limit set at 10 per cent could reduce the scope for variations in pricing levels across the industry with it being less likely for there to be differing charges (i.e. with a cap of 10 per cent - 15 per cent some will charge towards the higher/ lower end). With a 10 per cent limit it is expected that most would charge the maximum 10 per cent, as, based on the available evidence, no CMC currently charges lower than this.

### **Option 3: Amend rules affecting other financial claims.**

5.8 Under this option the following rule changes are proposed:

- A completion fee cap of 25 per cent (Inc. VAT) of the net amount of the final compensation awarded per product for all other claims in the financial claims sector;
- A ban on any upfront fees being charged to a consumer for the pursuit of any financial claims.

5.9 The level of cap is set at 25 per cent as we believe this reflects the additional level of the work required to pursue these types of claims. Other financial claims are thought to be more complex than PPI/PBA claims, and involve a greater level of resource. This is the reason a higher cap has been set for these types of claims. A 25 per cent cap is also around the industry average for these types of fees so will minimise the impact on CMCs operating in these sectors.

### **Option 4: Request that CMCs voluntarily adhere to Options 1 or 2 and 3.**

5.10 Under this option the CMRU would request CMCs to comply with the rule changes proposed under Options 1 or 2 and 3, with the threat of the CMRU imposing regulation in the future should they not choose to do so. The prospect of future regulation should provide the incentive for CMCs to reform fee structures and adopt best practices.

5.11 There are a number of issues that may occur under this option. Firstly, it is expected that the majority of CMCs would not comply, or be willing to follow, a voluntary code that reduces or restricts the level of fees that CMCs are able to charge consumers for financial claims. The Regulator was originally deemed necessary following a failure by the industry to improve its conduct or govern itself appropriately. Regulations and rules that govern the behaviours and practices of CMCs were introduced to help the industry improve its conduct further. However, a number of CMCs currently do not follow the intention of the current rules, which are intended to rule out some practices that the proposals set out now seek to address further.

5.12 Further, CMCs already have an opportunity to sign up to a voluntary code in relation to the Professional Financial Claims Association Code (PFCA). The PFCA currently operates a voluntary code for its members who are financial claims CMCs. This voluntary code agrees not

to charge consumers up-front fees, but the vast majority of its additional requirements focuses on providing better service to consumers. This code does not have any further restrictions on price (and is therefore probably weaker than the proposed voluntary code proposed under this option), but, even still, only 5 CMCs out of around 850 have signed up to the PFCA.

- 5.13 Finally, a voluntary code would also cause confusion amongst consumers as to what the fee charging requirements are and would effectively contradict the intention of the proposed changes. CMCs would have a clear monetary incentive not to follow a voluntary code, particularly if the numbers of CMCs choosing to work under the code remained low.

#### **Option 5: Improve consumer awareness and advertising around free alternatives for bringing a claim.**

- 5.14 Under this option a consumer awareness campaign would be launched to advertise the free alternatives for bringing a claim. However, the specific details of how such a campaign would work have not been scoped out yet.
- 5.15 As with Option 4 above, there are a number of reasons to believe that this option would not address the issues described in the Rationale section.
- 5.16 Firstly, CMCs are already obliged to provide clear and comprehensive information to consumers about their options (including alternative methods) and potential charges to consumers should they be successful in making a claim, prior to the agreement of any contract. The issue appears to be that some consumers, even where provided with clear information regarding their potential options and relevant charges, do not fully understand the information they are presented with or the scope of the potential options available.
- 5.17 Lenders also have guidance on their own websites and mechanisms that allow consumers to bring claims themselves. Although accessibility and exposure to this sort of information is expected to continue to improve, consumers currently do not appear to be understanding the costs to them of using a CMC early enough in the process.
- 5.18 Finally, the role of the CMRU is to ensure that CMCs act appropriately in all dealings with clients, and therefore it may be inappropriate for the CMRU to actively advise consumers to pursue other avenues of redress. Some consumers may prefer to pursue claims through a CMC.

## **6. Costs and Benefits**

- 6.1 This IA attempts to identify both monetised and non-monetised impacts on individuals, groups and businesses in the UK, with the aim of understanding what the overall impact to society might be from implementing these options. The costs and benefits of each option are compared to the 'do nothing' option where the current arrangements concerning CMC fees remain in place.
- 6.2 Where possible this IA has attempted to quantify and monetise the expected costs and benefits, however, it has not been possible to monetise some of the identified impacts in this IA, as sufficient data or estimates are not available at this point. Instead we have collated information provided by lenders, the FCA, Citizens Advice Bureau (CAB) and the Financial Ombudsman on the volume of cases and the average up-front and completion fees to monetise certain impacts. However, in order to provide more certainty around these estimates and to quantify other costs we need to understand different CMCs operating models and charging structures, which is sensitive commercial information. We aim to acquire more of this

information during the consultation in order to provide a fuller assessment of the costs and benefits for the final impact assessment.

## **General Data and Assumptions**

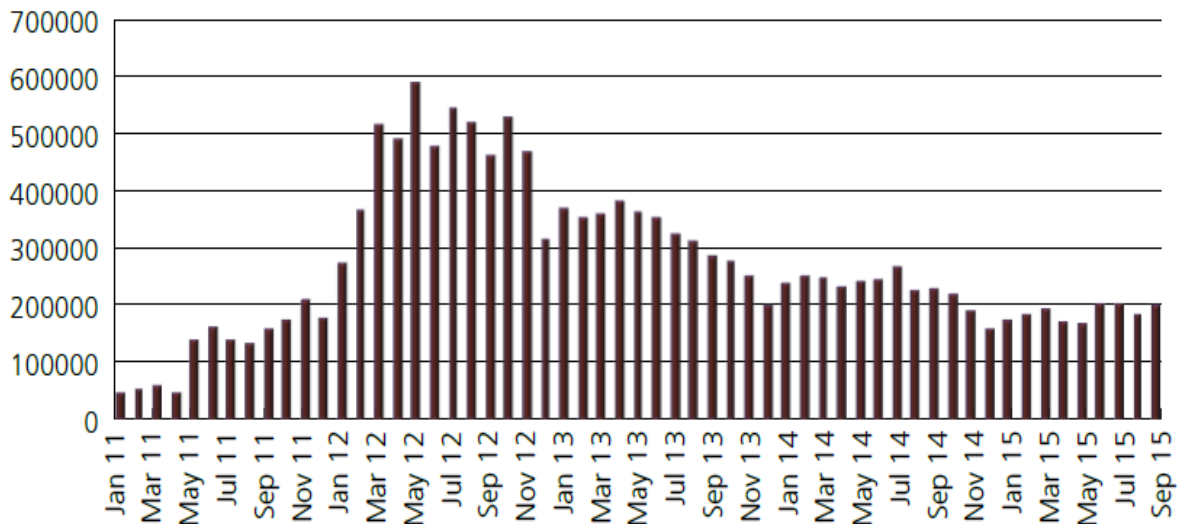
### Volume of PPI/ PBA claims

6.3 In order to estimate the total amount of income CMCs receive from completion fees and up-front fees it is necessary to understand the total volume of PPI/ PBA claims, which received redress in 2014-15. Claims that didn't receive redress would not have a fee associated with them and so are not included in the analysis.

#### *PPI Claims*

6.4 The consultation published by the Financial Conduct Authority (FCA)<sup>3</sup> provides information on the number of PPI claims to lenders (see Figure 1). Unfortunately, it has not been possible to obtain the underlying data, so we have assumed an average of 200,000 PPI complaints per month in 2014-15 (i.e. from April 2014 to March 2015). This gives a total annual amount of 2.4 million complaints.

Figure 1: PPI complaints to lenders by month January 2011 – September 2015



6.5 The FCA consultation also states that during this period the uphold rate was 75 per cent, and that in 2014, the number of cases which were lodged with lenders by CMCs was 47 per cent. Multiplying the approximated annual amount of complaints (2.4 million) by the uphold rate (75 per cent) and by the proportion of cases which went through the CMCs (47 per cent) we estimate the volume of upheld cases which went to lenders through the CMCs to be approximately 850,000 for 2014-15.

6.6 In addition to this, the Financial Ombudsman received 160,000 PPI claims from CMCs in 2014-15, of which 61 per cent were upheld. This equates to approximately 100,000 cases. Adding the total claims CMCs levelled to businesses with the number of claims they levelled to the Financial Ombudsman, gives us an overall number of upheld PPI claims from CMCs of around 950,000.

<sup>3</sup> <http://www.fca.org.uk/static/fca/documents/consultation-papers/cp-15-39-ppi-complaints.pdf>

## *PBA Claims*

6.7 We assume the volume of PBA claims is equal to the number of claims which reached the Financial Ombudsman. The Financial Ombudsman estimate that approximately 15,000 were levelled in 2014-15. The uphold rate on these claims was estimated to be 27 per cent, which means the overall number of upheld PBA claims is roughly 4,000. This is likely to underestimate the number of PBA claims as it does not include the number of PBA claims upheld by lenders. We do not currently have information on the number of PBA claims submitted to lenders, but will attempt to obtain this information during the consultation.

## *Total*

6.8 Combining the volumes for PPI and PBA claims the total volume of upheld claims is estimated to be around 950,000.

## Volume of non-PPI/PBA financial claims

6.9 The Financial Ombudsman also received around 5,000 claims in 2014-15 relating to other financial claims. Of these 27 per cent were upheld. Therefore, we assume the number of upheld other financial claims is 1,380. This is expected to underestimate the total number of other financial claims as it doesn't include the number of claims submitted by CMCs direct to lenders. During the consultation we will endeavour to collate this information in order to refine this assumption.

## Consumer redress

6.10 The consultation published by the FCA states that 12 million consumers have received total redress for PPI claims of £21 billion since 2007. Therefore, dividing total redress (£21 billion) by the volume of upheld claims (12 million) we estimate the average redress per consumer to be approximately £1,800 for PPI claims, which we will use as the average consumer redress for PPI and PBA claims. During the consultation we will aim to refine this estimate by acquiring a more detailed breakdown on completion fees and the associated volume of cases for both PPI and PBA claims.

## Completion fee charged by CMCs

6.11 Looking at the completion fee charged by the top 100 CMCs, we estimate an average completion fee of 29 per cent of the amount of redress received by the consumer. However, there is significant variation amongst different providers and so to account for this we apply a range of +/- 5 percentage points to our best estimate.

## Up-front fees charged by CMCs

6.12 We assume the average upfront fee charged by CMCs in 2014-15 is approximately £720 between January 2015 and June 2016. This is based on data collected by the CAB<sup>4</sup>.

6.13 To account for potential uncertainty we apply a range of +/- 10 per cent, which gives a lower bound of £650 and an upper bound of £790.

## Compliance

6.14 We assume all firms will be compliant with the new proposed rules.

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<sup>4</sup> Intelligence document for the Ministry of Justice claims management regulator; Quarter 4 2014-15 & Quarter 1 2015-16

## Turnover

6.15 Based on the information provided in the assumptions above (regarding the annual volume of claims, the value of the average claim, the average proportion retained by the CMC in completion fee as well as figures regarding upfront fees) we estimate turnover for CMCs to be between £500 million and £760 million with a best estimate of £640 million. This is a best estimate based on the available data which does not correspond with the figure mentioned in paragraph 1.7. We hope to try and better align these figures using information gathered during the consultation period.

### **Option 0: Base case (do nothing)**

6.16 Under this option, no intervention would be made. This means the current regime would remain meaning that high charges, speculative claims and nuisance calls would continue.

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

### **Option 1: Amend rules affecting PPI and PBA claims only – 15 per cent cap**

#### Costs

##### *MoJ/ CMRU*

6.18 The MoJ will not incur any costs to implement the proposed rule changes, as the CMRU is self-funded via regulatory fees paid by CMCs. However, there is a risk to the CMRU that, due to the reduced profitability of the industry, their regulatory fee revenue may be reduced to below full cost recovery meaning either the MoJ may have to contribute towards the CMR's running costs if it cannot finance itself from fees it collects from the industry, or regulatory fees are increased for those CMCs who remain in the market. It is not possible to quantify this impact at this stage, because it is not known how many CMCs would exit the market. As the proposed cap would not come into force until part-way through the 2016-17 regulatory year and would apply to new claims only, the impact on CMRU would likely be felt from the 2017/18 regulatory year at the earliest. The information obtained via the consultation exercise will be used to provide further analysis in this particular area.

##### *CMCs*

6.19 Under Option 1, there would be a cap of 15 per cent (Inc. VAT) of the net amount of the final compensation awarded, for one or more PPI or PBA claims with a lender, where the total net value of all relevant claims equals £2,000 or less. This would be combined with an overall maximum fee cap of £300 for one or more PPI or PBA claims with a lender where the total net value of all relevant claims totals more than £2,000.

6.20 We assume the average income CMCs gain per completion fee is between £420 and £590, with a best estimate of £500. This is calculated by multiplying the average amount of consumer redress (£1,800) with the average percentage charged by CMCs on this redress (between 24 per cent and 34 per cent). Multiplying this by the volume of PPI/ PBA complaints (950,000) we estimate current income from completion fees of between £390 million and £560 million, with a best estimate of £480 million.

6.21 Assuming the same volume of claims, and given the new 15 per cent cap on completion fees, we estimate the new income generated from completion fees will be £250 million<sup>5</sup>. Therefore,

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<sup>5</sup> The average fee for CMCs will be equal to 15 per cent of the average consumer redress (£1,750), which equals around £250.

there is an annual cost to CMCs from capping completion fees of between £140 million and £310 million, with a best estimate of £230 million. Over ten years<sup>6</sup>, in present value terms, this equates to a cost between £1.2 billion and £2.7 billion, with a best estimate of £2 billion.

- 6.22 The current FCA consultation proposes to place a deadline for mis-sold PPI complaints 2018. If this is the case then this option will only impact CMCs and consumers for 2 years, and so the NPV would be between £280 million and £610 million, with a best estimate of £450 million.
- 6.23 This option also proposes a ban on all up-front fees. The CAB provided pre-consultation information on the proportion of CMCs that charge up-front fees. The estimates are for all types of claims (i.e. PPI, Motor Insurance, Professional Services etc.) and not just for financial claims products.
- 6.24 The CAB found that between January and March 2015, 27 per cent of cases mentioned up-front fees and between April and June 2015, 18 per cent of CMCs mention up-front fees. Using a weighted average based on the number of cases CAB found mentioned up-front fees we assume up-front fees are charged in 24 per cent of cases<sup>7</sup>. To account for uncertainty we use 27 per cent as an upper bound and 18 per cent as a lower bound. This might not be representative if the firms who charge up-front fees are those with a high number of claims, but we will seek to identify the proportion of claims in which an up-front fee is paid during the consultation.
- 6.25 Applying the proportion of cases with up-front fees (18 per cent to 27 per cent), to the total volume of claims (950,000), we assume there were between 170,000 and 260,000 claims in 2014-15 where an up-front fee was paid. Our best estimate is 220,000. Multiplying this by the average up-front fee (between £650 and £790), we estimate current income from up-front fees for CMCs to be between £110 million and £200 million with a best estimate of £160 million.
- 6.26 Under the new proposal CMCs will not be able to profit from upfront fees and hence their new income from the fee will be zero. Therefore, there is an annual cost of between £110 million and £200 million, with a best estimate of £160 million. Over 10 years, in present values, we estimate costs to CMCs from up-front fees of between £0.9 billion and £1.7 billion with a best estimate of £1.4 billion. CMCs remaining in the market who charge up-front fees may look to recover their costs by charging the maximum completion fee (i.e. 15 per cent of claim value or £300), which is already factored into the analysis presented in paragraph 6.21.
- 6.27 The rule regarding a fee cap of £300 on cancellations which occur for work completed after a 14 day “cooling off period” will also create a cost to CMCs who charge more than £300. From the data available we estimate the average cancellation fee to be between £10 and £90 *per hour* but we do not know the average number of hours charged for. Therefore, we are unable to estimate the total average cancellation fee. There would be a cost to CMCs if the average number of hours charged for was above 3 (at £90 per hour) or above 30 (at £10 per hour). There is also limited data on the volume of cancellations and so during the consultation we will try to obtain data on the volume of cancellations and the average cancellation fee to better assess this impact.

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<sup>6</sup> The recent Financial Conduct Authority (FCA) consultation is consulting on whether to introduce a deadline by which all PPI complaints are handled. The proposal is for the deadline to be in two years, so the total costs to CMCs in present values might need to be assessed over two years if the FCA decides to go ahead with this proposal. As this has not yet been agreed we are still assessing costs and benefits over a ten year time period.

<sup>7</sup> There were 91 cases in 2014-15 Q4 and 52 cases in 2015-16 Q1.



6.28 This option also includes the following rule changes:

- A ban on any charges to a consumer where it is identified that the consumer does not have a relationship or relevant policy with the lender
- A ban on CMCs receiving or making any financial payment for referring or introducing a client to a third party

6.29 For the former, there will be a cost to CMCs if they undertake initial investigation costs and it transpires that there is no relevant policy or relationship between their consumer and lender. We do not have data on the volume of these types of investigations or of the costs to the CMCs as it is sensitive commercial information, and so are unable to quantify the potential impact. We will attempt to gather information on this during the consultation, to better assess the impact prior to implementation of the policy.

6.30 The latter will impose a cost to CMCs who only refer consumers as they will need to alter their business models to a client representation model or refer their clients with no charge. This may cause a one-off change as it will render certain business models unviable. At this stage we do not know how many CMCs operate with this business model, or how much it would cost to adapt their business structure, but we will try to fill these evidence gaps during the consultation.

6.31 In summary, the total cost of the Option 1 to CMCs is estimated to be between £250 million and £510 million with a best estimate of £390 million, cutting their current income from managing PPI/PBA claims by between 51 per cent and 67 per cent. Over ten years, this would impose a cost of between £2.1 billion and £4.4 billion, with a best estimate of £3.3 billion.

6.32 The current FCA consultation proposes to place a deadline for mis-sold PPI complaints 2018. If this is the case then this option will only impact CMCs and consumers for 2 years, and so the NPV would be between £500 million and £1 billion with a best estimate of £760 million.

6.33 The fall in profitability in the PPI/PBA market makes it likely that some firms will exit the market. The Regulator expects a third of CMCs to either move into other sectors or exit the market altogether. The consultation exercise will be used to test these assumptions.

#### *Consumers*

6.34 There is a possible cost to consumers in terms of the cancellation fee cap (£300 if after 14 day cooling off period) if CMCs charge the full cap, although the previous average cancellation fee was below £300. However, as for the costs to CMCs we do not currently have data that will enable us to quantify this impact. During the consultation we will attempt to gather data out the volume of cancellations and the current average cancellation fee consumers pay to CMCs in order to work out if there is a cost to consumers.

#### Benefits

#### *Consumers*

6.35 Consumers will benefit from the proposals, as they are designed to allow consumers to keep more of their compensation. In general, consumers would benefit from the policy at the CMCs expense. Therefore, we estimate consumers would benefit between £250 million and £510 million, with a best estimate of £390 million. Of this, £230 million is due to the cap on completion fees, and £160 million results from the proposed ban on up-front fees. Over ten years, in present values, this equates to benefit between £2.1 billion and £4.4 billion, with a best estimate of £3.3 billion.

6.36 As with the costs to CMCs, we are unable to quantify the potential benefits from some of the other proposed rules, but will use the consultation to collect data that will help assess these benefits prior to the implementation of the policy.

#### *Businesses and the Financial Ombudsman*

6.37 Businesses may save time from dealing with a reduction in speculative claims made by CMCs. We do not currently know the amount of time lenders and the Financial Ombudsman spend in dealing with speculative claims so the consultation will be used to collect data to help quantify the savings businesses may make in having a more efficient use of resources.

#### Net Impact

6.38 Overall, we assess this option to have an annual net cost of zero, and a 10 year cost, in present value terms of zero. This is because the monetised costs to CMCs are offset by benefits to consumers. There may be further costs to CMCs and benefits to consumers and businesses that have not been quantified at this stage, and for which we will seek the data during the consultation.

### **Option 2: Amend rules affecting PPI and PBA claims only – 10 per cent cap**

#### Costs

##### *MoJ/ CMRU*

6.39 Consistent with Option 1 (paragraph 6.18), The MoJ will not incur any costs to implement the proposed rule changes. However, there is a risk to the CMRU that, due to the reduced profitability of the industry, their regulatory fee revenue may be reduced to below full cost recovery. This means that either the MOJ may have to contribute towards the CMR's running costs if it cannot finance itself, or regulatory fees are increased for those CMCs who remain in the market. It is not possible to quantify this impact at this stage, because it is not known how many CMCs would exit the market. As the proposed cap would not come into force until part-way through the 2016-17 regulatory year and would apply to new claims only, the impact on CMRU would likely be felt from the 2017/18 regulatory year at the earliest. The information obtained via the consultation exercise will be used to provide further analysis in this particular area.

##### *CMCs*

6.40 As with Option 1 (paragraph 6.20), we estimate current income from completion fees of between £390 million and £560 million, with a best estimate of £480 million. We also estimate current income from up-front fees to be between £110 million and £200 million, with a best estimate of £160 million (paragraph 6.20).

6.41 Assuming the same volume of claims, and given the new 10 per cent cap on completion fees, we estimate the new income generated from completion fees will be around £165m million<sup>8</sup>. Therefore, there is an annual cost to CMCs from capping completion fees of between £230 million and £390 million, with a best estimate of £310 million. Over 10 years, in present value terms, this equates to a cost of between £2 billion and £3.4 billion with a best estimate of £2.7 billion. Over two years<sup>9</sup>, in present value terms the cost is between £450 million and £770 million, with a best estimate of £610 million.

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<sup>8</sup> The average fee for CMCs will be equal to 10 per cent of the average consumer redress (£1,750), which equals around £175.

<sup>9</sup> The recent Financial Conduct Authority (FCA) consultation is consulting on whether to introduce a deadline by which all PPI complaints are handled. The proposal is for the deadline to be in two years, so the total

- 6.42 Further, under the new proposal CMCs will not be able to profit from upfront fees and hence their new income from the fee will be zero. Therefore, there is an annual cost of between £110 million and £200 million, with a best estimate of £160 million. Over 10 years, in present values, we estimate costs to CMCs from up-front fees of between £0.9 billion and £1.7 billion with a best estimate of £1.4 billion. CMCs remaining in the market who charge up-front fees may look to recover their costs by charging at the maximum completion fee (i.e. 10 per cent of claim value or £200), which is already factored into the analysis.
- 6.43 In summary, the total cost of Option 2 to CMCs is estimated to be between £340 million and £600 million with a best estimate of £470 million, cutting their current income from managing PPI/PBA claims by between 67 per cent and 78 per cent. Over ten years, this would impose a cost of between £2.9 billion and £5.1 billion, with a best estimate of £4.1 billion. The current FCA consultation proposes to place a deadline for mis-sold PPI complaints 2018. If this is the case then this Option will only impact CMCs and consumers for 2 years, and so the NPV would be between £660 million and £1.1 billion, with a best estimate of £930 million.

#### *Consumers*

- 6.44 The potential costs to consumers described in paragraph 6.34 also applies here for Option 2. There is a possible cost to consumers in terms of the cancellation fee cap (£200 if after 14 day cooling off period) if CMCs charge the full cap, although the previous average cancellation fee was below £200. More information on this will be sought during consultation.

#### Benefits

#### *Consumers*

- 6.45 Consumers would benefit from the policy at the CMCs expense. Therefore, we estimate consumers would benefit between £340 million and £600 million, with a best estimate of £470 million. Of this, £310 million is due to the cap on completion fees, and £160 million is results from the proposed ban on up-front fees. Over ten years, in present values, this equates to benefit between £3 billion and £5.1 billion, with a best estimate of £4.1 billion. The current FCA consultation proposes to place a deadline for mis-sold PPI complaints 2018. If this is the case then this Option will only impact CMCs and consumers for 2 years, and so the 2 year NPV equates to between £660 million and £1.2 billion with a best estimate of £930 million.
- 6.46 As with the costs to CMCs, we are unable to quantify the potential benefits from some of the other proposed rules, but will use the consultation to collect data that will help assess these benefits prior to the implementation of the policy.

#### *Businesses and the Financial Ombudsman*

- 6.47 Consistent with 6.37, businesses may save time from dealing with a reduction in speculative claims made by CMCs and the extent of this will be investigated during consultation.

#### Net Impact

- 6.48 Overall, we assess this option to have an annual net cost of zero, and a 10 year cost, in present value terms of zero. This is because the monetised costs to CMCs are offset by benefits to consumers. There may be further costs to CMCs and benefits to consumers and businesses

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costs to CMCs in present values might need to be assessed over two years if the FCA decide to go ahead with this proposal. As this has not yet been agreed we are still assessing costs and benefits over a ten year time period.

that have not been quantified at this stage, and for which we will seek the data during the consultation.

### **Option 3: Amend rules affecting other financial claims**

#### Costs

##### *MoJ/ CMRU*

6.49 As with Option 1, the MoJ will not incur any costs to implement the proposed rule changes, as the CMRU is self-funded via regulatory fees paid by CMCs. However, there is a risk to the CMRU that, due to reduced profitability of the industry, their regulatory fee revenue may be reduced below full cost recovery. The MoJ may have to contribute towards the CMRU's running costs if it cannot finance itself from fees it collects from the industry, or regulatory fees may have to be increased for those CMCs who remain in the market. It is not possible to quantify this impact at this stage, because it is not known how many CMCs would exit the market. The effects of this would not likely be seen before the 2017/18 regulatory year. The information obtained via the consultation exercise will be used to provide further analysis in this particular area.

##### *CMCs*

6.50 It is assumed that businesses currently charge an average of 25 per cent for completion fees relating to other financial claims, and under the new proposals, there will be a cap of 25 per cent on these completion fees. We have assumed all CMCs will charge fees at the cap and so the net cost of introducing the cap on CMCs is zero.

6.51 However, if those who currently charge below 25 per cent remain below 25 per cent then there will be a net cost to CMCs. This is because CMCs who charge above 25 per cent will have to reduce their fees to the cap, whilst CMCs who charge below 25 per cent do not have to adjust their fees. This means the industry average for other financial claims might fall below 25 per cent, which in turn may mean there is a fall in income for CMCs from introducing the fee cap. It is not possible to quantify this at this stage but information on CMCs charging structures will be sought during the consultation.

6.52 It would also no longer be possible to charge upfront fees on all financial claims. We do not currently have information on the proportion of claims in which an up-front fee has been charged, and so we assume the same proportion of cases are charged up-front fees as in PPI/PBA cases. Therefore, combining the number of claims (around 1,000), with the proportion of claims assumed to have been charged an up-front fee (between 18 per cent and 27 per cent) we estimate the current income for CMCs from up-front fees for other financial claims to be between £0.2 million and £0.3 million.

6.53 Under this option, up-front fees would be banned so income from up-front fees would fall to zero. Therefore, there is an annual cost to CMCs of between £0.2million and £0.3 million. Over ten years, in present values, this equates to a cost between £1 million and £3 million, with a best estimate of £2 million.

6.54 The current FCA consultation proposes to place a deadline for mis-sold PPI complaints 2018. If this is the case then this option will only impact CMCs and consumers for 2 years, and so the NPV for upfront fees would be between £0.3m and £0.6m with a best estimate of £0.5m.

## Benefits

### *Consumers*

- 6.55 Consumers may benefit from paying a lower percentage in completion fees, providing CMCs who currently charge below the 25 per cent cap will continue to do so whilst CMCs charging higher fees are capped to 25 per cent, the current perceived average. It is currently not possible to quantify this as we do not have a breakdown of CMCs charging structures but information on this will be sought during the consultation.
- 6.56 Consumers will benefit from the ban on upfront fees, estimated to be between £0.2 million and £0.3 million. In present value terms this will be approximately £2 million over ten years.

### *Businesses and the Financial Ombudsman*

- 6.57 As with Option 1, it is envisaged that lenders and the Financial Ombudsman will experience a reduction in speculative claims from CMCs. However, the scale of this reduction and amount of resource freed up is not currently known. The extent of this impact will be investigated in consultation.

## Net Impact

Overall, we assess this option to have an annual net cost of zero, and a 10 year cost, in present value terms of zero. This is because the monetised costs to CMCs are offset by benefits to consumers. There may be further costs to CMCs and benefits to consumers and businesses that have not been quantified at this stage, and for which we will seek the data during the consultation.

### **Option 4: Request that CMCs voluntarily adhere to Options 1 or 2 and 3.**

- 6.58 Imposing a voluntary code would necessitate the CMRU to request CMCs comply with the rule changes proposed under Options 1 or 2 and 3, with the threat of the CMR imposing regulation in the future should they not choose to do so. The prospect of future regulation should provide the incentive for CMCs to reform fee structures and best practises, although to what extent CMCs may do this (if at all) and the quantity of CMCs who would conform (if any) is unknown. We illustrate the costs and benefits of the following scenarios:

- All of the rules proposed under Options 1 and 3 are complied with by zero per cent, 50 per cent and 100 per cent of CMCs;
- None of the rules proposed under Options 1 and 3 are complied with by 0 per cent, 50 per cent and 100 per cent of CMCs;
- All of the rules proposed under Option 1 only are complied with by zero per cent, 50 per cent and 100 per cent of CMCs;
- All of the rules proposed under Option 3 only are complied with by zero per cent, 50 per cent and 100 per cent of CMCs; and
- All of the rules proposed under Option 2 only are complied with by zero per cent, 50 per cent and 100 per cent of CMCs.

*All of the rules proposed under Options 1 and 3 are complied with by zero per cent, 50 per cent and 100 per cent of CMCs*

- 6.59 Under this scenario the costs and benefits will be the same as for Options 1 and 3 explained above. This is because the proposed voluntary code would be identical to the proposed rule changes.

6.60 If all CMCs complied the annual cost to CMCs would be between £250 million and £510 million with a best estimate of £390 million, cutting their current income from managing PPI/ PBA claims by between 51 per cent and 67 per cent. There are also additional costs to CMCs and potentially consumers under Options 1 and 3, which we have been unable to quantify but would also apply under this scenario. Table 6.1 shows how the cost to CMCs changes depending on various levels of compliance.

6.61 As with Options 1 and 3 the cost to CMCs would be offset by benefits to consumers and there may also be benefits to lenders and the Financial Ombudsman. These are set out in paragraphs 6.35 to 6.37 and 6.55 to 6.57 above.

Table 6.1: Costs to CMCs from following all of the voluntary code

Proportion compliant	Lower Bound	Central Estimate	Upper Bound
Zero per cent	£0	£0	£0
50 per cent	£130m	£190m	£260m
100 per cent	£250m	£390m	£510m

*None of the rules proposed under Options 1 and 3 are complied with by 0 per cent, 50 per cent and 100 per cent of CMCs*

6.62 Alternatively, if CMCs chose not comply with any of the voluntary code then the costs and benefits would mirror the Do Nothing option. Therefore, there would be no cost to CMCs as the current market structure would remain. There would also be no benefits to consumers and lenders.

*All of the rules proposed under Option 1 only are complied with by zero per cent, 50 per cent and 100 per cent of CMCs*

6.63 If all CMCs only complied with Option 1, i.e. complying with rules relating to PPI/ PBA claims but not complying with rules relating to other financial claims, then the annual costs to CMCs is estimated to be between £250m and £510m with a best estimate of £390m. Again, as with the scenario where all of the voluntary code were followed, the costs to CMCs varies by the level of compliance. For example, if the level of compliance was 50 per cent then the costs to CMCs are estimated to be between £130m and £260m, with a central estimate of £190m (see Table 6.1). These costs are offset by benefits to consumers, lenders and the Financial Ombudsman.

Table 6.2: Costs to CMCs from following the part of the voluntary code relating to PPI/PBA claims

Proportion compliant	Lower Bound	Central Estimate	Upper Bound
Zero per cent	£0	£0	£0
50 per cent	£130m	£190m	£260m
100 per cent	£250m	£390m	£510m

*All of the rules proposed under Option 3 only are complied with by zero per cent, 50 per cent and 100 per cent of CMCs*

6.64 If all CMCs only complied with Option 3, i.e. complying with rules relating to other financial claims but not complying with rules relating to PPI/PBA claims, then the annual costs to CMCs is estimated to be between £0.2m and £0.3m with a best estimate of £0.2m. Again, the costs to CMCs varies by the level of compliance. For example, if the level of compliance was 50 per cent then the costs to CMCs are estimated to be around £0.1 million (see Table 6.3). These costs are offset by benefits to consumers, lenders and the Financial Ombudsman.

Table 6.3: Costs to CMCs from following the part of the voluntary code relating to other financial claims

Proportion compliant	Lower Bound	Central Estimate	Upper Bound
Zero per cent	£0	£0	£0
50 per cent	£0.1m	£0.1m	£0.1m
100 per cent	£0.2m	£0.2m	£0.3m

*All of the rules proposed under Options 2 are complied with by 0 per cent, 50 per cent and 100 per cent of CMCs*

6.65 If option 4 was to be a voluntary code that reflected Option 2; the 10 per cent cap on completion fees with £200 maximum on claims over £2000, £200 cancellation fee and concurrent ban on upfront fees, then a similar scenario would be expected. With 0 per cent compliance from CMCs, they will bear no cost. With 50 per cent compliance, they will bear a cost of and between £170 million and £300 million, with a best estimate of £240 million. With 100 per cent compliance, they will bear a cost of between £340 million and £600 million, with a best estimate of £470 million.

6.66 The likelihood of CMCs following a voluntary code is thought to be low due to the reasons explained in paragraphs 5.11 and 5.12.

### **Option 5: Improve consumer awareness and advertising around free alternatives for bringing a claim.**

#### Costs

##### *MoJ/ CMRU/ lenders*

6.67 There would be considerable costs to running a consumer awareness campaign, which would most likely be incurred by the CMRU. The FCA consultation estimates annual costs of running a consumer awareness campaign of around £21 million for two years. This would be for a campaign that would involve broadcasting on TV, digital advertising, creating an information helpline and programme of public relations. We have assumed that, since the size of the market the FCA are proposing to target is the same as for this policy option, the costs of a consumer awareness campaign would also be the same. Therefore, we estimate annual costs of £21 million for two years, giving a total cost of £42 million. Over ten years, in present values, this equates to a cost of £41m.

6.68 These costs could fall directly on the MoJ/ CMRU, or the CMRU could follow the same approach as the FCA and create a new rule charging lenders a fee to cover these running costs.

##### *CMCs*

6.69 If the consumer awareness campaign were successful then it may mean that more consumers will lodge claims directly with lenders rather than go via CMCs. This means that CMCs will receive a smaller proportion of the total amount of redress paid out to consumers. It is not possible to quantify the reduction in claims made by CMCs because of the campaign, but we show a couple of scenarios below:

- Assuming the same level of claims as for Options 1 and 3, if 10 per cent of claims switched from being lodged by CMCs to being lodged independently then annual costs to CMCs would be between £50m and £80m; and
- If the switch was 50 per cent then annual costs to CMCs would be between £190m and £260m.

#### Benefits

Consumer

6.70 As with the other options the costs to CMCs are offset by the benefits to the consumer. If consumers decided to switch from contracting with a CMC to dealing directly with the lender themselves then they would receive all of the compensation and pay nothing in fees to CMCs. Therefore, if 10 per cent of consumers switch then the benefits to consumers would be between £50m and £80m, whilst if 50 per cent of consumers switch then the benefits will be between £250m and £380m.

## 7. Summary

7.1 Table 7.1 below outlines the costs and benefits of the proposed changes.

Table 7.1: Costs and Benefits of the proposed changes

Option	Costs	Benefits
1	<p><u>Monetised</u> £3,400 million over 10 years (in present values) to CMCs, which breaks down as:</p> <ul style="list-style-type: none"> <li>• £2,000m from a cap on completion fees</li> <li>• £1,400m from a ban on up-front fees</li> </ul> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Costs to CMCs from the cancellation fee cap to those who charge more than £300 for a cancellation fee</li> <li>• Costs to CMCs who charge even when no relationship to the lender is found</li> <li>• Costs to CMCs who need to alter their business structures following the regulatory changes</li> </ul>	<p><u>Monetised</u> £3,400 million over 10 years (in present values) to consumers, which breaks down as:</p> <ul style="list-style-type: none"> <li>• £2,000m from a cap on completion fees</li> <li>• £1,400m from a ban on up-front fees</li> </ul> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Benefits to consumers, businesses and the financial ombudsman from a reduction in nuisance calls and speculative claims.</li> </ul>
2	<p><u>Monetised</u> £4,100 million over 10 years (in present values) to CMCs, which breaks down as:</p> <ul style="list-style-type: none"> <li>• £2,700m from a cap on completion fees</li> <li>• £1,400m from a ban on up-front fees</li> </ul> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Costs to CMCs from the cancellation fee cap to those who charge more than £300 for a cancellation fee</li> <li>• Costs to CMCs who charge even when no relationship to the lender is found</li> <li>• Costs to CMCs who need to alter their business structures following the regulatory changes</li> </ul>	<p><u>Monetised</u> £4,100 million over 10 years (in net present values) to consumers, which breaks down as:</p> <ul style="list-style-type: none"> <li>• £2,700m from a cap on completion fees</li> <li>• £1,400m from a ban on up-front fees</li> </ul> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Benefits to consumers, businesses and the financial ombudsman from a reduction in nuisance calls and speculative claims.</li> </ul>



3	<p><u>Monetised</u> £2 million over 10 years (in present values) to CMCs from a ban on up-front fees.</p> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Costs to CMCs if the industry average completion fee falls below 25 per cent after the regulations.</li> </ul>	<p><u>Monetised</u> £2 million over 10 years (in present values) to consumers from a ban on up-front fees.</p> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Benefits to consumers, businesses and the financial ombudsman from a reduction in nuisance calls and speculative claims.</li> </ul>
4	<p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• If CMCs voluntarily adhere to the proposed rules then we expect there to be other potential costs to CMCs from capping cancellation fees, the proposed ban on fees being charged if no PPI/ PBA exists for the client and the proposed ban on making and receiving financial payments to a third party for PPI / PBA claims.</li> </ul>	<p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• If CMCs are compliant with the voluntary code then consumers would benefit from keeping more of their redress from lenders.</li> </ul>
5	<p><u>Monetised</u> £41 million over two years (in present values) to MoJ/ CMRU to fund a consumer awareness campaign.</p> <p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• If consumers switch away from pursuing claims with CMCs then CMCs may lose business and subsequently turnover.</li> </ul>	<p><u>Non-monetised</u></p> <ul style="list-style-type: none"> <li>• Consumers would be more aware of their options and save money through pursuing cases themselves.</li> </ul>

7.2 Based on the evidence available at this point in time the preferred option would be to implement Options 1 and 3. This is because, as explained above, CMCs have not indicated that they would be willing to follow a voluntary code and the MoJ/ CMRU may face a conflict of interest in pursuing a consumer awareness campaign.

7.3 The net effect of the preferred option is zero as the expected costs to CMCs will be transferred as benefits to consumers. There is the potential for further benefits to lenders and the Financial Ombudsman if the number of speculative claims falls, making the net effect of this policy positive.

## 8. Sensitivity Analysis

### *Level of Fee Cap impact*

8.1 The size of the cap on completion fee will affect the scale of the cost to the CMC, and the benefit gained by the consumer. The lower the cap charged on the completion fee, the bigger the cost will be to the CMC and the greater the benefit will be that is experienced by the consumer. To assess the impact of changes to the completion fee, we have modelled a variety of different fee caps between 0 per cent and 29 per cent<sup>10</sup>.

<sup>10</sup> Anything over 29 per cent is above the indicative estimation of the current industry average therefore being ineffectual.

Table 8.1: The annual cost to CMCs from the fee changes.

Percentage cap on completion fee	Cost to CMC
No cap	£0
5 per cent	£390m
10 per cent	£310m
15 per cent	£230m
20 per cent	£140m
25 per cent	£60m

## 9. Risks

- 9.1 There are a number of risks associated with the preferred option (Options 1 and 3). These are summarised below.

### Increase in CMCs operating unauthorised

- 9.2 Some CMCs may surrender their authorisation to provide regulated claims management services if they are unable to adapt to the new requirements. There is therefore a risk that some CMCs may attempt to continue to pursue claims without authorisation, particularly if they have a large client portfolio with unresolved claims.
- 9.3 This could lead to an increase in the number of investigations into unauthorised trading and prosecutions carried out by the Regulator. Increased regulatory costs could affect the Regulator's ability to achieve full cost recovery of annual regulation fees. This could mean that the Regulator would need to consult further on increased regulatory fees or seek a financial contribution from the MoJ in order to maintain an appropriate level of regulation.

### CMCs leaving the market or moving into other sectors

- 9.4 Some CMCs may leave the claims market altogether if they are unable to adapt to the new requirements. In addition, some CMCs may move into other regulated sectors in which they do not have sufficient knowledge. This could affect the level of service provided to those wishing to pursue claims in other regulated sectors and increase the level of consumer complaints as well as regulatory enforcement action regarding other regulated claims areas.

### Surge of business activity in affected sectors prior to implementation of new rules/regulations

- 9.5 CMCs may increase their marketing prior to the implementation of the proposals leading to an increase in nuisance calls. If this occurs, even more consumers may contract with CMCs under the current requirements as a result of increased consumer initiatives designed to attract as many consumer as possible before the proposals are implemented.

### CMCs may conclude all claims once a lender has made a final decision and not refer to the Financial Ombudsman

- 9.6 CMCs may not be inclined to pursue cases via the Financial Ombudsman where a lender does not uphold a claim in the first instance. Although this may reduce the level of speculative claims that are ultimately lodged with the Financial Ombudsman, there may be proportion of consumers that do not ultimately receive compensation via the Financial Ombudsman. This is because, in some instances, the Financial Ombudsman may judge that the lender's initial decision and judgement around the merits of a claim was deemed to be incorrect.

## CMCs may merge with solicitors firms

- 9.7 Some CMCs may merge with solicitors firms as an alternative to referring claims onwards to a solicitor. This would take a CMC out of scope of CMR and place them within the remit of the Solicitors Regulation Authority. Under current conditions solicitors are able to charge up to 50 per cent of any final compensation for all claims types except personal injury and employment. The number of solicitors pursuing financial claims is extremely low at present but could potentially increase as a result.
- 9.8 In addition there are risks associated with both the voluntary code option (Option 4) and the consumer awareness option (Option 5).
- 9.9 Under Option 4 CMCs would have a financial incentive not to comply on a voluntary basis and this could mean that some CMCs do not agree to comply. This would leave those that do comply at a significant disadvantage to those that don't and would not ensure that all consumer using financial claims CMCs are protected from high or unreasonable charges.
- 9.10 There is also a risk that this could create further confusion for consumers as to what the requirements are around permitted fee levels and would mean that some consumers continue to pay unreasonable charges. CMCs would be able to charge higher fees without justification when compared with those that choose to limit their fees voluntarily and this could distort the market.
- 9.11 For Option 5, increases in consumer awareness initiatives would need to be taken forward by external agencies (who may already be running similar initiatives) in order to avoid a conflict of interest between the regulator, CMCs and consumers. As information is already available to consumers via lenders, the Financial Ombudsman and pre-contractual information provided by CMCs to consumers prior to the agreement of a contract with a CMC, it is possible that some consumers could remain unclear on the scope of their options or fail to fully understand the information presented to them before they contract with a CMC. For those that choose to utilise the services of a financial claims CMC under these circumstances, there is a risk that these consumers would remain at a significant financial disadvantage and would still be subject to unreasonably high fees in some instances.

## **10. Summary of One In, Three Out Implications – Options 1 and 3**

### Costs

- 10.1 The preferred option (Options 1 and 3) will have a direct annual cost to businesses of between £250 million and £510 million, with a best estimate of £390 million. There may be further costs to CMCs from implementing the preferred option, but these have not been quantified at this stage.

### Benefits

- 10.2 The preferred option has the potential to generate indirect benefits to businesses who were lenders of financial claims products. These may arise from a reduction in speculative claims by CMCs, however, have not been quantified at this stage.

### Net Effect

- 10.3 The net effect on businesses is an annual cost of between £250 million and £510 million, with a best estimate of £390 million. The equivalent annual net cost to business is estimated to be £383 million.

## Business Impact Target

- 10.4 This measure is a qualifying regulatory provision under section 22 of the Small Business Enterprise and Employment Act 2015. The measure will result in costs to business and the cost have been assessed as an 'IN' in scope of the Business Impact Target and One-in, Three-out, requiring an offsetting 'OUT/s'.

## **11. Enforcement and Implementation**

- 11.1 Subject to the relevant clearance and consultation, the Regulator proposes to implement the new rules in summer 2016. The restrictions will apply to all regulated CMCs although any existing contractual agreements with clients will not be affected by the proposed changes, as the restrictions will not apply retrospectively. The new conduct rules will only apply to client contracts agreed after the implementation of the new requirements.

## **12. Monitoring and Evaluation**

- 12.1 Although there will be no changes made to the Compensation (Claims Management Services) Regulations, the amendments would place additional costs on regulated CMCs that remain in the financial claims sector. The effectiveness of the rules is monitored on a continual basis and so it is not necessary to set a specific, future review date. The CMC industry is continuously evolving, therefore future reviews of the rules may be conducted, prompted by specific, emerging issues. The effectiveness of the CMR regime and the rules is assessed on an annual basis and set out in the CMRU annual report which is cleared through Ministers.

## **13. Specific Impact Tests**

### Small and Micro Business Assessment (SaMBA)

- 13.1 The current financial claims market is made up of around 858 CMCs operating in the financial claims sector. Of these we estimate 517 are micro businesses (with less than 10 employees) and 92 are small businesses (with more than 10 but less than 50 employees). Therefore, small and micro businesses account for 71 per cent of the total number of businesses in the industry.
- 13.2 In 2014-15 turnover in the financial claims sector was £458m. For micro CMCs turnover was £82 million and for small CMCs it was £113m. Using the number of small and micro CMCs, we estimate average total turnover per firm to be approximately £0.2m a year for a micro CMC and £1.2 million for a small CMCs.
- 13.3 This shows that small and micro CMCs account for a relatively small amount of turnover for the whole industry. Turnover for small CMCs is around 25 per cent of total turnover and turnover for micro CMCs is around 18 per cent.
- 13.4 To calculate the likely impact of the reforms on small and micro businesses we assume the proportion of turnover small and micro businesses account for is equal to the proportion of the costs imposed on CMCs from Options 1 – 5 described above.
- 13.5 Based on the available evidence the preferred option is to implement Options 1 and 3 concurrently. This option estimates costs to CMCs of approximately £390m. Therefore, we

estimate costs to small businesses to be £97m, and costs to micro businesses to be £70m. Dividing this by the number of firms qualifying as small and micro businesses, we estimate the cost per small business to be £1.1m and the cost per micro business to be £1.0 million.

- 13.6 In comparison to the level of turnover provided by the CMRU the estimated costs to small and micro businesses would be around 85 per cent of total turnover. However, based on the assumptions described in Section 6, we show the estimated level of turnover to be above the amount recorded by the CMRU. If this value was used instead, then we estimate turnover per small firm to be £1.7m and turnover per micro firm to be £0.2m. In this instance the costs would be 60 per cent of turnover.
- 13.7 These estimates may over-estimate costs to small and micro businesses because the average claim value is thought to be lower than for larger firms. However, it may also underestimate costs to small and micro businesses if the average claims value is higher than for large firms, or if the average completion fee/ up-front fee is lower for small and micro businesses. Unfortunately we do not have specific data on small and micro businesses but during the consultation we will aim to gather this to make a fuller assessment of the impact on small and micro businesses for the final stage IA.
- 13.8 We are not able to quantify the impact of Options 4 and 5 at this time and so therefore are unable to quantify the impact on small and micro businesses. However, data on enforcement shows that small and micro CMCs are less likely to be compliant with a voluntary code. Based on enforcement action carried out by CMRU, micro firms account for around 90 per cent of formal enforcement activity (including cancellations and financial penalties), whilst small firms account for around 60 per cent of all enforcement contact.
- 13.9 It is not envisaged that the proposals would have a disproportionate impact on small or micro businesses. It is important to maintain uniformity and uphold the integrity of the regulatory regime as 71 per cent of all CMCs operating the financial claims sector are classed as small or micro businesses. The proposed changes could not feasibly be implemented unless they applied to all CMCs in the financial claims sector.