Title: Transferring regulation of Claims Management Companies (CMCs) to the FCA **RPC Reference No:** **Lead department or agency: HM Treasury** **Other departments or agencies: Ministry of Justice**	Impact Assessment (IA) **Date: 08 March 2017** **Stage: Final** **Source of intervention:** Domestic **Type of measure:** Primary legislation **Contact for enquiries:** Lucy Baldwin, 02072702892

Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB in 2014 prices; 2015 present value)	**In scope of One-In, Three-Out?**	**Business Impact Target Status**
-15.93	-0.70	0.1	Yes	IN

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

The Claims Management Regulation Unit (CMRU) was established in the Ministry of Justice (MoJ) in 2007. It is unusual for a government department to directly regulate an industry and it was originally intended as an interim measure. Despite reforms to CMRU's powers, widespread misconduct among claims management companies (CMCs) continues and CMRU lacks sufficient power and resource to supervise the market properly. Carol Brady's independent review of claims management regulation, which reported at Budget 2016, recommended strengthening the regulatory regime, re-authorising all CMCs and introducing a Senior Managers Regime, and suggested transferring responsibility for CMC regulation to the FCA. The decision to exercise this option was announced in the March 2016 Budget Statement.

What are the policy objectives and the intended effects?

Tougher regulation aims to tackle a range of conduct issues and other problems in the CMC market, including: non-compliance with the existing rules; misleading advertising; information asymmetries; large volumes of speculative and unnecessary claims; and "phoenixing" of unscrupulous companies. Transferring regulatory responsibility to the Financial Conduct Authority (FCA) enables the FCA's Senior Managers Regime and allows for the creation of more detailed conduct rules. Secondary legislation and detailed FCA rules will follow, which will be accompanied by further impact assessments as appropriate.

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

Two options have been considered: the 'do nothing' option (baseline); and the preferred option, as outlined below. Other options that were considered and discounted by officials include: strengthening the existing regulator; establishing a new independent regulator; and self-regulation via industry codes.

The preferred option is for the government to establish a tougher regulatory regime for CMCs by transferring supervisory responsibility from the Ministry of Justice to the FCA. The FCA's broader suite of supervision and enforcement powers will more effectively facilitate the implementation of Carol Brady's recommendations and allow for the creation of detailed rules, leveraging their extensive experience as a conduct regulator. Re-authorising CMCs will ensure they are willing and able to comply with the new regime, while the Senior Managers Regime will ensure CMC managers can be held personally accountable for the actions of their businesses. Responsibility for dealing with complaints about CMCs will be transferred from the legal ombudsman (LeO) to the financial ombudsman service (FOS), which will result in a more coherent framework and help smooth the overall transition to FCA.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date: June 2022**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** None	**Non-traded:** None	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: ____________________ Date: ______________

Summary: Analysis & Evidence

Policy Option 1

Description: Preferred option: transfer regulation to FCA

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2019	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -100.09	**High: 7.45**	**Best Estimate: -15.93**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	10.9		5.0	**53.7**
High	23.0		16.1	**161.2**
Best Estimate	14.9		7.2	**77.0**

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

All costs to CMCs are illustrative, to be revised ahead of secondary legislation and FCA consultation stages.
The one-off costs are expected to be:

- Regulatory transfer to FCA (£8.9m-£17.6m)
- Interim permissions regime (£0.2-£0.3m)
- CMRU exit costs (£0-£1m)
- Admin costs during application for reauthorisation (£0.4m-£0.6m)
- Reauthorisation fees (£1.35m-£3.3m)
- Complaints transfer (£0.03m-£0.17m)

The expected ongoing costs will arise from:

- FCA levy (£2.3m-£11.3m)
- Reauthorisation admin costs for new CMCs (£0.1m-£0.2m)
- FCA authorisation fees (£0.2m-£2.39m)
- FOS case fees (£1.77m)

The Senior Managers' Regime is roughly estimated to result in £3.5m - £6.3m of one-off costs and £0.3m - £0.4m ongoing costs to business, however these costs have not been included in the above calculation or submitted for EANDCB validation at this stage, which is consistent with the approach taken for the IA submitted to the RPC on the Senior Managers and Certification regime. These estimates are accurate as of March 2017.

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

Further costs to CMCs will arise once the FCA designs and implements its more detailed rules, which will be impact assessed when the rules are consulted upon and designed.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0.0		7.1	**61.1**
High	0.0	1	7.1	**61.1**
Best Estimate	0.0		7.1	**61.1**

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

There is currently no data available to assess the one-off benefit of the transfer, which will impact on consumers, CMCs and banks, for example due to the reduction in speculative claims lodged with banks. We will attempt to monetise these in further impact assessments during the course of establishing the regime through secondary legislation and the FCA designing its detailed rules.
The monetised annual benefits of this policy result from CMCs not having to pay:

- CMRU levy (£6.7m)
- CMRU authorisation admin costs (£0.1m)
- CMRU authorisation fees (£0.3m)

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

Benefits for consumers: higher service standards and value for money from CMCs; reduced nuisance calls; increased transparency; and swifter claims resolution.
Benefits for CMCs: reputational benefits for CMCs, improved capability, and increased competition and innovation.
Other benefits: fewer unmeritorious claims submitted to and processed by firms, and fewer complaints to the ombudsman.

Key assumptions/sensitivities/risks	**Discount rate**	3.5%

All costs are estimates to the best of our ability given the lack of data: we have used proxy costs from similar policies where appropriate, as well as estimates from the FCA, CMRU and the ombudsmen. All costs set out in this impact assessment are based on discussions with the FCA, CMRU, the legal ombudsman and the financial ombudsman service. FCA estimates are based on the assumption that they take on 900 firms in April 2019.
The FCA will establish tougher regulation through its more detailed rules at a later stage, the costs of which cannot be assessed at this stage as they are yet to be designed.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target (qualifying provisions only) £m:**
Costs: 6.1	**Benefits: 6.0**	**Net: -0.1**	0.5

Evidence Base (for summary sheets)

Introduction

1. The Claims Management Regulation Unit (CMRU) was established within the Ministry of Justice (MoJ) in April 2007. It is relatively unusual for a government department to directly regulate an industry and it was originally intended as an interim measure. The claims management company (CMC) sector established itself soon after civil justice reforms were established allowing 'no-win no-fee' arrangements. Regulation was quickly required to tackle unscrupulous marketing and trading practices in the personal injury sector, and in some cases fraudulent activity after the sector had demonstrated it was unable to govern itself effectively.

2. Despite incremental reforms and improvements to the regulator's powers and rules since its creation, there continues to be widespread misconduct among CMCs. At Summer Budget 2015, the government commissioned an independent review to examine the nature and extent of problems in the market and make recommendations to improve the regulatory regime.

3. At Budget 2016, the government announced its intention to accept the review's recommendations, and that responsibility for supervising CMCs would transfer to the Financial Conduct Authority (FCA). This final primary legislation stage impact assessment therefore sets out illustrative cost estimates of the policies announced at Budget:

   - transferring claims management regulation to the FCA
   - re-authorising all CMCs
   - establishing a Senior Managers Regime

4. This primary legislation will enable the transfer to FCA. FCA intends to use an "interim permissions" regime to smooth the transition from CMRU. In principle, the 'interim permissions' regime means that the firms will be expected to adhere to FCA's regulatory standards but only existing CMRU standards will be enforceable. FCA's interim permissions regime is expected to begin in January 2019, with the FCA's enhanced regime coming into force in 2020.

5. Secondary legislation to establish more detail on FCA regulation of CMCs will follow, after which the FCA will consult on, design and implement its more detailed conduct rules. The impact of FCA's new rules are not accounted for in this analysis, since they have not yet been consulted upon or designed. It is therefore not possible to assess the full impact on business of the FCA's regime at this stage.

6. This impact assessment draws on that prepared for extending the Senior Managers and Certification Regime to extension to all FSMA authorised persons (RPC reference no. RPC15-HMT-3143). The impact of extending the SM&CR will only arise when detailed rules to implement the reforms are made by FCA. These are likely to be made in 2018, following public consultations (which will include publishing cost benefit analyses) on draft rules. As a result, it is assumed that the industry will incur one-off preparatory costs in 2018 to prepare for the coming into force of the statutory provisions and the regulators' rules in 2019. Consequently the PV base year is taken to be 2018 while the EANDCB will be scored in the 2018-19 Business Impact Target (BIT) reporting period. Provisional estimates of costs and benefits and the EANDCB have therefore been included in the Summary and Policy Option 1 tables but these will need to be finalised and these are not submitted for validation purposes. The impact on business could differ significantly from those illustrated in this analysis, and in a further impact assessment will be prepared and submitted to the RPC for verification in the light of the work the FCA undertakes for their cost benefit analysis. Under the RPC framework, this Impact Assessment has therefore been prepared on the grounds of scenario 2: an indication of the likely scale of impacts has been provided, however substantive decisions will not be taken until the

secondary legislation stage. We commit to providing an updated IA at the secondary legislation stage.

Proportionality - level of analysis used

7. In compiling this Impact Assessment, we have taken into account the Better Regulation Framework Manual's guidance on proportionate analysis, which states that the resource invested in undertaking an Impact Assessment is proportionate.

8. There are a number of factors we have taken into account when assessing the level of resource to invest in this analysis. Firstly, the policy is not novel or contentious. It was announced at Budget 2016 to limited reaction, and there is broad support from stakeholders and Parliament for the increased regulation of CMCs. Secondly, much of the impact on business cannot be assessed by government at this stage, as it largely depends on the detail of the FCA's regulatory regime, which is yet to be designed. Consequently, this impact assessment is focused on the aspects of the regime on which there is certainty, namely the transfer of responsibility, application of the Senior Managers Regime, the re-authorisation process and the transfer of complaints-handling responsibility. Thirdly, the data available on the cost of the FCA's regulation remains subject to change as FCA continue to make policy decisions related to resourcing the transfer. The figures used are accurate as of March 2017.

9. Given the above, this Impact Assessment has been carried out to the best of our abilities given the limitations of available data, in a manner proportionate to the impact of the policy at this stage, and with the knowledge that the RPC will see further Impact Assessments at later stages of the development of the regulation.

Background and rationale for intervention

10. CMCs offer advice or other services to consumers in relation to making a claim for compensation. Typically, a consumer will contract a CMC to pursue a claim on their behalf. CMCs can also offer other services, such as doing preparatory work for third parties, such as solicitors, in return for a fee. CMCs currently operate in six sectors: personal injury; financial services; criminal injuries compensation; industrial injuries disablement benefits; employment; and housing disrepair. The personal injury and financial services sectors are the largest, comprising 99.5% of CMC turnover.[1]

11. According to CMRU, there are currently around 1,500 authorised CMCs in operation. The CMRU Annual Report for the 2015/16 regulatory year indicates that the overall turnover of the claims management sector during the 2015/16 financial year was a reported £751m.[2] This is a decrease of £21 million on the previous year's reported turnover of £772m.

12. CMCs provide access to justice for consumers who may be unwilling or unable to bring a claim themselves. A well-functioning CMC market can also act as a check and balance on the conduct and complaint handling processes of businesses, thereby benefitting the public interest.

<u>Problems with CMCs</u>

13. In 2015-16 alone, 247 warnings were issued to CMCs, and 66 licences, representing 4% of the total, were cancelled by the regulator. Cancelling a CMC's authorisation is effectively a last resort, as it can lead to further consumer detriment where the CMC can no longer act on behalf of existing clients, therefore indicating the scale of the challenge faced by the regulator. The CMRU's annual report for 2014-15 reflected on the CMRU's approach, saying that 'in the first instance the task is to bring claims management companies (CMCs) to compliance'. In 2014/15 nearly a quarter (23%) of all CMCs faced some sort of regulatory intervention from the CMRU, such as being given a warning or having their authorisation cancelled. In addition to the rule breaches reported by the regulator, almost all stakeholders engaging with the independent review provided information on poor practices among many CMCs.[3] Common themes include:

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[1] www.gov.uk/government/publications/claims-management-regulator-annual-report-2014-to-2015

[2] www.gov.uk/government/publications/claims-management-regulator-annual-report-2014-to-2015

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508160/PU1918_claims_management_regulation_review_final.pdf

- Poor value for money services offered by CMCs – caused by information asymmetries

- Misrepresentation of service offered to consumers and a reliance on nuisance tactics such as unsolicited calls and texts

- Progression of inappropriate (i.e. speculative and/or fraudulent) claims by CMCs

- Consumers are distrustful of CMCs

14. The independent review confirmed these findings and also found that CMC advertising was often misleading, focusing on achieving higher value compensation claims rather than the practical benefits of using a CMC, which relate to time-saving or convenience. Evidence from the Financial Ombudsman Service (FOS) presented to the review shows that CMCs do not in practice achieve higher value redress settlements than consumers complaining directly. The FOS reiterates this advice on its website.[4]

15. The Legal Ombudsman (LeO), which is currently responsible for dealing with complaints about CMCs, report that 94% of complaints received by the LeO in its first six months of operating the service were about CMCs dealing with financial products and services claims. These include mis-sold mortgages, investments and interest rate swaps; but the majority (88%) were about mis-sold Payment Protection Insurance (PPI). The biggest source of complaints about CMCs of all kinds related to unclear or unjustified fees, followed by delays and the failure to provide regular updates. Research commissioned by the LeO has also found that more than two thirds (76%) of the public are not confident that CMCs tell the truth to their customers[5].

16. The FCA has commissioned its own research into PPI mis-selling, which reflected similar themes about CMC misconduct.[6] In relation to CMC marketing techniques, the research found that consumers ‘who made their complaint via a CMC were often prompted to do so by heavy and persuasive marketing tactics; many engaged only after turning away multiple companies.’ They also found that CMCs ‘deterred many potential future complainants from pursuing complaints… through their persistent phone calls and encouragement to complain’. So while CMC advertising encourages some consumers to use CMCs, it simultaneously discourages others. Further, the FCA’s analysis found that ‘while potential future complainants had occasionally heard or read about PPI in the media… CMCs’ advertising and direct marketing (e.g. live sales calls) had led to widespread confusion and misconceptions about the PPI complaints process.’

17. Some CMCs have also been responsible for speculative and/or unmeritorious claims. In the financial claims sector, the main issues arise from complaints about PPI and packaged bank accounts, where a substantial portion of complaints are submitted where the consumer never had the product in the first place. This places an unnecessary additional burden on banks, with costs ultimately passed on to consumers and wider society, and also clogs up complaint handling processes, delaying the many legitimate complaints. Large volumes of such complaints are passed to the FOS, which results in further costs to financial services firms (which are charged a fixed fee for each case regardless of its merit) and FOS is burdened with illegitimate claims, delaying genuine claims for redress.

18. There is also evidence that CMCs operating in the personal injury sector have been responsible for pursuing unnecessary claims. The Insurance Fraud Taskforce reported in January 2016 that “unscrupulous CMCs play a role in encouraging fraudulent claims. As well as causing a social nuisance through their reliance on cold calls, also known as ‘claims farming’, CMCs have been reported to pressurise otherwise honest people to exaggerate or make up claims”.[7] In a similar way to PPI claims against banks, these unnecessary claims place financial and operational burdens on insurers.

Objectives

[4] http://www.financial-ombudsman.org.uk/about/Joint-FCA-note.pdf

[5] http://www.legalombudsman.org.uk/weve-published-our-first-report-on-claims-management-complaints/

[6] http://www.fca.org.uk/your-fca/documents/consultation-papers/understanding-ppi-redress

[7] www.gov.uk/government/uploads/system/uploads/attachment_data/file/494105/PU1817_Insurance_Fraud_Taskforce.pdf

19. Government intervention in the CMC market has three broad objectives:

- To ensure that CMCs are willing and able to comply with the regulator's rules, resulting in higher quality, better value service for consumers;

- To establish a more robust regulatory regime, which acts as a credible deterrent to poor conduct and addresses the conduct issues outlined above; and

- To reduce the impact of speculative and unnecessary claims on the wider economy.

20. The policy proposals outlined below will go some way to meeting these objectives. Once regulatory responsibility has been transferred to FCA, further consultation and impact assessments will be undertaken to establish what additional rules may be necessary to further these objectives.

<u>Policy proposals</u>

Reauthorisation of all CMCs

21. Authorisation processes have benefits for both regulators and regulated businesses. For regulators, they are a way of preventing unscrupulous or incompetent businesses undertaking regulated activities and trading in the first place. Having a robust authorisation process for CMCs therefore reduces the need for enforcement activity, which in turn eases resource burdens for the regulator and helps to keep the regulatory levy to a minimum. For firms, the authorisation process can provide a mechanism to ensure they understand the regulatory requirements before they start trading. This can help them run their business in a compliant way which minimises the risk of detriment to consumers.

22. As described above, evidence of non-compliance by CMCs is widespread, suggesting that many CMCs are either unwilling or unable to run their businesses in a compliant and appropriate way. Furthermore, the FOS has also expressed concern in its evidence submitted to the independent review about the amount of resource it dedicates to advising CMCs on compliance issues. Both of these factors suggest the authorisation process for CMCs should be made more robust, both in terms of acting as a barrier to unscrupulous firms, and ensuring firms understand the rules.

23. Furthermore, re-authorising CMCs will provide an opportunity for FCA to gain detailed understanding of the firms operating in the market, which will be essential in order for it to supervise the market effectively.

24. The Government and FCA are agreed that all CMCs should be subject to a rigorous reauthorisation process. It is intended that the process would be similar to that undertaken by the FCA in respect of consumer credit firms (for which it has recently taken responsibility from the former Office of Fair Trading).

Senior Managers Regime

25. Stakeholders, including the CMRU, expressed concerns about the ability of directors of a liquidated firm to take over another authorised firm without requiring approval from the CMRU. There are two ways in which this is possible. The first is by acquiring multiple authorisations simultaneously, with the extra companies to be used at a later stage if the first business experiences financial difficulties or the CMRU begins enforcement action. The second method – which the CMRU reports is increasingly common – is to acquire an existing legitimate CMC, as a change in company director does not require authorisation from the regulator.

26. Another concern is that CMCs can easily re-emerge as a new firm following liquidation or insolvency, with some or all of the directors remaining in place. CMRU has already taken some steps to tackle this issue, by refusing or otherwise deterring authorisations for so-called 'phoenix' companies.

27. These examples demonstrate how the authorisation process alone is not sufficient to deter or prevent unscrupulous business or individuals operating in the CMC sector and suggests that the current regime is not robust enough to ensure that individuals are accountable for their actions.

Under the CMRU's Conduct of Authorised Persons Rules 2014[8], there is a requirement that CMCs 'shall be directed by people with the necessary competence who must have a working knowledge of the legislation and rules relating to regulated claims management services'. However, the CMRU lacks a legislative mandate to enable these rules to hold individuals personally accountable for actions of the firms they control. The rules do not therefore create a sufficient deterrent to poor conduct.

28. A Senior Managers Regime would address these concerns by requiring the pre-authorisation of all individuals who perform a 'controlled function' for an authorised firm. The controlled functions are those roles for a regulated claims management service that have a particular regulatory significance. An example is being a director of a regulated firm, or being responsible for regulatory compliance.

29. Such a robust regime of personal accountability would have several benefits. Firstly, directors would be subject to regulatory scrutiny if they attempted to use dormant authorised companies, acquire legitimate CMCs, or establish 'phoenix' companies. Secondly, it would hold individuals personally accountable for the conduct of their companies, providing a proper framework to ensure that poor conduct does not go unpunished. Thirdly, it would diminish the likelihood of a firm being controlled from behind the scenes, as individuals would be reluctant to be held accountable for regulatory breaches.

30. A majority of stakeholders (including the insurance industry, some in the banking industry, consumer bodies and many CMCs) supported a system of personal accountability.[9] Many stakeholders explicitly referenced the FCA's Senior Managers Regime as a being a suitable model for CMCs. The precise design of the regime would need to be subject to more detailed policy work and be tailored to the CMC sector, but will consist of three basic components:

    a. Senior Managers Regime – the regulatory pre-approval of key individuals at the top of the firm;

    b. Certification Regime – the pre-approval (certification) and annual re-certification of other key individuals by the firm; and

    c. Rules of conduct – the regulators may make rules of conduct for senior managers, certified persons and other employees.

31. The Senior Managers and Certification Regime (SM&CR), introduced to strengthen the regulation of individuals in the banking sector following the financial crash and ensuing misconduct in the sector (e.g. LIBOR), was extended to other financial services firms as part of the Bank of England and Financial Services Act 2016, implemented by the FCA and the Prudential Regulation Authority (PRA). However, this extension did not apply to CMCs, as claims management was not a regulated activity under FSMA, and therefore did not fall under the scope of financial services firms for the extension.

Transfer to FCA

32. The FCA has a reputation for being an effective conduct regulator that has a track record of taking strong regulatory action where necessary. The FCA also has first-hand experience of implementing the two policy proposals above, each of which will require detailed policy work to design and implement. The FCA's extensive experience of conduct regulation and extensive rulemaking powers will provide a solid basis for establishing any additional conduct rules that are necessary to improve the functioning of the CMC market.

33. The FCA also proved itself capable of taking on additional regulatory responsibilities: responsibility for consumer credit was recently transferred to the FCA from the OFT, and it has also been awarded powers to regulate competition in financial services. The FCA's relatively large size also means that it is comparatively easy to scale up during the initial phase of designing and implementing the Senior

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[8] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380623/CMRU_Conduct_of_Authorised_Persons_Rules_Oct14a.pdf

[9] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508160/PU1918_claims_management_regulation_review_final.pdf, pp32-33

Managers Regime, new authorisation process and any other conduct rules it deems necessary and, in the medium term, adjust resource in response to changing market conditions.

34. The FCA has detailed knowledge of financial services which makes up more than 60% of CMC turnover. This figure rises to over 99% once personal injury claims – relevant to the FCA because of their impact upon insurance – are factored in. The FCA has therefore already developed some knowledge of CMCs, particularly given their responsibility for PPI, one of the largest drivers of CMC activity.

35. In agreement with the conclusions drawn by Carol Brady's independent review, the government's view is therefore that the FCA are the most appropriate regulator of the CMC market.

Transferring complaints handling responsibility to the Financial Ombudsman Service (FOS)

36. The Legal Ombudsman (LeO) currently provides a dispute resolution service for consumers who complain about their CMC, similar to that provided by the FOS in respect of financial services firms. Alongside the overall regulatory transfer to FCA, this policy will transfer responsibility for handling complaints about CMCs to the FOS. We anticipate that responsibility for handling CMC complaints will transfer from LeO to FOS on the date at which the interim permissions regime comes into force; estimated to be in April 2019. From this point, FOS will take on all new CMC complaints, and LeO will complete all existing cases over a period of a few months.

37. Given that FOS has responsibility for dealing with complaints against all firms currently regulated by the FCA, transferring complaints handling responsibility from LeO to FOS will result in a more coherent framework. Having a single ombudsman for all FCA regulated firms removes the risk of objection and confusion from both firms and consumers who have to navigate complicated complaints resolution procedures. Crucially, FOS has experience of working closely with the FCA, understanding of its regulatory framework and has experience of dealing with a wide range of firms. FOS is also familiar with CMCs due to its significant role in dealing with PPI complaints.

Discounted options

38. The independent review of claims management regulation analysed four options for future regulatory responsibility:
    a. Strengthen and restructure the existing regime;
    b. Transfer regulation of claims management to the FCA;
    c. Establish a new independent regulatory body; and
    d. Dual regulation between FCA and MoJ.

39. The review concluded that the option of establishing a new independent regulatory body, although most suitable, was unlikely to be accepted by government, given its drive to reduce the number of public and arm's length bodies, and the fact that establishing an entirely new organisation is likely to be more expensive than other options. Therefore, the review chose strengthening the existing MoJ based regulator and passing responsibility to the FCA as the most credible options.

40. Following the independent review's recommendations, the government assessed the following options:
    a. Transferring CMC regulation to the FCA;
    b. Strengthening the existing regulator;
    c. Establishing a new independent regulator; and
    d. Self-regulation and industry codes.

41. More information on the discounted options has been set out below.

<u>Strengthening the existing regulator</u>

42. Strengthening the existing MoJ regime is likely to be less disruptive than transfer to FCA. However, the existing regulator's location within MoJ does give rise to practical and resource constraints, particularly as regards staffing capacity. Designing and implementing the re-authorisation process

and Senior Managers Regime will be resource intensive and would require the regulator to expand significantly its operational, strategic and policy capacity. MoJ is not currently in a position to resource such an expansion.

Establishing a new independent regulator

43. Establishing a new independent regulator would allow for a sole focus on CMC regulation. It could pursue its objectives without risk of the interference or competition from other organisational priorities. It would be free to set priorities directly according to issues in claims management, without having to divert resources to other issues or sectors, and would be well-placed to retain existing knowledge and expertise. However, in addition to the disadvantages described as part of strengthening the existing regulator (above), establishing an entirely new regulator is likely to be more expensive than other options. Furthermore, establishing a new regulator would run contrary to Government's drive to reduce the number of public and arms-length bodies.

Self-regulation and industry codes

44. Under this option, the outcomes above would be sought through voluntary action by industry. Firstly, it is expected that the majority of CMCs would not comply with, or be willing to follow, a voluntary code that places additional burdens on their businesses. It is important to note that the CMRU 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. It is therefore unlikely that a voluntary code would achieve the outcomes sought by Government.

Monetised costs and benefits

Overall approach

45. The estimated monetised costs and benefits below have been calculated separately for the four policies, namely: the transfer of CMC regulation to the FCA; the introduction of the Senior Managers Regime; the reauthorisation of all CMCs; and the complaints transfer. The costs of these have been assessed against the 'do nothing' option. There is currently no equivalent to the Senior Managers Regime or the reauthorisation process in the existing regime. In contrast, the ongoing cost of FCA authorisations (i.e. for new CMCs coming to market) has been assessed against the ongoing cost of authorisations by CMRU, and the transfer to the FCA has been assessed against the ongoing cost of regulation by CMRU.

46. The data available to calculate estimates is limited, due to the early stage of the transition process. For example, the FCA is not yet able to assess the costs of the potential interim permissions regime and reauthorisation programme, given that the final details of these schemes are yet to be decided. Reasonable proxies have therefore been used for many of the data required. The data used have been provided by the FCA, the CMRU, or calculated from publicly available sources, including the cost benefit analysis commissioned by the FCA for the extension of the Senior Managers' regime to the rest of the financial services industry. The FCA and the CMRU have reviewed the calculations set out below, and agree with our approach, with the caveat that these are very early estimates and are subject to change. The table at Annex A sets out details and sources for the proxies or estimates that have been used.

47. Summer Budget 2015 announced a cap on the amount CMCs can charge consumers, calculated as a percentage of the total claim value. The level of the cap and enforcement mechanism is currently being consulted on by MoJ. However, it is anticipated that the cap imposed by MoJ will be transferred to the FCA when regulatory responsibility for the CMC market transfers. Therefore, since the fee cap is expected to already be affecting CMCs at the time of the transfer, and will be impact assessed before implementation by the MoJ, it has not been impact assessed here.

48. The methodology and calculations for arriving at the estimates for each of the figures in this Impact Assessment have been set out below.

Methodology

A. Transfer to the FCA and the interim permissions regime

Interim Permissions

49. CMCs will need to apply for an interim permission to carry out claims management services, to cover the period between responsibility for transferring and CMCs receiving their full FCA authorisation. FCA expect to model their approach on that used for the transfer of regulation of consumer credit firms from the former Office of Fair Trading (OFT). As such, CMCs will not incur any costs associated with familiarising themselves with new rules. The interim permissions regime for consumer credit was a relatively simple process, with firms providing basic information confirming their contact details and activities. We have used data from that regime as the basis for the estimated cost to CMCs. The FCA will consult on the fee charged to cover the administrative costs of the application process for interim permission. Firms will also incur their own administrative costs in completing the application form, although this cost is anticipated to be low.

50. The FCA recovered £11.3 million in 2013/14 from a one-off charge for OFT regulated consumer credit firms who wished to enter the FCA's interim permissions regime. This forms the basis for the estimated cost; however the number of CMCs expected to enter interim permissions (1,000, see above) is significantly lower than the number of consumer credit firms who applied for interim permissions (49,472), and the interim permissions regime is expected to last one year rather that two. Therefore we have estimated the cost of interim permissions on CMCs as £11.3 million divided by 49,472 and then multiplied by our estimated range of numbers of CMCs expected to apply for interim permissions (i.e. scaled to the size of the market), giving an estimated cost to CMCs of £0.18m to £0.26m.

51. The Interim Permissions regime is a one-off cost with no equivalent in the existing regulatory regime, so has been assessed against a zero baseline cost.

ONE-OFF COST

Incurred in 2019 (expected), £million at 2017 prices

	Interim permissions
max	0.3
min	0.2

Costs to regulators

52. The transfer of CMC regulation to the FCA will require the FCA to incur a range of costs: technology and data transition; policy, legal, strategy and market research staff; project management, proposition and communications support; operating model and process design; and any TUPE, relocation, office closure of contingency costs. These costs will be recouped through a supplementary levy on CMCs, spread over a number of years, beginning from the point of transition of CMC regulation to the FCA, which is expected to be in 2019. The length of this supplementary levy is yet to be determined, but will be set at a sustainable level, once there is a clearer indication of the overall transition costs. The FCA have provided very early estimates of ranges of costs for each of these areas, resulting in a total range of £8.9m to £17.6m in costs to the FCA for the transition. They expect to be able to recoup transitional costs of £12m over five years based on the fee arrangements outlined below.

53. The range of transition costs borne by FCA are dependent upon a number of policy choices which are yet to be finalised. On the lower end of the scale, costs to business will be £2m lower if CMRU systems are not migrated into FCA systems. The upper range represents FCA's preferred regulatory approach, which would result in a more robust regime.

54. The CMRU will also incur one-off transition costs, which will be met from existing CMR funding. Costs will depend on a range of policy decisions relating to the transfer which are as yet undecided and are subject to further policy work, including: whether all CMRU staff are retained; whether the existing Burton offices continue to be used; which systems and controls, such as databases, are retained and the extent of integration with the FCA's existing systems. Overall costs could therefore differ widely: if little operational change is deemed necessary, the transfer costs are likely to be negligible; whereas full integration with FCA and moving the location of the regulator would result in significantly higher costs. CMRU have estimated that exit costs could range up to £1 million.

ONE-OFF COST

Incurred in 2018 (expected), £million at 2016 prices

	FCA	CMRU	Total
max	17.6	1	18.6
min	8.9	Negligible	8.9

55. There will also be costs to CMCs arising from the FCA's annual levy. Information from FCA shows that the size of the levy on CMCs is likely to fall into two categories. There is a flat fee range from £300 to £1000, depending on whether the CMC is classified as being standard risk or high risk. A rated component will then impose a fee on firms based on turnover. Current FCA modelling is based on assumptions for Standard Risk firms with an income up to £88,000 of 0.01% of regulatory turnover, then for High Risk firms two bands are assumed: of 0.012 for firms with regulatory income of £88,000 to £19.5m, then 0.013% for firms with regulatory turnover of £19.5m or more. The resulting forecast (based on FCA assumptions) is for an ongoing annual levy of £5.1m for an assumed firm population of approximately 900 firms, of which around 600 are assumed to be High Risk and 300 are assumed to be Standard Risk.

ONGOING COST

Beginning in 2019 (expected), full year amounts, £million at 2017 prices

	FCA levy	Total
Best estimate	5.1	5.1
max	11.3	11.3
min	2.6	2.6

56. There will be a corresponding ongoing benefit to CMCs from no longer paying the CMRU levy. CMCs currently pay a levy totalling £6.7m per annum to the CMRU in order to be regulated. As set out above, this will be replaced by a higher levy by the FCA. The administrative costs incurred from processing the annual levy payment to FCA has been taken to be equivalent to that incurred by CMCs when processing existing annual fee to CMRU, resulting in zero net costs.

ONGOING BENEFIT

Beginning in 2019 (expected), full year amounts, £million at 2017 prices

	CMRU levy	Total
max	6.7	6.7
min	6.7	6.7

B. Senior Managers Regime

57. There is currently no equivalent to the Senior Managers Regime under the current regulation by the CMRU, so this policy is not assessed against any current costs to CMCs. CMCs were not included in the extension of the SM&CR to the rest of financial services, as they are not currently regulated under FSMA. As such, there are no ongoing monetary benefits to the Senior Managers Regime through any loss of costs of a previous regime.

58. The costs of the Senior Managers Regime are as follows:

    a. <u>Introduction of the Senior Managers Regime</u>: firms will be required to incur costs to set up systems and make other organisational changes (no expected ongoing costs);

    b. <u>Introduction of certification:</u> firms are expected to have to make one-off systems changes to accommodate the introduction of certification requirements (no expected ongoing costs);

    c. <u>Continuing fitness and propriety checks:</u> firms will have a statutory obligation to make annual fitness and propriety checks on senior managers and certified persons, and so will incur both one-off systems changes costs and ongoing costs in making these checks regularly; and

    d. <u>Rules of conduct:</u> many larger firms will have to make one-off systems changes to ensure they can track the individuals subject to rules of conduct, and notify and train those individuals in the rules that apply to them (no expected ongoing costs).

59. To estimate the costs of the Senior Managers Regime, data have been taken from the detailed cost benefit analysis prepared by Europe Economics for the FCA and PRA's joint consultation paper on their proposed Senior Managers Regime rules for banking published in July 2014 (hereafter referred to as 'the Europe Economics Senior Managers analysis').[10] This follows the approach taken in the Impact Assessment for the extension of the Senior Managers and Certification Regime to all FSMA authorised persons.

60. The Europe Economics Senior Managers analysis provides estimates of the costs per firm for large and small banks, large and small building societies, and credit unions, including those associated with firms familiarising themselves and complying with the new rules. The available evidence on the annual income of CMCs indicates that most CMCs are significantly smaller than banks or large building societies. Credit unions, which operate a mutual structure with a non-commercial focus, were not deemed a suitable comparator for CMCs. Therefore, this Impact Assessment uses small building societies as the most appropriate proxy for CMCs to calculate the cost of the Senior Managers Regime.

61. Costs for each of the above aspects (except rules of conduct) will be determined by the number of senior managers and certified persons rather than the number of firms. These costs have been calculated (except for rules of conduct) by using the one-off cost estimated for the FCA regime for small building societies (scaled to 2015 prices using the March 2016 GDP deflator statistics, which is negligible). An adjustment has been made for the number of Senior Managers in CMCs (1.9) compared to small building societies (11.1) at the time of the report (i.e. costs are multiplied by 1.9/11.1 = 0.17).[11] The overall impact is calculated by multiplying by the expected number of affected CMCs.

62. The overall number of authorised CMCs has been reducing by an average of 17% per year for the last three years. Extrapolating this trend (from a 2016 baseline of 1500 firms) gives an estimated 858 CMCs in 2019. The calculations in this impact assessment are based on the assumption that FCA takes on 900 CMCs in April 2019.

63. The costs to firms of ensuring the rules of conduct are being followed by their staff will be scaled by the size of the company, rather than the number of senior managers. The Europe Economics Senior Managers analysis found that it was proportionally more expensive for larger firms to implement a Senior Managers Regime, due to the costs of designing and maintaining appropriate systems and controls to keep track of large numbers of senior managers in large, complex firms. The range of costs have been scaled by the number of staff in CMCs (13.7) in comparison to small building

[10] *Strengthening accountability in banking: a new regulatory framework for individuals* FCA CP 14/13 PRA CP 14/14, published 30 July 2014 and available on the Bank of England and FCA websites. The report by the consultants (Europe Economics) is in Annex 10.

[11] CMRU has 2,494 registered Directors of CMCs, and a further 532 registered non-Directors with significant influence, giving a total of 3,026 'senior managers' across 1,587 CMCs. Therefore, average number of senior managers per CMC is 3,026/1,587 = 1.9.

societies (at least 110) at the time of the Europe Economics Senior Managers analysis (i.e. costs are multiplied by 13.7/110 = 0.12), and multiplied by the expected number of affected CMCs (900).

64. The range of costs per firm for rules of conduct will depend on the numbers of individuals concerned and therefore on the reach of the rules i.e. whether and how far they extend beyond senior managers and certified persons. The Europe Economics Senior Managers analysis provides a reasonable proxy on which to base estimates: the range minimum figures have been calculated on the assumption that the FCA will only make rules of conduct for senior managers and certified persons (£2,000); the range maximum figures have been calculated on the assumption that the FCA would make rules of conduct for all employees other than ancillary staff (£11,600).

ONE-OFF COST

Incurred in 2019 (expected), £million at 2017 prices

	Introduction of SMR	Introduction of certification	Continuing fitness and propriety checks	Rules of conduct	Total
max	4.4	0.3	Negligible	1.6	6.3
min	3.1	0.2	Negligible	0.2	3.5

65. Ongoing costs have been calculated in the same way as one-off costs for each area.

ONGOING COST

Beginning in 2018 (expected), full year amounts, £million at 2016 prices

	Introduction of SMR	Introduction of certification	Continuing fitness and propriety checks	Rules of conduct	Total
max	Negligible	Negligible	0.4	Negligible	0.4
min	Negligible	Negligible	0.3	Negligible	0.3

C. Re-authorising CMCs

66. The cost of reauthorisation for existing firms is a one-off cost with no equivalent in the existing framework. This cost comprises two parts: administrative costs and reauthorisation fees payable to the FCA.

<u>Administration</u>

67. CMCs will incur administrative costs associated with filling in forms and responding to queries from the regulator in relation to their reauthorisation. Drawing on survey responses, Europe Economics estimated that that completing an authorisation would require 3-4 days of a compliance officer's time. The associated cost of this has been assessed against a zero baseline cost. The ongoing cost of authorisations, for new firms joining the market, has been assessed against cost of the ongoing authorisations given by the CMRU.

68. The day rate for a compliance officer has been calculated using ONS data on average earnings from 2015.[12] The relevant occupations is Regulatory Professionals (SOC 2462) which had gross hourly median wages of £21.52 at April 2015. Adjusting this for annual average earnings growth of 2.1%[13] indicates an hourly rate of £21.97 in 2016 and assuming 7.5 hour working day suggests a day rate of £165. This indicates costs per CMC of £495 - £660.

[12]ONS: Annual Survey of Hours and Earnings – hourly pay excluding overtime 2015 http://www.ons.gov.uk/file?uri=/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digitsoc2010ashetable14/2015/rft-14.zip

[13] ONS: Average weekly earnings (seasonally adjusted), private sector, % changes year on year, 3 month average www.ons.gov.uk/file?uri=/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/averageweeklyearningsearn01/current/earn01aug2016.xls

69. Multiplying this by the estimated numbers of CMCs in 2019 (900) gives an estimated administrative cost to CMCs of £445,500 - £594,000.

Re-authorisation

70. As announced at Budget 2016, the FCA will re-authorise all CMCs who wish to continue trading. CMCs will have to apply to the FCA for reauthorisation.

71. FCA estimate that CMCs will be subject to authorisation fees ranging from £1500 to £15,000. The lower value, £1,500, is payable by standard risk CMCs, with high-risk firms' fees ranging from £2,500 to £15,000 based on their turnover. Taking the lower bound and multiplying it by 900 firms gives a minimum value of £1.35m. Taking the upper bound and multiplying it by 900 firms gives a maximum cost of £3.3m. In practice, neither of these figures is expected. Therefore, we have drawn on FGCA's model when calculating our best estimate, which shows a yield of £450,000 for standard risk firms and £2.3m for high risk firms, totalling £2.7m.

ONE-OFF COST

Incurred in 2019 (expected), £million at 2017 prices

	Reauthorisation admin costs for CMCs	Reauthorisation fees paid by CMCs	Total
Best estimate	0.5	2.7	3.2
max	0.6	3.3	3.9
min	0.4	1.35	1.75

72. There will be an ongoing cost to new CMCs, who will have to pay to be authorised by the FCA. Before calculating the cost of these new authorisations, it must first be noted that planned reforms, such as the PPI claims deadline in August 2019, fee cap, and whiplash reforms, may affect the number of new CMCs applying for authorisation. However, since some of these reforms may increase and some decrease the number of CMCs, we have not made any assumptions about the likelihood of there being more or fewer new CMCs applying for authorisation per year after the transfer to the FCA. The calculations below are therefore based on CMRU's figure for 2016 of 159 new applications for authorisation.

73. As above, FCA expect the cost of authorisation to be within the range of £1500 - £15,000 per new CMC with associated administrative costs of £495-660. Multiplying these figures by the expected number of new authorisations a year (159, see above) gives estimated total ongoing costs to new CMCs in the range of £0.3 million to £2.59 million per year.

ONGOING COST

Beginning in 2019 (expected), full year amounts, £million at 2016 prices

	Reauthorisation admin costs for CMCs	FCA authorisation fees for CMCs	Total
max	0.2	2.39	2.59
min	0.1	0.2	0.3

74. There will be an ongoing benefit to new CMCs, who will no longer have to pay to be newly authorised by the CMRU (£2,000 per new CMC, of which there are approximately 159 per annum) or incur administrative costs in relation to the estimated 2 days of a compliance officer's time required to complete the existing CMRU authorisation process.

ONGOING BENEFIT

Beginning in 2018 (expected), full year amounts, £million at 2016 prices

	Authorisation admin costs	CMRU authorisation fees	Total
max	0.1	0.3	0.4

min	0.1	0.3	0.4

D. *Transferring complaints-handling responsibility from the Legal Ombudsman (LeO) to the Financial Ombudsman Service (FOS)*

75. LeO deals with an annual CMC caseload of approximately 3,000 investigations, although this number is volatile. This is because a single firm ceasing to trade can generate multiple complaints within a short period of time; the greatest was 700 complaints. LeO have 28 staff working on CMCs, based in the midlands, and their budget for 2016/17 is £2.99m. This figure is stable, regardless of the number of CMC complaints which arise. LeO also apportion 15-20% of their corporate costs to CMCs. LeO is funded through a combination of a case fee income (£400 per complaint) and a grant in aid from MoJ, which comes from the Lord Chancellor's fee on CMCs. The approximate value of the latter is £1.6m per year (2016/17 figure, accounting for a reduction in the size of the CMC market).

76. The FOS resolved more than 438,000 cases in 2015; the number of complaints about CMCs would therefore represent a very small proportion of FOS' overall case load. FOS also have a prior understanding of the CMC market, given its experience in dealing with PPI complaints. In addition to the fact that PPI and other mass claims are dealt with separately within the organisation, and that FOS have flexible staffing arrangements, the impact of the transfer of complaints to FOS is expected to be minimal. Similarly to LeO, FOS is funded through a combination of case fees, which is currently £550 per complaint (although FOS retain the ability to review case fees as necessary), and a levy on industry, which is collected through FCA's annual levy. This latter cost to business has already been included in the calculations above, and does not appear in the tables below. Firms covered by FOS' complaints scheme are entitled to 25 free cases.

77. The calculations below are based on the assumption that the complaints transfer will coincide with the beginning of FCA's interim permissions regime. At this point, all complaints about CMCs will go to FOS who will decide complaints against their own framework. LeO will continue to deal with all complaints received before this date, in an expected run-off period of 3-6 months. The clean break approach is beneficial for a number of reasons: it reduces transition costs by removing the need for LeO to familiarise itself with the new FCA regime, simplifies the practical arrangements which need to be made, and simplifies the process for consumers, who will know that all complaints about CMCs from a specific date will be dealt with by FOS.

78. All costs arising as a result of the complaints transfer will be passed onto industry, most likely via a levy or increased case fees.

ONE-OFF COST

79. The one-off costs of the complaints transfer include: project management costs; staff training and market familiarisation; decommissioning IT systems; and people costs. These costs may be incurred at different stages of the transfer. For example, LeO estimate that project management costs will be incurred over the next two financial years and that training costs will be incurred in 2018/19, in order to facilitate a transfer in April 2019.

80. LeO expect project management costs to be lower in 17/18 than in 18/19. Allowing for 0.25 FTE of a Team Leader and 0.25FTE of an Ombudsman for 2017/18, rising to 0.5FTE of each in 18/19, with an average salary of £60,000, this equates to total staff costs of £90k over two years. In the interests of clarity, the table below has grouped the estimated two-year project management cost as a single, one-off cost.

81. Regarding people costs, LeO estimate that the majority of staff will find alternative roles within LeO and will manage their staffing levels using fixed term contacts and turnover, rather than redundancies, with leavers assumed to find alternative work in the midlands. As a worst-case scenario, LeO have estimated that making all staff who work on their CMC operation redundant would cost £168,000 (28 staff x £6,000 redundancy package). According to LeO, their staff are highly

unlikely to move across to FOS, so the costs of TUPE have not been assessed. The lower bound assumes that only 5 staff are made redundant, costing business £30,000.

82. Where training FOS staff is concerned, LeO would anticipate dedicating a team of three people for one month to develop and deliver training to FOS staff. LeO expect that staff costs would amount to £15,000, and that travel and subsistence would cost no more than £5,000. The cost of this training will be borne by FOS and passed onto industry, as with other transition costs.

83. LeO estimate that the cost of a LeO team dealing with residual CMC complaints during the run-off period will be £0.12m in 2019/2020. This accounts for a team comprising an Ombudsman, a Team Leader and three investigators (average cost of £40k).

84. Finally, LeO anticipate that there will be no additional IT costs resulting from the transfer. Similarly, FOS expect to incorporate CMC complaints into their current IT systems. The cost for IT is therefore £0m, and has not been included in the following table.

(Expected start date), full year amounts, £million

	Project management (2017-2019)	People	Training (2018/19)	LeO run-off period (2019/20)	Total
Max	0.09	0.17	0.02	0	0.17
Min	0.09	0.03	0.02	0	0.03

ONGOING COST

85. The levy and case fees form the ongoing cost to CMCs. FOS' levy on firms is collected by FCA and is accounted for in the calculations regarding FCA's annual levy, so the cost is shown here to be £0m. Regarding case fees, FOS have no reason to believe that dealing with CMC complaints will be any more costly than other types of complaints they deal with, so the unit cost (based on the current estimate of 2017/18) is assumed to be £589 per case.[14] This will be paid for by a combination of case fee (£550 per case for the 26th and subsequent cases) and an annual levy – to be set by the FCA. Multiplying this by the current average number of complaints per year (3,000) gives an estimated cost of £1.77m.

Beginning in 2019 (expected), full year amounts, £million

	Annual levy	Case fees	total
Best estimate	0	1.77	1.77

86. As indicated previously, we cannot accurately predict the future behaviour and size of the CMC market, nor the complaints it generates, but have based these calculations on data provided to us from the CMRU, FCA, LeO and FOS.

ONGOING BENEFIT

87. Once complaints-handling responsibility has transferred to FOS, CMCs will not have to pay the annual LeO levy, resulting in a benefit of approximately £1.6m per year (at 2016/17 prices and market size). However, this levy is included in the CMRU annual fee, and therefore the impact of this has already been assessed. For the purpose of the following table, the cost is documented as being £0m.

Beginning in 2019 (expected), full year amounts, £million

	Annual levy	total
Best estimate	0	0

[14] This number may be reviewed by FOS when it publishes its final budget on 31 March 2017.

Total costs and benefits

88. Summing the above:

	ONE-OFF COST Incurred in 2018 (expected), £million at 2016 prices	**ONGOING COST** Beginning in 2018 (expected), full year amounts, £million at 2016 prices	**ONGOING BENEFIT** Beginning in 2018 (expected), full year amounts, £million at 2016 prices
A. Transfer to FCA and interim permissions	9.1 – 18.9	2.6 – 11.3	6.7
B. Senior Managers Regime	3.5 – 6.3	0.3 – 0.4	-
C. Reauthorisations and ongoing authorisations	1.75 – 3.9	0.3 - 2.59	0.4
D. Complaints responsibility transfer	0.03-0.17	1.77	-
Total	**14.38– 29.27**	**4.97 – 16.06**	**7.1**
Total, excluding Senior Managers Regime[15]	10.88 – 22.97	4.67 – 15.66	7.1

Non-monetised costs and benefits

Costs

Compliance costs and annual fees

89. The costs to CMCs from policies announced at Budget 2016 and the transfer of complaints responsibility have been monetised above. However, further impacts on businesses will arise once the FCA has taken over responsibility for CMC regulation and designs and implements its detailed rules. Therefore, it is possible that there will be additional compliance costs and further increases to annual fees resulting from as yet unknown FCA rules. FCA will provide a full cost benefit analysis before any new rules are introduced, in line with their statutory obligations.

CMCs exiting the market

90. FCA regulation of CMCs will involve increased one-off and ongoing costs for CMCs to be fit for reauthorisation and the Senior Managers Regime. Some firms may choose not to incur these costs and exit the claims management market, leading to a reduction in the supply of claims management services. This could reduce the availability of access to justice for consumers who may be unwilling or unable to bring a claim themselves. However, increased transparency in the market should mean that consumers will be better informed about their options for bringing a claim themselves, and the possibilities and costs of pursuing justice through a CMC.

91. The calculations of monetised costs have assumed a percentage of CMCs will exit the market as an average of the number of CMCs exiting the market annually over the last three years. We have not attempted to estimate the additional effect of the above reforms and other policy changes (such as the PPI claims deadline, CMC fee cap, changes to whiplash claims) on CMCs exiting the market.

Benefits

Benefits to consumers

[15] Please note that the costs and benefits for the senior managers' regime have not been included in the EANDCB calculation at this stage, for the reasons outlined on page 3.

92. 94% of all complaints to Legal Ombudsman in first 6 months of operating its CMC service were about CMCs dealing with financial product claims. Consumers are likely to benefit from better service standards and value for money from CMCs under these proposals, due to tougher regulation and increased competition.

93. Increased transparency and guidance means consumers are also likely to become more aware of their options, and therefore the proposals are likely to increase the number of consumers who manage their own claims, and do not give up a percentage of their redress to CMCs.

94. Consumers are expected to benefit from reduced demand from CMCs for leads sourced through nuisance calls and text messages. Fewer unmeritorious or speculative claims will also mean legitimate claims will be paid out to consumers more quickly.

95. Consumers may also benefit from the transfer of complaints-handling responsibility, given that the FOS has a higher award limit than LeO, although we have not seen evidence that any redress payments in respect of CMC complaints under LeO have actually been large enough to engage the cap.

Benefits to CMCs

96. There are likely to be reputational benefits for the CMC industry, which will face tougher regulation and therefore will be required to have higher service standards. Tougher regulation and increased competition are also likely to improve CMCs' capability and practices and improve innovation.

Other benefits

97. Fewer spurious and/or fraudulent claims will reduce both the risk of firms paying out non-legitimate claims, and complaint-handling costs.

Wider impacts

98. The impacts on the CMC market and consumers have been set out in the previous two sections. This section sets out wider impacts.

<u>Devolved issues</u>

99. Financial services matters are reserved in Wales, Scotland and Northern Ireland, and the Financial Services and Markets Act 2000 (FSMA) apples to the whole of the UK. However, the extent of CMRU regulation under the Compensation Act 2006 is England and Wales only, defined at the point of access.

100. When the Compensation Act 2006 and accompanying secondary legislation was developed, MoJ received advice stating that claims management services were probably devolved and open to Scotland and Northern Ireland to legislate on if they wish. This view, combined with the policy position of the devolved administrations at the time and the lack of evidence of CMC activity outside England and Wales, resulted in the current regulatory scope. Following recent engagement with the devolved administrations, both the Scottish Government and the Northern Ireland Executive have reviewed whether they wished to introduce regulation and concluded that it is neither necessary nor proportionate at this time. This view has been confirmed by the relevant ministers.

101. The amendments to FSMA will reflect the decision to retain the current territorial scope of CMC regulation. The government will continue to work with the devolved administrations to ensure that there is coherent claims management regulation across the UK. Any new or amended legislation passed will only apply to devolved areas if the consent is given by the appropriate devolved authority.

102. Legislating on this issue in England and Wales does not preclude bringing forward further legislation in future, should ministers or the devolved administrations require.

<u>Financial and resource impact for the Ministry of Justice (MoJ)</u>

103. The existing regulator is self-financing and the financial impact of this transition will be recouped through the levy on CMCs, to ensure there is no net cost to MoJ arising from the transfer. However, there will also be a resource impact on both CMRU HQ and the Compliance Office.

104. Responsibilities of the CMRU over the transition period will include:

a. managing the operational side of the transfer to the FCA, including managing relations with the Compliance Office in Burton-on-Trent (provided by Staffordshire County Council under contract to the MoJ);

b. sharing CMC market knowledge with the FCA, which may involve accepting FCA secondees into the CMRU;

c. sharing knowledge on the current regulatory regime; and

d. managing the interim period to ensure a smooth transition between regulators.

105. The sponsoring department in the MoJ will provide ongoing oversight of the transfer and advise on related policy issues.

Impact on small firms and micro-businesses

106. These reforms are not expected to have a disproportionate impact on small firms and micro-businesses.

107. The vast majority of claims management companies are small and many fall within the definition of micro-businesses. However, in aggregate they serve a very large number of consumers, and therefore claims management companies of all sizes have the potential to cause significant consumer detriment; of the c.1.3m PPI complaints the Financial Ombudsman has received since it was set up, 79% were complaints made on behalf of consumers by claims management companies.[16] It is important therefore that the proposals outlined in this impact assessment apply to all CMCs, regardless of their size, if the policy objectives are to be achieved.

Table: breakdown of active CMCs by no. of staff[17]

Size	**Total**	**No. of staff**	**No. by category**
Micro	1,292	0	454
		1 to 3	629
		4 to 9	188
Small	139	10 to 15	54
		16 to 49	85
Medium	38	50 to 249	38
Large	9	250 or more	9

108. However, that does not mean that these reforms should be applied in an identical way irrespective of the size of the firm. The one-off and ongoing obligations imposed by the transfer to the FCA and the reauthorisation process are necessarily proportionate to the size of the firm. Further discussion for each aspect of the policy proposals is provided below.

FCA levy

109. The FCA levy imposed on CMCs is based on the annual turnover of the firm. Costs incurred by the FCA as part of this transfer are expected to be recovered through this levy, which is the subject of an annual consultation by FCA to ensure that it is set at a level which is sustainable for the regulated community. FCA estimate that the levy on micro and small CMCs will be £500.

[16] http://www.financial-ombudsman.org.uk/publications/ar15/ar15.pdf

[17] Source: CMRU, 2017

Reauthorisation process

110. The cost of FCA authorisation is dependent on the size and complexity of the firm. Small and micro-SMEs will have simpler business models, systems and controls than larger firms and hence incur lower fees to become authorised by the FCA, helping ensure the approach is proportionate. Their applications will also necessarily be less complex and hence they will incur lower administrative costs associated with completing their application. FCA has extensive experience of regulating a wide range firms, including many micro-enterprises, and will seek to ensure their approach remains proportionate. For small firms, the application fee for reauthorisation is expected to be £1500.

Senior Managers Regime

111. The Senior Managers Regime should also not be disproportionate with respect to small businesses; the bigger the firm, the more staff or certified persons it is likely to have for the Senior Managers Regime. The evidence set out above shows that the majority of costs associated with the regime are upfront costs, mainly related to the cost of putting in new systems and controls to comply with the regime, the cost of which will be dependent on the size of the firms.

112. The Europe Economics Senior Managers analysis found that it was in fact proportionally more expensive for larger firms to implement a Senior Managers Regime, due to the costs of designing and maintaining appropriate systems and controls to keep track of large numbers of senior managers in large and complex firms. On the whole, CMCs are smaller and less complex than small building societies (the proxy used), so while this remains a reasonable proxy, burdens on CMCs, including small businesses and micros, may in fact be somewhat less than the illustrative figures in this impact assessment. No suitable evidence is available, so no attempt has been made to estimate the impact of this effect on CMCs.

113. While senior managers must form a much higher proportion of the staff of a small or micro business than in a larger business, the main driver of Senior Managers Regime costs is the number of senior managers. If a firm has only one senior manager, the work involved in preparing statements of responsibilities or responsibility maps must be less than in a large bank, which could have 20-30 senior managers and a complex senior management hierarchy (i.e. there could be senior managers reporting into another senior manager, such as an executive director or the chief executive). The Senior Managers Regime should not, therefore, bear disproportionately on small firms or micro businesses, which have fewer senior managers than larger firms.

114. Similar arguments apply for the Certification Regime and the application of rules of conduct to a wider range of employees. Small firms and micro businesses will not have many certified persons or other employees subject to rules of conduct. It will be easier and more straightforward for these firms to identify the roles and individuals to whom certification and conduct rule requirements apply, and therefore to make fitness and propriety checks, to issue certificates and to notify and train individuals in conduct rules. Therefore, neither the Certification Regime nor the introduction of rules of conduct for other employees should bear disproportionately on small firms or micro businesses.

115. Small CMCs should not therefore be disproportionately affected by the introduction of the Senior Managers Regime. The evidence from the banking sector is that the burdens of the SM&CR fall much more heavily on large firms, particularly the very largest firms. There is no reason for assuming that impact on the CMC sector would be different.

Exempting micro-businesses from FCA regulation

116. It would not be appropriate to exempt micro-businesses from FCA regulation. These firms are unlikely to be disproportionately affected by the transfer, the Senior Managers Regime, or reauthorisation for the reasons set out above, and the FCA have the power when making the detailed implementing provision to take steps to reduce any unnecessary burdens on such firms. As explained above, the detriment that a firm can cause an individual consumer need not be related to the size of the firm. It could even be harmful to micro-businesses to incorporate provision in legislation which might be taken to suggest that they were less well-regulated than other claims management companies, particularly since the majority of claims management companies are micro-

businesses. Exempting micro-businesses from these requirements might reduce, rather than enhance, their ability to compete with other firms because banks often check the CMRU's register of authorised firms before they progress a claim.

Impact on competition

117. These measures are likely to enable more effective competition within the claims management industry, through improved transparency. All competing firms in the industry will be affected in essentially the same way, and as indicated above, exempting micro-businesses from these requirements might reduce, rather than enhance, their ability to compete with other firms because banks often check the CMRU's register of authorised firms before they progress the claim.

Impact on innovation

118. There is no expected impact on innovation.

Impact on wider economy

119. There will be a positive impact on the wider economy through the loss of impact on banks of poor conduct by CMCs.

Equality impact

120. The Government has considered its obligations under the Equality Act 2010's Public Sector Equality Duty.[18] It does not believe these reforms will impact upon persons with relevant protected characteristics and has given due regard to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct, the need to advance equality of opportunity and the need to foster good relations.[19] All England and Wales residents have the potential to be affected to a greater or lesser extent by misconduct or poor performance from claims management companies and will benefit accordingly from tougher regulation.

Environmental, social and sustainable development impacts

121. The government does not anticipate any impact upon greenhouse gases, wider environmental issues, health and well-being, human rights, rural proofing and sustainable development. There is a minimal expected impact on the justice system and this has been discussed with MoJ and HMCTS.

There is likely to be a social benefit to consumers relating to reduced nuisance calls from CMCs.

Summary

122. In conclusion, transferring CMC regulation to the FCA confers clear benefits to both the consumer and the claims management industry itself. These measures will deal with widespread misconduct and consumer detriment and tougher regulation will reduce nuisance calls, leading to higher standards from CMCs and improving legitimate access to justice.

123. Although the costs set out above are only estimates at this stage, due to the limited data available and FCA's need to consult on detailed rules following secondary legislation, the positive impacts on an area that has been the centre of a lot of criticism in recent years outweigh the costs to CMCs and the FCA.

124. The transfer to the FCA, the Senior Managers Regime, the reauthorisation requirement and the complaints transfer all require primary legislation. The government then expects to legislate in more detail on the FCA's regime, and the FCA will then work to design and implement its more detailed rules. Further Impact Assessments will be provided at later stages as appropriate.

[18] S149 Equality Act 2010

[19] The protected characteristics under the Equality Act 2010 are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation.

Next steps

125. This impact assessment sets out early impacts on businesses of the transfer of claims management regulation to the FCA, the senior managers' regime, and the reauthorisation process. It precedes primary legislation which will effect the transfer to the FCA.

126. Following primary legislation, the Government will consult on and implement secondary legislation to establish further detail on the FCA regime. The FCA will also consult on and implement detailed rules for its regulatory regime.

127. Further impacts on businesses will arise once the FCA has taken over responsibility for CMCs and designs and implements its detailed rules. The FCA will undertake further assessments of costs and benefits in due course, and the government will also undertake further assessments of costs and benefits ahead of secondary legislation.

Annex A: Data used to estimate monetised costs

Data	Proxy used	Source	
A. Transfer to the FCA			
FCA one-off costs of transfer	FCA estimates as of February 2017: Reauthorising firms (£4m-£7m) People costs (£1m-£2m) Project team (£750,000-£1.6m) Systems development (£2m-£4m) GCD support (£250,000 - £300,000) Policy (£150,000 - £180,000) Communications and Contact centre (£80,000 - £150,000) Sector view (£50,000 -£100,000) Fees and finance (£50,000 - £90,000) SME input/ secondees/ process design etc. (£300,000 - £500,000) Thematic Review (£280,000) Data migration (£1m)	FCA	£8.9m - £17.6m
Exit costs for CMR	CMRU early estimates.	CMRU	£1m
FCA levy		FCA	2.6m – 11.3m
CMR levy	n/a	CMRU	£6.7m p.a.
B. Senior Managers Regime			
One-off costs of SMR introduction	One-off costs of extending SMR to small building societies [to be scaled for average numbers of senior managers in CMCs, and indexed to March 2016 prices using GDP deflator]	Europe Economics *Cost benefit analysis of the new regime for individual accountability and remuneration*, July 2014 (annexed here) Table 3.7, p31	£22,500 [unscaled]
One-off cost of introduction of certification	One-off costs to small building societies [to be scaled as above]	As above	£1,400 [unscaled]
One-off cost of continuing fitness and propriety checks	One-off costs to small building societies [to be scaled as above]	As above	Negligible
Inflation uplift (CPI) July 2014 to March 2016	n/a	GDP deflator calendar year 2014 (99.726, 2015=100) March 2016 Quarterly National Accounts gov.uk	1.00

Average number of Senior Managers per CMC	n/a	CMRU has 2,494 registered Directors and 532 non-Directors with significant influence, making a total of 3,026 'senior managers' across 1,587 CMCs, giving an average of 1.9 senior managers per CMC.	1.9
Average number of Senior Managers per small building society (at time of estimates)	n/a	Impact Assessment for the extension of the Senior Managers and Certification Regime to all FSMA authorised persons	11.1
Number of CMCs affected	The overall number of authorised CMCs has been reducing by an average of 16% per year for the last three years. Extrapolating this trend gives an estimated 1,127 CMCs expected in 2018. Following a qualitative assessment taking these and other regulatory reforms into account, CMRU estimate there will be between 800 and 1,000 active CMCs in the market. FCA estimates are based on the assumption that they take on 900 firms in April 2019.	CMRU	900
One-off cost of rules of conduct	Range of one-off costs to small building societies [to be scaled to reflect average staff numbers in CMCs, and indexed to 2016 prices]	As above	£2,000 - £11,600 [unscaled]
Average number of staff per CMC	n/a	CMRU	13.7
Average numbers of staff per small building society (at time of estimates)	n/a	KPMG Building Societies Database 2014 The Europe Economics Senior Managers analysis [section 9.2, p105] indicates that there are 6 large and 39 small building societies. Staff numbers from KPMG peer group table 5 was used to calculate the average on this basis.	110

Ongoing costs of SMR	Ongoing costs of extending SMR to small building societies [indexed to 2016 prices]	Europe Economics *Cost benefit analysis of the new regime for individual accountability and remuneration*, July 2014 (annexed here) Table 3.8, p32	Negligible
Ongoing cost of introduction of certification	Ongoing costs to small building societies [scaled as above]	As above	Negligible
Ongoing costs of continuing fitness and propriety checks	Ongoing costs of extending SMR to small building societies [indexed to 2016 prices]	As above	£2,100 [unscaled]
Ongoing cost of rules of conduct	One-off costs to small building societies [scaled to reflect average staff numbers in CMCs, and indexed to 2016 prices]	As above	Negligible
C. Reauthorisation and interim permissions			
Interim permissions one-off costs	Costs recovered by FCA from one-off charge to OFT Consumer Credit firms that wished to join the FCA interim permissions regime [scaled for size of market)]	FCA, figures from 2013/14	£11.3m [unscaled]
Number of Consumer Credit firms that registered for interim permissions	n/a	FCA	49,472
Cost of FCA authorisation	FCA's estimates as of February 2017 All standard risk firms: £1,500 Small high risk firms: £2,500 Medium high risk firms: £7,500 Large high risk firms: £15,000	FCA	£1,500 - £15,000
Cost of CMRU authorisation	n/a	CMRU	£2,000
Number of CMCs applying for authorisation per year	2016 figures	CMRU	159