

<b>Title:</b> Recovering the costs the Lord Chancellor incurs in meeting the expenditure of the Legal Ombudsman, dealing with complaints about CMCs: Updated fees for the authorised claims industry.  <b>IA No:</b> MoJ018/2015  <b>Lead department or agency:</b> Ministry of Justice  <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 16/11/2015		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> Rebecca Woodward, Legal Services Policy, Ministry of Justice, rebecca.woodward@justice.gsi.ov.uk			

## Summary: Intervention and Options

**RPC Opinion:** N/A

### Cost of Preferred (or more likely) Option

Total Net Present Value	Business Net Present Value	Net cost to business per year	In scope of One-In, Measure qualifies as Two-Out?	
-0.1m	-6.9m	-0.8	No	N/A

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

The problem under consideration is how the fees charged to authorised Claims Management Companies (CMCs) should be adjusted to ensure that the costs the Lord Chancellor incurs in relation to the Legal Ombudsman (LeO) dealing with complaints about authorised CMCs are recovered from the authorised claims industry. Intervention is required to ensure that the relevant costs arising from poor services and poor complaints handling by CMCs do not have to be met, in part, by the taxpayer.

### What are the policy objectives and the intended effects?

The policy objective is to ensure that the total costs incurred by the Lord Chancellor in relation to the Legal Ombudsman expenditure in dealing with CMCs are recovered from authorised CMCs in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller CMCs.

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

- Option 0: Retain the current fees (as specified in The Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014) (Do nothing)
- Option 1: Adjust the fee levels to achieve full cost recovery.

Option 1 is the preferred option. Adjusting the fee levels will ensure that the costs the Lord Chancellor incurs, in relation to the Legal Ombudsman dealing with complaints about CMCs, can be fully recovered from the authorised claims industry and will not have to be met by the taxpayer.

### Will the policy be reviewed? It will be reviewed. If applicable, set review date: 09/2016

Does implementation go beyond minimum EU requirements?				N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> No	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)				<b>Traded:</b> N/A		<b>Non-traded:</b> N/A

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

Signed by the responsible Minister

Shailesh Vara

Date: 16/11/15

# Summary: Analysis & Evidence

# Policy Option 0

**Description:** Retain the current fees (as specified in The Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014).

## FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2016-17	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: -6.9

COSTS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Cost
Low	NQ		NQ		NQ	
High	NQ		NQ		NQ	
Best Estimate	0		0.8		6.9	

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

The Ministry of Justice will incur cost from having to meet the Legal Ombudsman's costs in relation to dealing with complaints about CMCs. This is estimated to amount to around £0.8m in 2016-17. Ultimately this cost would fall on the taxpayer.

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

N/A

BENEFITS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Benefit
Low	NQ		NQ		NQ	
High	NQ		NQ		NQ	
Best Estimate	0		0		0	

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

N/A

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

N/A

### Key assumptions/sensitivities/risks

Discount rate (%) 3.50

It is assumed that the Legal Ombudsman will deal with 17,500 consumer contacts and 2,000 complaint cases in 2016-17. It is estimated that a total of around 1,700 CMCs will be required to pay their fee at the time of renewal in February 2016, and that around 20% of them will exit the market before paying their fees. It is also assumed that there will be no change in CMCs' nominal turnover compared to the previous year. Any changes to the above assumptions may result in higher or lower costs to the taxpayer.

## BUSINESS ASSESSMENT (Option 0)

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

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Adjust the existing fees to ensure full cost recovery

## FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2016-17	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: 0

COSTS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Cost
Low	NQ		NQ		NQ	
High	NQ		NQ		NQ	
Best Estimate	0		0.8		6.9	

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

In aggregate, the cost to the CMC industry in 2016-17 is the difference between the total fee income generated under this option (around £2.3m) and that generated assuming no change in the fees (around £1.6m). This is estimated to be around £0.8m in 2016-17. (Figures may not sum due to rounding.) The impact on individual firms would depend on their profitability, and there is the risk that some firms may decide to exit the market as a result of the increase in the fees.

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

Some CMCs may also incur the opportunity cost of having to pay a higher fee would the increase have been invested otherwise and generated return.

In aggregate, consumers may be adversely affected if the increase in the fees is passed on to the consumer in the form of artificially higher prices for services.

Lastly, any reduction in CMCs' profitability following the increase in the fees may affect business volumes of any parties who derive income from CMCs' business activity.

BENEFITS (£m)	Total (Constant Price)	Transition Years	Average (excl. Transition)	Annual (Constant Price)	Total (Present Value)	Benefit
Low	NQ		NQ		NQ	
High	NQ		NQ		NQ	
Best Estimate	0		0.8		6.9	

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

The Ministry of Justice will benefit from not having to meet the Legal Ombudsman's cost in relation to dealing with complaints about CMCs. This would provide annual savings of around £0.8m in 2016-17. Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving.

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

N/A

### Key assumptions/sensitivities/risks

Discount rate (%) 3.50

It is assumed that the Legal Ombudsman will deal with 17,500 consumer contacts and 2,000 complaint cases in 2016-17. It is estimated that a total of around 1,700 CMCs will be required to pay their fee at the time of renewal in February 2016, and that around 20% of them will exit the market before paying their fees. It is also assumed that there will be no change in CMCs' nominal turnover compared to the previous year. Any changes to the above assumptions may result in under or over recovery of the Legal Ombudsman's costs.

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m, 2014 prices:			In scope of OIOO?	Measure qualifies as
Costs: 0.8	Benefits: 0	Net: 0.8	No	NA

# Evidence Base (for summary sheets)

## Introduction

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

1. The Legal Services Act 2007 (the 2007 Act) 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. Since October 2010, the Legal Ombudsman has been the single point of contact for consumers wishing to complain about the service provided by authorised legal professionals such as solicitors, barristers and legal executives. In January 2015, the Legal Ombudsman's remit was expanded to include consideration of complaints about claims management companies (CMCs) authorised by the Claims Management Regulator (CMR).

### *The Claims Management Regulator*

2. The Secretary of State for Justice exercises the function of the CMR under the provisions of the Compensation Act 2006. The Claims Management Regulation Unit (CMRU) within the Ministry of Justice has been responsible for directly regulating the activities of businesses providing claims management services since April 2007. Regulation covers six claims sectors: personal injury, financial products/services, criminal injuries, industrial injuries, employment and housing disrepair. There are currently around 1,700 authorised CMCs.

### *Funding of the Legal Ombudsman's claims management remit*

3. In relation to its claims management remit, the Legal Ombudsman is funded through a combination of grant-in-aid from the Ministry of Justice (MoJ) and fees the Legal Ombudsman charges directly (predominantly case fees which are charged by the Legal Ombudsman directly to respondent firms against whom there is a complaint).
4. The cost of the grant-in-aid is recovered through a separate 'cost recovery' fee charged to authorised CMCs by the MoJ. The fees are set out in the Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014 (the 'Fee Regulations') a statutory instrument agreed by Parliament. The fee is a cost recovery measure for the Lord Chancellor and is separate from the CMR's regulatory fees and activities. The cost recovery fees will usually be invoiced in the February before the financial year to which the fee relates.

## Problem under consideration

5. The current Fee Regulations were made prior to the start of the Legal Ombudsman's CMC remit, on 28 January 2015, and set out the fees for the first two months of operation of the scheme in the 2014-15 financial year (February and March) and the fees that would apply from the first full year (April 2015- March 2016) and subsequent years.

### *The first six months of the Legal Ombudsman's authorised claims management remit*

6. During the first six months of operation of the Legal Ombudsman's claims management complaints scheme (28 January – 31 July 2015) it has received higher numbers of initial consumer contacts<sup>1</sup> than predicted but has accepted lower numbers of complaints for investigation than expected. The Legal Ombudsman estimated that, in its first year of operation, it would receive 12,000-15,000 initial contacts from consumers. Should the current rate of contacts continue, the actual number will be around 16,000- 17,000.
7. With regard to complaints cases<sup>2</sup>, the Legal Ombudsman estimated that in the first year of operation they would accept around 3,000 cases for investigation. From January- July 2015, the Legal Ombudsman has accepted a total of 648 cases. This has been, in part, due to greater

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<sup>1</sup> 'Contacts' refer to initial phone calls, emails etc. from consumers, these contacts do not necessarily result in 'cases' being created, where complaints are investigated.

<sup>2</sup> 'Cases' refer to those complaints that are accepted for investigation by the Legal Ombudsman scheme.

numbers of complaints being resolved informally than predicted. Although the number of cases accepted for investigation has been lower than estimated, the number of cases accepted per month has been increasing with 145 cases accepted in June and 120 in July.

8. Taking into account the higher levels of consumer contacts, that case numbers have been generally increasing and the difficulties with drawing clear trends with only 6 months data, the Legal Ombudsman has revised its estimate for numbers of consumer contacts per year to around 17,500 and the estimated number of complaints cases to around 2,000 per year.
9. The Legal Ombudsman estimates that 17,500 consumer contacts per year and 2,000 complaint cases being investigated per year would generate running costs of approximately **£2.1m<sup>3</sup>** per year (This figure does not take account of the Legal Ombudsman's separate case fee income: see paragraphs 17-18).
10. In addition, the number of authorised CMCs has declined from around 2,000 when the fees were first set, to around 1,700.

#### *Legal Ombudsman's set-up costs*

11. In preparation for taking complaints about CMCs, the Legal Ombudsman incurred set up costs, including recruitment, training, marketing and IT. The Legal Ombudsman estimated that set up costs would be in the region of £0.8m. It was intended that these set up costs would be charged back to regulated CMCs over the course of three years, divided into approximately a third per year.
12. In actuality the Legal Ombudsman incurred around £0.4m in set up costs. Therefore, it has been assumed that the proportion of estimated set-up costs invoiced for 2014-15 and 2015-16 has been recovered (around £0.3m) and the remainder, around £0.1m, will be charged back over the remaining 1 year and 10 months of the intended 3 year charge-back period. Set-up costs will therefore be in the region of **£50k** for 2016-17 and 2017-18, after which the set-up costs should be recovered.

#### *Shortfall in invoicing of 2014-15 and 2015-16 fees*

13. A shortfall in the amount it was aimed to charge CMCs for the 2014-15 and 2015-16 financial years has also had to be carried forward. This was mainly the result of more firms with high turnovers leaving the market than was taken into account in the fee modelling for those years. This meant that the total amount invoiced for in February 2014 (for the two months of operation in the 2014-15 financial year and the 2015-16 financial year) fell short of what we had aimed to charge, by around **£500k**. It is intended to recover this shortfall as part of the 2016-17 fees. It should be noted that this shortfall does not include any under recovery as a result of CMCs failure to pay fees owed.
14. Although the Legal Ombudsman has dealt with fewer cases than estimated, this has not made up for the shortfall in fees invoiced for in the 2014-15 and 2015-16 financial years. This is, in part, due to the fact that in dealing with fewer cases, the Legal Ombudsman has had substantially less case fee income than anticipated in 2014-15 and 2015-16 (see paragraphs 17-18 for information on case fees).

#### *Total Legal Ombudsman's costs*

15. Taking into account the Legal Ombudsman's estimated costs for 2016-17 (approximately £2.1m), the proportion of set-up costs to be recovered (around £50k) and the shortfall from the 2014-15 and 2015-16 cost recovery (around £500K), the total costs to be recovered for 2016-17 will be in the region of £2.6m. (This figure does not take account of the Legal Ombudsman's separate case fee income: see paragraphs 17- 18).

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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.

### *The extent of cost recovery – income required from the fees*

16. Under the 2007 Act, the Legal Ombudsman can already charge a case fee for each case it considers against a respondent business. The cost recovery fee therefore has to cover the shortfall between the Legal Ombudsman's costs of dealing with complaints about CMCs (as detailed above) and the fee income from the Legal Ombudsman's case fees.
17. Case fees are paid directly to the Legal Ombudsman on closure of a case by the respondent business. This cost falls on non-compliant business. Rather than cover the total costs of dealing with complaints, the case fee is instead intended to encourage good in-house complaints handling within businesses. In certain circumstances the case fee is waived. The 2007 Act requires the case fee to be waived (or refunded) if a complaint is resolved in favour of the respondent business and if the Legal Ombudsman is satisfied that the respondent took all reasonable steps to try and resolve the complaint under their in-house complaint procedure. Under the Legal Ombudsman's scheme rules, the case fee is also waived if a case turns out not to be within the Legal Ombudsman's jurisdiction, or if the case is dismissed or discontinued under the Legal Ombudsman's scheme rules, for example because the complaint is vexatious. The case fee can also be waived if the complaint is withdrawn or abandoned by the complainant during the course of the investigation. When setting the case fee the Legal Ombudsman considers it important that its mere presence does not unduly encourage lawyers or CMCs to settle complaints, even those without merit, in order to avoid the risk of incurring a case fee. Currently, the Legal Ombudsman's case fee is £400.
18. In light of the experience of the first six months of operation of the Legal Ombudsman's CMC complaints scheme, the Legal Ombudsman has revised their estimate of the proportion of complaints cases they expect to attract a case fee per year. The Legal Ombudsman estimates that around 40% of the (approximately) 2,000 complaints cases per year will attract a case fee. This would mean the Legal Ombudsman would have a case fee income of around £0.3m per year.
19. The annual cost to the Legal Ombudsman of dealing with complaints about CMCs equates to the relevant annual operating costs (around £2.1m) plus a proportion of the outstanding set-up costs (around £50k) making a total in the region of £2.1m. In addition, the shortfall in the total amount invoiced for the 2014-15 and 2015-16 needs to be added (around £500k), making a total cost of around £2.6m. If around £0.3m case fee income is generated by the Legal Ombudsman's case fees then the new Lord Chancellor's fee needs to generate around **£2.3m** in order for the Legal Ombudsman's costs to be recovered<sup>4</sup> for 2016-17.

### **Policy Objectives**

20. The policy objective is to ensure that the costs incurred by the Lord Chancellor in relation to the Legal Ombudsman dealing with complaints about CMCs are recovered from the authorised claims management industry in a fair and proportionate way, ensuring that the fees imposed are not overly burdensome on smaller CMCs. The objective is to secure full cost recovery from authorised CMCs to cover the Legal Ombudsman's costs. Without full cost recovery some of these costs would be met by the taxpayer.
21. Intervention via secondary legislation is required to meet this objective in order to amend the existing Fee Regulations (The Legal Services Act 2007 (Claims Management Complaints) (Fees) Regulations 2014). This fee income is to be used in addition to the current case fees which the Legal Ombudsman can charge and are already provided for under the 2007 Act.
22. This Impact Assessment covers the specific issue of how the current Fee Regulations should be adjusted to make sure the costs incurred by the Lord Chancellor, in relation to the Legal Ombudsman dealing with complaints about authorised CMCs, are recovered from the authorised claims industry. In particular the total outstanding cost for 2016-17 around £2.3m which remains after the Legal Ombudsman's case fee income is taken into account.

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<sup>4</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.

## Description of Options Considered

23. This Impact Assessment aims to identify the potential impacts from society's perspective with the aim of understanding what the net social impact might be from implementing these options:

### **Option 0 - Retain the existing fees (outstanding costs fall to Ministry of Justice)**

24. Under this option, the fees set out in the existing Fee Regulations would be charged to CMCs. The Legal Ombudsman would also charge their case fee (although this is waived in some circumstances: see paragraph 17) in the usual way. Under the assumptions listed above, the fees set out in the existing Fee Regulations would raise approximately £1.6m. The Legal Ombudsman's case fee would raise around £0.3m which would leave a shortfall of around £0.8m. The Lord Chancellor would need to meet the outstanding costs relating to the Legal Ombudsman dealing with complaints about authorised CMCs.

### **Option 1 - Adjust the existing fees to ensure full cost recovery**

25. Under this option, the fees set out in the existing Fee Regulations would be amended to ensure full cost recovery, in relation to the Legal Ombudsman's costs of dealing with complaints about CMCs, could be achieved for the Lord Chancellor. The updated fee levels would be designed to ensure, once the Legal Ombudsman's case fee income was taken into account, the outstanding costs could be recovered from authorised CMCs.

26. Costs are based on the Legal Ombudsman's current expectations about complaints volumes, costs and case fee income and the claims management market. As explained above, total cost to be recovered through the cost recovery fee is estimated to be around £2.3m for 2016-17.

27. The overall structure of the Lord Chancellor's 'cost recovery' fee would not change: it would remain a sliding scale of fees, based on business turnover in relation to regulated claims management activities. This ensures that disproportionate cost does not fall on smaller businesses, which may result in a number of businesses leaving the market and negatively impact on competition. Basing fee levels on turnover is also the method with which the regulated CMCs are familiar, as their existing annual regulation fee is based on turnover. Details of the fee structure are provided at Annex A.

28. The Government believes that option 1 better meets its policy objectives.

## Affected Stakeholder Groups, Organisations and Sectors

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

- *Authorised CMCs*: Any increase in the fees charged to recover the Legal Ombudsman's costs would have an adverse impact on authorised CMCs' profitability. As a result, some CMCs may decide to exit the market altogether.
- *Consumers*: There is the risk that any reduction in CMCs' profitability may be passed on to consumers via an increase in the fees CMCs charge them for their services.
- *Taxpayer*: Any potential shortfall in the amount recovered through the fees paid by authorised CMCs would have to be met by the taxpayer.

## Key Assumptions and Risks

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

- The Legal Ombudsman estimates that it will deal with 17,500 consumer contacts and 2,000 complaint cases in 2016-17. There is a risk that baseline 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.
- Based on the latest data from the CMRU, it is estimated that a total of around 1,700 CMCs will be required to pay their fee at the time of renewal in February 2016. Of these, a total of around 20% will fail to pay their fee. There is a risk that the Lord Chancellor will be unable to

recover the full costs he incurs if additional CMCs fail to pay the annual fee. If this occurs, the Lord Chancellor would have to meet the shortfall. CMCs that do not pay the annual fee will face the having their authorisation suspended or cancelled.

- It is assumed that there will be no change in CMCs' nominal turnover compared to the previous year. As the fee firms pay is depending on their level of turnover, any changes to overall industry turnover are likely to affect the total fee income collected.

## **Cost and Benefits of Options Considered**

31. This section provides an overview of the likely costs and benefits of our proposals All costs and benefits are in 2014 prices. All figures are rounded to the nearest 0.1m.

### **Option 0 - Retain the existing fees (outstanding costs fall to Ministry of Justice)**

#### Costs of Option 0

##### *Costs to CMCs*

32. Under this option the fees would remain unchanged, and therefore there would be no additional costs for the authorised claims management industry.

##### *Costs to taxpayer*

33. The Ministry of Justice will incur a cost from having to meet the Legal Ombudsman's cost in relation to dealing with complaints about CMCs. The current fees structure is expected to generate around £1.6m per annum, thus resulting in a shortfall of around £0.8m. Ultimately, this cost would fall on the taxpayer. (Figures may not sum due to rounding).

#### Benefits of Option 0

34. This option is not expected to generate any additional benefits compared to the *status quo*.

### **Option 1 - Adjust the existing fees to ensure full cost recovery**

#### Costs of Option 1

##### *Costs to CMCs*

35. In aggregate, the annual cost to the CMC industry is the difference between the total fee income generated under this option (around £2.3m) and that generated assuming no change in the fees (around £1.6m). This is estimated to be around £0.8m in 2016-17. (Figures may not sum due to rounding.) The precise impact on individual firms would depend on their revenue. The large majority (over 85%) of the fee income generated would be recovered from the largest firms (i.e. those with a turnover of £1m or above). Depending on their profitability, some firms may decide to exit the market following the proposed fee increase.

36. Some CMCs may also incur the opportunity cost of having to pay a higher fee would the increase have been invested otherwise and generated return. Due to the uncertainty over CMCs' behavioural choice, it has not been possible to monetise this impact.

##### *Costs to the consumer*

37. Any reduction in CMCs' profitability following the increase in the fees can potentially be passed on to the consumer through artificially higher prices. Due to the uncertainty over CMCs' behavioural responses, it has not been possible to monetise this impact.

##### *Costs to other affected parties*

38. Any reduction in CMCs' profitability following the increase in the fees may affect business volumes of any parties who derive income from CMCs' business activity. Due to the uncertainty over CMCs' behavioural choice, it has not been possible to monetise this impact.

#### Benefits of Option 1

##### *Benefits to the taxpayer*

39. The Ministry of Justice will benefit from not having to meet the Legal Ombudsman's cost in relation to dealing with complaints about CMCs. This would provide annual savings of around £0.8m per



annum. Ultimately this cost would fall on the taxpayer, so it is this group that benefits from the saving.

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

40. The preferred option is Option 1. Adjusting the existing fees to take account of changes to the Legal Ombudsman's expectations about complaints volumes, costs and case fee income and changes in the claims management market, means that full cost recovery can be achieved. This will also ensure a reasonable apportionment of the total costs across regulated CMCs and mean that regulated CMCs are treated equitably with regulated legal services providers.
41. Regulations, amending the existing Regulations, to put in place updated fees will be laid before Parliament for debate and approval.

### **EANCB**

42. The aggregate net cost to CMCs of the Lord Chancellor recovering the costs incurred in meeting the costs of the Legal Ombudsman from the authorised claims industry is expected to be around £0.8m per annum. Option 1 has an overall NPV equal to zero and a business NPV of around -£7m over ten years. The overall EANCB figure (in 2014 prices) is expected to be around -£0.8m.

### **Inclusion of Micro businesses**

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

## Annex A: Fee Setting Model

44. The fees are modelled based on the cost target to be recovered by the Lord Chancellor, to meet the costs of the Legal Ombudsman in relation to dealing with complaints about CMCs.
45. Scenario 1 sets out an example of the fee levels for the 2016-17 financial year, based on the Legal Ombudsman's current expectations about complaints volumes, costs and case fee income, and the current claims management market.
46. The intention is that fees will be adjusted, usually annually, to reflect changes to the Legal Ombudsman's expectations about complaints volumes, costs and case fee income and changes in the claims management market. The claims management market is fluid, with the number of CMCs and annual turnover subject to variation. As a result, we have not modelled long run fees in this analysis. Instead fees will be modelled and set each year using the latest annual revenue data from the CMR.

### Assumptions

47. It has been assumed that a number of firms will leave the market during the year. We have modelled the following exit profile dependent upon firm revenue:

<b>Claims management company market exits</b>	
<b>Turnover upper bound £</b>	<b>% of CMCs exiting the market</b>
4,999	28
14,999	14
24,999	7
74,999	22
154,286	8
Above 154,286	21

48. It has been assumed that in 2016-17 there will be around 17 new CMCs authorised per month. Each newly authorised CMC pays the Legal Ombudsman fees for the part year, which is calculated on a pro-rata basis (i.e. if a firm starts halfway through the year it will pay half an annual fee). The applicable pro-rata fee depends on the predicted turnover of the company for the coming financial year which is stated by them on application for authorisation to the CMRU. It is assumed that the turnover of newly authorised CMCs is distributed according to predictions made by newly authorised claims companies in the previous year. Around 85% of the claims companies authorised between April 2014 and August 2015 predicted turnover of £75k or less when they entered the industry.

### Full Financial Year Fees

49. Under scenario 1, the Lord Chancellor charges fees to recover his costs in relation to Legal Ombudsman complaints handling for the 2016-17 financial year.
50. The annual cost is calculated from the Legal Ombudsman's yearly operating cost, plus a proportion of set-up costs and the shortfall from the invoicing for the 2014-15 and 2015-16 fee collections.
51. Applying these, the annual cost to the Legal Ombudsman is around £2.1m plus £50k of the outstanding set-up costs (to be charged back over three years from January 2015) and £500k shortfall in the invoiced total from the 2014-15 and 2015-16 financial years, making a total cost of around £2.6m.

52. The Legal Ombudsman's expected case fee income (around £0.3m) 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 2016-17 financial year (based on current expectations of complaints volumes, costs and the claims management market.)**

53. Where the annual turnover of an authorised CMC is £154,286 or less, then the amount payable will be a fixed fee of –

<b>Turnover band £</b>	<b>Annual Fee</b>
£0-£4,999	£105
£5,000- £14,999	£210
£15,000- £24,999	£350
£25,000- £74,999	£476
£75,000- £154,286	£756

54. Where the annual turnover of an authorised CMC is over £154,286 then authorised businesses shall pay an amount equal to 0.49% of annual turnover up to £1 million, plus 0.33% of annual turnover between £1 million and £5 million, plus 0.27% of annual turnover above £5 million.

\* These fees would be subject to a cap of £59,950

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

## **Annex B: Small & Micro Business Test**

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

### **Number of firms impacted**

57. Over 1,500 out of a total of around 1,700 regulated CMCs have declared that they employed or were due to employ between 0 and 10 staff over the forthcoming year. CMCs range in size from large national companies to smaller local firms that employ small numbers of people and operate within a more localised community. Information provided by the monitoring and compliance unit suggests that some small CMCs however, do declare annual turnovers in excess of £500,000 despite employing little or no additional staff. For example, some CMCs in the personal injury sector with fewer than 10 members of staff are operating with a turnover in excess of £1m and have appeared in the top 50 grossing personal injury CMCs. This is an indication that the current regulatory regime promotes high business volumes to smaller firms. The high volume of firms operating in this industry indicates that the current Fee Regulations encourage a competitive environment, in particular amongst micro businesses, which make up the majority of CMCs. The proposed changes could not feasibly be applied without impacting small and micro businesses due to the large proportion that make up the claims management industry.

### **Exemptions**

58. For the purpose of the small and micro assessment, the following exemptions were considered:
  - Full Exemption
  - Partial exemption
  - Extended transition period
  - Temporary exemption
  - Varying requirements by type and/or size of business
59. Following from the evidence above, allowing any exemptions targeted at small and micro business would negate the ability of the Legal Ombudsman to achieve cost recovery as around 89% of CMCs are micro businesses. Full exemptions, partial exemptions or a temporary exemption are therefore not possible. An extended transition period would not allow for cost recovery.

### **Mitigations**

60. The proposal to update the existing fee levels includes retention of the existing fee structure, this mitigates the impact on the smallest firms by varying the size of payment required depending upon the size on annual turnover. The fees are levied based upon annual turnover and on a sliding scale (see annex A). CMCs with low annual turnovers of £0 to £154,286 per year will pay £105 to £756 per annum. The majority of the Legal Ombudsman's costs (around 85%) will be recovered from the largest firms. CMCs with turnovers greater than £1 million will pay the majority of the annual cost recovery target of the Legal Ombudsman. The fee cap, however, is intended to ensure that no firm will pay in excess of £59,950.