

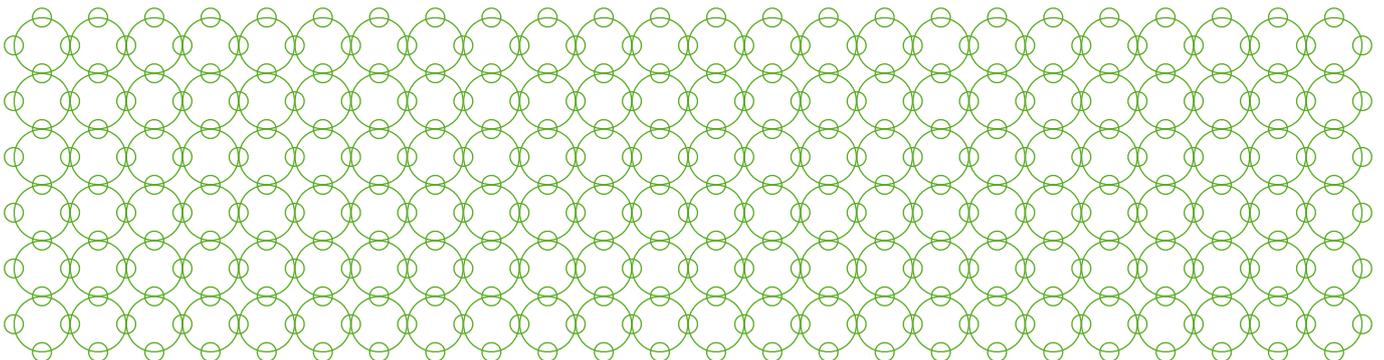


Ministry of  
**JUSTICE**

# Claims Management Regulation

## Impact of Regulation Third Year Assessment

A Report by Mark Boleat for the  
Claims Management Regulation Unit  
Ministry of Justice  
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## Introduction

A rigorous analysis of the impact of regulation has been an integral part of the Ministry of Justice's approach to regulating the claims management industry. This is the fourth impact report commissioned since regulation was commenced in 2007. Previous impact reports have concentrated on the impact of regulation on reducing malpractice as identified in an initial baseline study. After three years it is necessary to refine the process as the markets have changed substantially, in particular through new markets being developed and new forms of malpractice appearing. This study follows the pattern of previous studies by analysing how malpractice has been reduced but also considers, in as much detail as is possible, the impact on promoting access to justice. This is a more difficult subject to analyse, and this section of the report should be regarded as a tentative first step. The report does not repeat much of the analysis that has appeared in previous reports, for example the approach to enforcement issues and the handling of claims in respect of the allegedly unenforceable terms in credit agreements.

The report also identifies how the claims management market and the regulatory regime have evolved over the years and suggests some issues that might usefully be considered by the Regulator.

The author is grateful to the staff providing the claims management function at the Ministry of Justice in London and in the Monitoring and Compliance Unit in Burton-on-Trent and to the various representatives of government agencies and departments, trade associations and individuals who have fed in their experience and views, in particular through a workshop on access to justice held on 26 March 2010.

**Mark Boleat**

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# 1. Executive Summary

## **Background**

- 1.1 The Compensation Act 2006 provided for the regulation of claims management activities. The regulatory regime was quickly put into place by April 2007 using an innovative structure with day-to-day monitoring and compliance functions being effectively outsourced to a dedicated unit provided by a local authority. The objectives of regulation are to provide better safeguards to consumers of claims management services and to promote access to justice.

## **Evolution of a Regulatory Regime**

- 1.2 Typically, new regulatory regimes go through five phases: identification of malpractice; construction of the regulatory regime; initial implementation; business reaction, and the regulator reaction.

## **Dealing with Malpractice – Personal Injury**

- 1.3 Personal injury claims were the principle driving force behind the introduction of regulation. Regulation quickly dealt with most of the overt malpractice, in particular unauthorised marketing in hospitals, cold calling in person and the misuse of the expression “no win, no fee”. The Regulator has also played a significant role in dealing with criminal activity in the form of staged accidents. Malpractice has now largely switched to telephone cold calling by marketing companies and misleading information being given in individual contacts. Personal injury business will be influenced by changes to the claims process.

## **Dealing with Malpractice – Financial Services**

- 1.4 When regulation began, there was only one substantive market for compensation claims for financial products - mis-sold endowment policies. The major malpractice, although it did not have a significant detrimental affect on consumers, was misleading claims on websites. This malpractice has been dealt with. For other reasons the volume of endowment claims has now been sharply reduced. Claims companies moved into the bank charge and unfair terms in consumer credit agreement markets, but both have largely been ended as a result of court judgments. The significant market now is payment protection insurance. The major area of malpractice has been the taking of upfront fees where there was no guarantee of the service being delivered. Regulation has succeeded in limiting the scope for malpractice in these new areas.

### **Dealing with Malpractice – Other Markets**

- 1.5 Regulation has largely dealt effectively with malpractice in three other small markets: criminal injuries compensation, industrial injuries disablement benefit and housing disrepair. Employment claims has proved a more difficult market as the nature of the issues are very different, the main problem being the poor standard of representation.

### **Keeping Inappropriate Businesses out of the Market**

- 1.6 The authorisation process has been used successfully to keep inappropriate businesses out of the market, largely through applications being withdrawn or not pursued. Over 450 businesses that paid the application fee for authorisation chose not to pursue their applications. The renewal process plays a similar but more muted role in this respect and also provides an opportunity for businesses to withdraw formally from the market. Over 650 businesses have voluntarily surrendered their authorisation. Effective action has been taken against businesses operating without authorisation.

### **Access to Justice or Compensation Culture?**

- 1.7 Access to justice is generally seen as being a “good thing” while the compensation culture is seen as being a “bad thing”. However, the two are if not the same then closely connected. In practice, the promotion of “good” access to justice at the margin inevitably is likely to lead to a belief, that can be realised in some cases, that compensation is available when it is not properly due. The more that “good” access to justice is promoted, the greater the scope for a “bad” compensation culture with compensation being sought and paid where it is not properly due.

### **Access to Justice in the Personal Injury Sector**

- 1.8 Personal injury claims have increased markedly in relation to injuries sustained as a result of road traffic accidents. Claims management companies have contributed to this trend by helping people claim compensation who would not otherwise have done so. There is an argument that they are unnecessary and do not add value. This is to ignore the reality of the market place. Advertising and marketing are essential parts of the process, not expendable extras. Regulation has probably played no more than a modest part in promoting access to justice, although it has helped raise the profile and credibility of claims management companies, particularly in their dealings with solicitors.

### **Access to Justice in financial services**

- 1.9 Claims management companies have played a significant role in increasing access to justice in respect of mis-sold endowment policies and more recently payment protection insurance. Without their activities, many people would not have obtained the compensation to which they are properly entitled. Regulation has played a modest role in increasing access to justice, largely by increasing the credibility of companies in the sector and also by limiting the scope for malpractice.

### **The Market for Claims Management Services**

- 1.10 Prior to the introduction of the legislation, it was estimated that there were about 500 claims management companies. In the event, more than 3,000 businesses are now authorised and the number of new businesses seeking authorisation is running at over 1,000 a year. However, the volume of business has not increased commensurately. There is a substantial turnover in the sector, many businesses coming into and out of the market each year. Regulation has probably made it more attractive for individuals and businesses to seek to enter this market as being able to say that they are regulated by the Ministry of Justice is a useful marketing tool.

### **Evolution of the Regulatory Regime**

- 1.11 The regulatory regime has evolved in response to market developments. Overt malpractice was dealt with very quickly, primarily through the authorisation process together with regulatory action against some authorised businesses. Malpractice has now become both more sophisticated and more difficult to detect, for example, misleading claims on websites being replaced by misleading claims in individual telephone conversations. The focus of regulation action has switched from personal injury to financial services.
- 1.12 The major problem areas are also those where other regulators are active and, increasingly, the Claims Management Regulator has had to work with those other regulators.
- 1.13 The Regulator has had to become smarter and has done so although the need to work with other regulators has meant that progress has sometimes been a little slow. Complaints to the regulator have proved to be a valuable source of intelligence, complementing existing sources.

### **Overall Assessment**

- 1.14 Claims management regulation has, at a very modest cost (£2.3 million in 2009/10), effectively dealt with overt malpractice in the market for claims management services. Regulation has prevented businesses that were likely to engage in malpractice from operating in the market and has significantly

reduced the scope for malpractice to develop, particularly in respect of the market in financial claims.

- 1.15 The effectiveness of the Claims Management Regulator has been recognised in a recent Better Regulation Executive report (Better Regulation, Better Benefits: Getting the Balance Right Case Studies, BIS October 2009). The report concluded that: “Claims management regulation is a good example of how regulation can be introduced quickly, efficiently and at low cost, with the support of the industry concerned, to protect consumers.”

### **Future Work**

- 1.16 The Regulator needs to build on what has already been done in differentiating the requirements that must be met by businesses engaged in activities that are high risk in respect of potential detriment to the consumer as opposed to businesses that do no more than introduce claims to another business. Possibilities that merit consideration are requiring outward telephone calls to be recorded, more mystery shopping of businesses where there is prime facie evidence of malpractice, changing the requirement that allows businesses to say that they are “authorised by the Ministry of Justice” and developing an even more robust authorisation procedure for certain business sectors. The Regulator also needs to further strengthen the ability to anticipate problems and further concentrate enforcement activities on those businesses that pose the greatest risk to consumers.

## 2. Background

### **The need for claims management regulation**

- 2.1 Over the last ten or so years a small industry has grown up of non-solicitor businesses that help people obtain compensation. This has been influenced by government policy initiatives – the introduction of conditional fee agreements for personal injury cases and the requirement on insurance companies to respond in a particular way to complaints about the mis-selling of endowment policies.
- 2.2 Whilst solicitors remain the principal providers of claims management services, the traditional culture of the legal profession, combined with the professional regulation to which solicitors are subject, allowed new entrants into the market who were subject to no regulation at all. Standards have varied from very good to very poor, but with no mechanism for excesses at the poor end of the scale to be addressed.

### **The Compensation Act 2006**

- 2.3 The Compensation Act 2006 became law on 25 July 2006. The Act and subsequent secondary legislation provide for the following activities to be subject to regulation -
- advertising for, or otherwise seeking out (for example, by canvassing or direct marketing), persons who may have a cause of action;
  - advising persons on the merits or handling of causes of action;
  - making representations on behalf of claimants;
  - referring details of potential claims or potential claimants to other persons, including persons having the right to conduct litigation; and
  - investigating, or commissioning the investigation of, the circumstances of, the merits of, or the foundations for, potential claims, with a view to the use of the results in pursuing the claim.
- 2.4 Claims in respect of the following are covered –
- personal injuries;
  - criminal injuries compensation;
  - Industrial Injuries Disablement Benefit;
  - employment;

- housing disrepair; and
  - financial products and services.
- 2.5 A number of businesses are exempt from the need to be authorised under the Act –
- lawyers regulated in respect of claims management services by their respective regulators;
  - independent trade unions;
  - insurance companies, insurance brokers and IFAs providing a claims management service that is regulated under the Financial Services and Markets Act 2000;
  - charities and advice agencies that meet the detailed exemption criteria set out in the regulations; and
  - certain very small scale introducers ('exempt introducers') although they need to comply with the rules on advertising, marketing and soliciting business.

### **The regulatory structure**

- 2.6 The time period from drafting the legislation to Royal Assent and then implementation was very short. At the time the legislation was drafted no decision had been taken as to the regulatory structure. The legislation accordingly allowed any option. The Secretary of State could establish a new regulatory body, designate an existing regulatory body to be the regulator or be the regulator himself. The latter direct regulation option was selected and fully implemented by April 2007.
- 2.7 An established civil servant supported by a small team in the Ministry of Justice takes decisions on behalf of the Secretary of State. A Monitoring and Compliance Unit is provided under contract by Staffordshire County Council. A non-statutory Regulatory Consultative Group, comprising representatives of relevant major stakeholders including claims management businesses, other regulators, trade associations and consumer organisations, acts as a sounding board for the Regulator and as a forum for discussion.

### **The objectives of regulation**

- 2.8 The objectives of regulation were set out in the Regulatory Impact Assessment for the Compensation Bill –

"This proposal aims to provide better safeguards for consumers of claims management services. It is designed to encourage the provision of quality services, to enhance consumer protection and to provide consumers with

a clear route to redress. In particular, the proposal aims to improve the effectiveness and efficiency of the system for those who have a genuine claim to compensation, and to tackle practices that have helped to spread the misperceptions and false expectations of compensation claims amongst consumers. This will help to build consumer confidence and promote effective competition within the sector, whilst ensuring that the sector will be able to contribute effectively to the widening of access to justice.”

### 3. The Evolution of a Regulatory Regime

- 3.1 Now that regulation has been in place for three years there is sufficient experience for this annual impact study to analyse how claims management regulation has impacted on the market for claims management services as a whole and how the regime itself has needed to adapt and will need to continue to adapt in the light of changing market conditions. Such an analysis needs to be conducted within a theoretical framework which can reasonably be constructed from the experience of other regulators.
- 3.2 Five very broad phases of a regulatory regime can be identified.

#### (1) Identification of malpractice

Regulation is introduced because there is, or is perceived to be, malpractice in the marketplace which does not lend itself to remedial action other than by new regulation. The malpractice may be well documented in an authoritative and well researched study or it might be based on rather more subjective views, influenced by the media and MPs.

#### (2) Construction of the regulatory regime

The policy-making process is such that there is likely to be a reasonably long interval between identification of the problem and the detailed work in putting in place a regulatory regime. This is done typically through a three-stage process of primary legislation, secondary legislation in the form of regulations and rules made under secondary legislation. This is a far from easy task. There can be a tendency for policy makers to take the market as they see it and not to work through what will happen in the market as a result of regulation. The process can also take such a long time that there is a risk that the market itself will have changed for reasons unconnected with the regulation. It is also inherent in the policy making process that the wording of specific regulatory requirements receives rather more attention than any enforcement mechanism, with there sometimes being an automatic assumption that rules are self enforcing.

However well it is done this process will be far from perfect and may well be influenced by extraneous political and other factors. The end result is unlikely to be ideal and in all probability there will be some unintended loopholes or gaps.

#### (3) Initial Implementation

The early days of a regulatory regime are vitally important in setting the tone. There can be a tendency for regulators to make loud noises, which may be interpreted as threats about the need for compliance and the penalties for failing to comply. Businesses in the sector will be nervous about the impact of regulation, perhaps aided by exaggerated claims by lawyers and compliance experts as to what will be needed to be done in order to comply.

The regulator is likely to deal fairly quickly with some forms of overt malpractice and will have sensibly identified some easy and quick wins at the outset. However, progress in dealing with any major malpractice may be more difficult, and to some extent there will be some sparring between those who profit from malpractice and the regulator.

#### **(4) Business Reaction**

Within a few months of the regulatory regime coming into force, and indeed sometimes even before it does so, businesses will react. In some cases they will reorganise their activities so as to fall outside the regulatory scope. Some may leave the market altogether, particularly if it is of marginal importance to them.

The most important reaction is of those who have profited from malpractice. They will want to preserve this ability so they will be keenly observing how the regulator behaves, in particular what forms of malpractice the regulator chooses to pursue and how the regulatory reach can best be circumvented. This can easily lead to malpractice being driven underground, to new businesses being created and in some cases to businesses openly challenging the regulator, knowing the prosecution, if not an empty threat, is something that is undertaken only rarely and is costly to the regulator.

At this stage there is likely to be some disillusionment with the regulatory regime, however successful it is. Consumer groups and others may well point out that it has failed to remove all malpractice, even though this was an impossible objective. Those businesses that sought to comply may complain that others have not done so and thereby gain a competitive advantage.

#### **(5) The Regulator Reaction**

The final and mature stage of a regulatory regime is when the regulator is in a position to react to the business response to the regulatory regime. Regulators have to learn from experience – not only their own experience but also how other regulators have performed and most importantly how the businesses they are regulating have reacted. In the same way that businesses wise-up to the regulator and find means of circumventing regulation, so the regulator has to wise-up to the activities of those intent on malpractice so as to ensure that they cannot evade the purpose of regulation.

This is a far more sophisticated regulatory regime than that imposed initially. There may well be a real battle between the regulator and a relatively small number of businesses that are both willing to engage in malpractice and are clever enough to play the regulatory game in such a way that they can do so to some extent.

## 4. Dealing with Malpractice – Personal Injury

- 4.1 Personal injury claims are the largest part of the claims management market. There are around 2,500 businesses in the market, with a turnover of approximately £250 million.
- 4.2 Personal injury claims were the principle driving force behind the introduction of the Compensation Act. Large scale advertising, particularly on daytime television, combined with reports about “ambulance chasing”, contributed to a climate in which the general view was that there was substantial malpractice; indeed there was, although the advertising itself did not on the whole offend against any rules or Codes of Practice.
- 4.3 There was real malpractice in a number of separate areas –
- unauthorised and sometimes aggressive marketing in hospitals targeted at people who had recently suffered an injury;
  - cold calling in city centres and housing estates, again sometimes quite aggressively;
  - cold calling by telephone;
  - use of the expression “no win/no fee” when it could not be justified;
  - on the part of some companies that went beyond introducing claims and represented clients, opaque contracts including hidden costs and charges;
  - at a very different level, the presence of organised crime involved in staged accidents; and
  - at a lower level in respect of consumer detriment, many personal injury cases were passed from introducer to solicitors, sometimes through several intermediaries, in ways that contravened the rules governing solicitors’ conduct. Commission was often not disclosed and there was no written contract between intermediary and solicitor.
- 4.4 In addition to these points there was also real concern about whether those entitled to compensation could secure access to justice.

### **The Impact of Regulation**

- 4.5 As previous impact reports have demonstrated, claims management regulation has been successful in removing most of the malpractice that was initially identified. An early win was virtually to eliminate marketing in hospitals that had not been authorised by the hospital management through aggressive regulatory action against those companies engaged in this activity.

The result has been welcome to hospitals that, at times, had to deal with a substantial nuisance factor. It has also benefited them commercially as the activities of those companies marketing without authorisation were adversely affecting the ability of the hospitals to conclude commercial contracts with other businesses.

- 4.6 Similarly, cold calling in the street has largely been eliminated through regulatory action against those involved and also seeking to cut off the supply chain to solicitors. Such regulatory action can never be 100% effective as long as money can be made through such activity. There remain isolated cases of cold calling in the streets but at a much reduced level and not such as to cause regulatory concern.
- 4.7 Another early success, largely achieved during the initial authorisation process, was to eliminate misuse of the expression “no win/no fee”, which, in the past, had all too often proved not to be the case. Here, the simple expedient was not to authorise businesses until they had removed any such claims from their websites or had qualified them appropriately. Inevitably, there were still isolated examples where exaggerated claims are made but, again, these are on a much reduced scale.
- 4.8 A minority of businesses have had contractual relationships with their clients, the majority simply acting as intermediaries. Where there are contracts with clients, these have had to comply with the rules of conduct, which have been designed to ensure transparency and clarity. Again, this work has largely been successful.
- 4.9 When the regulatory regime was established, staged accidents were not on the agenda. It rapidly rose up the agenda as it became clear that some of the businesses authorised seemed to be engaged in this criminal activity. Here, the Claims Management Regulator could not act independently of other regulators, nor indeed could it be the lead agency. Staged accidents are criminal offences; those perpetrating them are engaged in other forms of crime. Organised criminal activity in this area also requires complicity on the part of solicitors. The task of the Claims Management Regulator has been to work with other agencies, in particular the police and the Solicitors Regulation Authority, providing them with information and support wherever possible. In practice, the Regulator went further than this and in the early years took the lead in establishing an informal grouping of relevant regulators and enforcement agencies, which has proved a useful framework within which co-operation has increased. More recently, the Regulator has entered into information sharing agreements with individual police forces and has continued to work closely with the Solicitors Regulation Authority. This is an area where regulation can legitimately be said to have achieved more than could reasonably have been anticipated when it was established.
- 4.10 Finally, regulation has secured greater compliance with the rules governing solicitors’ conduct particularly in respect of contractual relationships

between solicitors and intermediaries and disclosure of commission. There is still widespread low level non-compliance in these areas. However, as there is generally no resulting consumer detriment, this has been a relatively low priority for both the Claims Management Regulator and the Solicitors Regulation Authority.

### **The Market Reaction to Regulation**

- 4.11 Chapter 2 of this Report explained how regulatory regimes evolve over time. The handling of personal injury claims reflects this theoretical analysis. The overt malpractice has largely been ended. But malpractice remains and as could reasonably be expected it has become both more sophisticated and more difficult to detect, this partly reflecting the high rewards still available in this sector.
- 4.12 Overt cold calling in the street or by telephone by authorised claims management businesses is virtually certain to be caught and therefore has ended. Those who believe that they can benefit from cold calling have had to use more complex techniques, generally involving an extended supply chain, cases passing through the hands of several intermediaries. A common ploy has been to insert a seemingly innocent question in, for example, life style questionnaires along the lines of “have you ever suffered a road accident as a result of which you have been injured?” followed by “If so, would you be interested in a solicitor investigating whether you were entitled to compensation?” In such cases, it can be quite difficult to determine whether the practice is actually cold calling and, if so, who is doing it. The potential consumer detriment as a result of such practices is modest.
- 4.13 There has also been a growth in cold calling by specialist marketing companies operating through call centres whose task is precisely that – to cold call. From the Claims Management Regulator’s perspective, it can be quite difficult to identify such businesses and to take action against them.
- 4.14 There is now virtually no misleading information in advertising particularly on websites but this does not prevent misleading information being given to potential clients either face-to-face or in telephone conversations. This is not widespread but can be quite damaging for the members of the public concerned. It is difficult to detect and deal with.

### **Future trends**

- 4.15 Significant changes to the claims process in respect of road traffic accidents have recently been introduced and further significant changes are possible in the years ahead. These could have a substantial effect on the claims management sector which, in turn, will have implications for the Regulator, perhaps by significantly reducing the number of businesses in the sector and the volume of their business.

## 5. Dealing with Malpractice – Financial Services

- 5.1 The financial services market was the second largest to come within the scope of claims management regulation, but that market was very different in nature from the market for personal injury claims and with little overlap of businesses between the two sectors. The number of businesses active in the market has increased markedly to around 1,100.

### **Endowment claims**

- 5.2 When regulation began, there was only one substantive market for financial products – mis-sold endowment policies. That there had been widespread mis-selling was generally accepted. The regulator, the Financial Services Authority (FSA), had required those selling endowment policies to advise their customers of the likely extent of any shortfall in their policy and, in so doing, in effect, advising them as to whether they had a claim for compensation. However, the FSA did not require those selling the policies to proactively review all cases. If a complaint was received, the FSA required this to be dealt with in a specified way, and the Financial Ombudsman Service could adjudicate at no cost to the claimant on whether the complaint had been properly handled.
- 5.3 This was a very easy market for businesses that could quickly style themselves as claims management companies. With a bit of advertising all they had to do was to attract clients then generally write one fairly standard letter that would be sufficient to set the ball rolling. If the claim was successful then the company would take a fee, typically 25% or 30% of the compensation amount.
- 5.4 When regulation was introduced there was malpractice, although much of it did not have a significant detrimental affect on consumers. The main problems were misleading claims on websites and in advertising, generally emphasising the certainty of a successful claim if using the claims management business combined with the difficulty of making a claim directly. In a relatively small number of cases, there was more serious detriment, generally as a result of upfront fees combined with a promise to repay these if a claim was successful, that promise not always proving easy to realise.
- 5.5 The overt malpractice was quickly dealt with, generally in the authorisation stage. Businesses had to ensure that their websites and other marketing were in order before they could be authorised.
- 5.6 There was always a finite number of endowment claims and the FSA also introduced time barring. As a result, very predictably, the business is running down and is now at less than 10% of its peak volume business.

### **Bank charges and consumer credit agreements**

- 5.7 The claims management companies and many individuals had accumulated some expertise in handling financial services claims and perhaps more importantly an appetite to earn money from handling such claims. Not unnaturally, they looked for new markets, but none has been as clear cut as that for endowment business.
- 5.8 The first significant new market was allegedly unfair bank charges, a subject which quickly resonated with the public and resulted in significant media attention. However, whether there was a legitimate claim was always open to question and a decision was taken jointly by the banks and the Office of Fair Trading (OFT) for this to be tested through an agreed court action. This has recently been resolved by the Supreme Court largely in favour of the banks, the effect of which has been to reduce greatly the scope for the business. Some consumers will have lost small amounts of money in make up front payments, typically £10 or £20, but there has been no significant consumer detriment in this area.
- 5.9 Attention then turned to a far more difficult market - the alleged unenforceability of certain consumer credit agreements (UCCA) on the grounds that the consumer credit provider had not complied with various requirements of the legislation in respect of the original agreement. Whether such claims were valid was open to debate, very different from the clear cut position in respect of endowment claims. In the event, recent court decisions have largely served to significantly reduce this market.
- 5.10 However, the actions of some claims companies have led to consumer detriment. Some not only took significant up-front fees but also encouraged people to believe that their consumer debts could be written off. In some cases, this extended to people being persuaded to make an up-front payment to the claims management company with the suggestion that if this was done by credit card then this could also be written off.
- 5.11 For the Regulator this proved to be a challenging area. It grew rapidly from a virtually standing start but was not something that fell wholly within the province of the Regulator. The OFT had a significant interest in this area and in respect of some business the locus of the Claims Management Regulator could be questioned. This point was examined in detail in the Second Year Impact Report (and that analysis is not repeated here). Largely as a result of the lack of clarity over regulatory jurisdiction, the regulators collectively had initial difficulties getting to grips with an emerging problem, but they have done so, culminating recently in an action to close down one of the largest businesses in this sector. And the recent court decision, *Carey v HSBC* [2009] EWHC 3417 (QB) has reduced significantly the scope for such business.

### **Payment protection insurance**

- 5.12 There has been one consequence of the focus on consumer credit loans. Many such loans have been accompanied by payment protection insurance (PPI), a product that many argue is of questionable value. Many customers do not realise they have bought it and those that have purchased it often find that they can never claim. Reports by the OFT, the Competition Commission and the FSA demonstrated that there had been substantial mis-selling in this area, therefore offering the prospect of a market for claims management companies. However, it is difficult to find customers who have been mis-sold a product where they do not know that they have the product. Often, it was the pursuit of a consumer credit claim that led claims companies to the payment protection policy that they have then pursued as a separate issue. The volume of personal payment protection business has dramatically increased over the past year, the vast majority of it handled through claims management companies.
- 5.13 Those businesses that were in the endowment market have also followed the well established marketing practice of tapping their existing, and largely satisfied, customer base to identify if they had any consumer credit loans supported by PPI or if PPI had been sold alongside the original or a later mortgage loan.
- 5.14 Through this means a “difficult to exploit” market has been turned into a fruitful market for claims management companies, and business has expanded rapidly. The best proxy for the extent of claims management business is the number of complaints made to the Financial Ombudsman Service (FOS), an indicator which probably lags claims management company activity by about six months. Between February 2009 and April 2009 FOS received 8,976 PPI related complaints, 65% of which were from claims management companies. Between November 2009 and February 2010 the number had increased to 19,725, with 75% from claims management companies. Similarly, the Financial Services Compensation Scheme is preparing for a large increase in the number of cases it will receive and the compensation bill it will have to pay. It is forecasting new claims of 4,020 in 2009/10 and 8,100 (but with a range of 4,250 – 25,500) in 2010/11.
- 5.15 There is comparatively little scope for malpractice in this market and the regulatory regime put in place to deal with mis-sold endowment claims should be sufficient to deal with malpractice.

### **Other issues**

- 5.16 As with other regulatory regimes there have been some attempts to use the Ministry of Justice names in scams. One problem occurred where a claims management company outsourced processing work. Staff at the processing centre then called customers of the claims company, purporting to be calling on behalf of the Ministry of Justice, the OFT or another official body. The

caller would say that they had recovered the consumer's bank charges and in order to release this to them, they would need an administrative fee paid, often 10% of the settlement, paid by money transfer. The victim would be given a code and told to go to the Post Office to make the transfer via a money transfer business such as Western Union etc. If the transfer was made, the scammers would usually call back giving further reasons for increasing sums to be paid over before the funds would become available.

- 5.17 Because the Ministry of Justice, 'claims regulation' or 'authorised businesses' were being used to facilitate the scam, the Regulator received many calls from members of the public who had received one of these calls, or had made payments. This scam is outside the scope of claims management regulation. However, the Regulator took the appropriate action through signposting, delivery of bad news, issuing warnings through press releases, directing consumers to their own police forces and putting together a 'package' for police to pursue.

### **Conclusion**

- 5.18 Generally in this area it can be concluded that initially the Claims Management Regulator was successful in removing the overt malpractice in respect of marketing activities of endowment business. Subsequently, over the last few years, it has managed to contain what could otherwise have been a huge growth in businesses seeking to persuade people that they have legitimate claims in respect of bank charges and subsequently consumer credit agreements when, in reality, there was little prospect of successful claims.
- 5.19 An effective regulatory regime is now in place to handle PPI claims - claims business which may by its nature not lend itself to the blatant malpractice that was seen in respect of unfair terms in consumer credit agreements.

## 6. Dealing with Malpractice – Other Markets

6.1 There are three small markets within the scope of the Regulator – criminal injuries compensation, Industrial Injuries Disablement Benefit and housing disrepair. The turnover in these markets is no more than about £5 million. Most of the businesses in these markets are also in the personal injuries market so there have been similar issues that have been dealt with in a similar way.

### **Criminal injuries compensation**

6.2 The Criminal Injuries Compensation Authority (CICA) pays out about £200 million a year. Claims management companies have a small part of the market, with a turnover of around £1 million a year. Specific areas of malpractice in this sector, largely relating to businesses claiming to have a connection with or even be part of the CICA, were largely eliminated in the first year of regulation. This was comparatively easy because every case is considered by the CICA, which can help monitor that businesses are authorised and that the [primary Rules of Conduct are being complied with.

### **Industrial Injuries Disablement Benefit**

6.3 As with criminal injuries, there is a single recipient of claims, the Department for Work and Pensions (DWP), which pays out about £800 million a year. The claims management business is small scale with turnover of around £1 million. The DWP has been asked to refer to the Regulator examples of businesses not complying with the rules.

### **Housing disrepair**

6.4 The market is small and local in nature with turnover of around £3 million. The malpractice in this area was mainly cold calling, and has been addressed in the same way as for personal injury business.

6.5 In practice, local authorities have largely dealt with the problem themselves, by rigorous scrutiny of claims so that they are not seen as a “soft touch.”

### **Employment**

6.6 Employment claims are very different in nature from other claims that come within the scope of claims management regulation in that the service provided is quasi-legal, involving representation before an Employment Tribunal. The regulatory regime is not well suited to employment claims, where the main problem areas relate to competence rather than more tangible rule breaches.

- 6.7 The Regulator has sought to address problems in this sector directly with a small number of businesses, but the absence of a specific competency test inevitably means that the impact is limited. While there is a good case for regulation in this sector, covering representation of defendants as well as claimants, the current arrangements are sub-optimal, although at first sight it is not possible to identify more optimal arrangements.

## 7. Keeping inappropriate businesses out of the market

7.1 Regulation is designed to ensure that those providing particular goods or services do so in compliance with appropriate laws and regulations. Part of this role is to prevent businesses that should not be in the market from being in the market because of their practices or the past record of the people running them. This is done by denying them the necessary authorisation to operate in the market, and if authorised then removing their authorisation or persuading them to exit the market. The Claims Management Regulator has demonstrated this role effectively since inception.

### **Authorisation**

7.2 The authorisation process was designed with a number of objectives in mind. It sought to obtain the necessary information about the people running the business, it sought to put modest hurdles in the way of those seeking to provide a claims management service and rather less modest hurdles on some businesses that would be representing clients. The process was also designed to draw attention to the rules of conduct, with businesses being asked to certify that they were aware of them and would comply with them.

7.3 It is tempting for outside observers to measure the effectiveness of a regulator by the number of businesses they refuse to authorise. On this score the Claims Management Regulator would not score that highly, only nine businesses having been formally refused authorisation. However, the reality is very different. Over 450 businesses have paid the application fee for authorisation but chose not to pursue their applications. In some cases the decision not to pursue was taken for quite innocent reasons, such as someone simply deciding that this was not a market they wanted to be in. But, in other cases, the challenge by the Regulator on the information, or lack of it, provided in application forms persuaded businesses that the Regulator was for real and that either because of past history they would fail to be authorised or if they were authorised then the Regulator was unlikely to allow them to engage in malpractice.

### **Regulation renewal process**

7.4 The annual information gathering and renewal process, although labour intensive, usefully serves again to draw the attention of businesses to the rules of conduct, and also enables the Regulator to update key information about each of the authorised businesses. Businesses are supposed to tell the Regulator of matters such as changes of name, changes in the composition of the board of directors and so on but in reality, and not just in this sector, many fail to do so. The annual renewal process rectifies this.

- 7.5 When faced with a renewal notice, businesses have to decide whether they wish to stay in the market. Some may legitimately wish to exit the market because their business has been declining or because they have moved into other areas or simply because they want to retire. Others that perhaps might have engaged in marginal malpractice and have had to face regulatory challenge may exit the market because they do not think they can make much money out of it. Over 650 businesses have surrendered their authorisation since the start of regulation, some of which were in the early stages of having enforcement action taken against them by the Regulator. All of this is good regulatory activity, helping to ensure that there are not businesses in the market that are determined to act inappropriately.

#### **Action against authorised businesses**

- 7.6 Naturally, the Regulator has to pursue those authorised businesses that are not complying with the rules of conduct. Where formal regulatory action is taken, this is time consuming and costly and there is a limit on the number of such cases that a regulator can engage in at any one time. However, it is important that firm regulatory action is taken and is seen to be taken, otherwise the credibility of the Regulator is at risk. In addition to the authorisation of many businesses being suspended for the simple reason that they fail to pay the renewal fee, the authorisation of 11 businesses has been suspended because of more serious breaches of the rules and in the case of a further 38 businesses the authorisation has been cancelled.

#### **Unauthorised trading**

- 7.7 The other related area is that of unauthorised trading or “policing the perimeter”. In itself this may not involve any consumer detriment. It may simply be that a business either did not realise that it had to be authorised or it realised but felt that it could get away with operating below the radar. The Regulator has to be vigilant about unauthorised trading even if there is little consumer detriment. The credibility of the regulator suffers if businesses are seen to be operating without authorisation. The Regulator has established a good intelligence mechanism for seeking to identify businesses that may be trading without authorisation, relying on complaints from customers, reports from other businesses and regular website sweeps. Every case is followed up. Where a business has been innocently trading without authorisation then it is required either to stop trading or to become authorised. Where businesses know they are trading without authorisation then they would not be authorised because they would fail the fit and proper tests. Where businesses persist in trading without authorisation when they should be authorised then the only appropriate remedy is prosecution and at the time of writing there were two prosecutions being considered. The Regulator has also been successful in persuading internet service providers to take down the websites of businesses operation without authorisation, an action that severely curtails their ability to do business.

- 7.8 In the majority of cases of suspected unauthorised trading, investigations determined that the business either was authorised, but perhaps was using a trading name that it had not declared, or did not require authorisation. 66 cases have been confirmed as trading without authorisation. In most cases a warning has been sufficient to stop any proven unauthorised trading. However, five businesses have been refused authorisation on the grounds of previous unauthorised trading and prosecutions are currently being considered in the cases of two businesses that are considered to have engaged persistently in unauthorised trading.

## 8. Access to Justice or compensation culture

- 8.1 The expressions “access to justice” and “compensation culture” have been widely used particularly in respect of personal injury claims. Access to justice is generally seen as being a “good thing” while the compensation culture, by contrast, is seen as being a “bad thing”. However, it is immediately apparent that they are, if not the same thing, then closely connected. The two expressions need unpicking.
- 8.2 Where people have suffered personal injury, for example as a result of a road traffic accident, and that injury has had a financial cost to them, for example in respect of lost earnings, or has caused genuine pain or discomfort, then few would dispute that they are entitled to compensation. Access to justice means that they can obtain such compensation. The same applies where people have suffered financial loss through being mis-sold a financial product.
- 8.3 By contrast, where someone has been involved in a minor accident but with no injury and no financial loss or where people bought a financial product that simply didn't perform, there would be a general view that they are not entitled to compensation. If the system enabled them to claim such compensation, then this compensation culture is a bad thing.
- 8.4 In between these two extremes is a large grey area. More importantly, many people have in the past suffered injury as a result of road traffic accidents that has cost them money or caused them discomfort or pain but they have made no attempt to claim compensation, and there has been large scale mis-selling of financial products which has caused financial loss but there has been no easy mechanism for people to claim compensation and many have not done so.
- 8.5 While personal injury and financial products and services may feature most prominently in this debate, there is a whole range of goods and services where consumers have suffered loss but there is virtually no opportunity for them to claim compensation short of going to court with the attendant hassle, costs and risks that that entails. A non-exhaustive list of such goods and services include holidays, purchase and repair of motor vehicles, defects in new or existing houses that are bought (although through the National Housing Council there is some protection), purchase of education from private schools or universities and all forms of building work.
- 8.6 What is different about personal injury and financial services is that government policy has made the claiming of compensation, where it is properly due, relatively easy compared with other goods and services. In respect of personal injury cases, the use of conditional fee agreements largely removes cost, risk and hassle from making a claim. In the case of financial goods and services the Financial Services Authority and the Financial Ombudsman Scheme between them ensure that complaints have to be

considered within a very strict framework such that a valid complaint will result in compensation. Where it becomes relatively easy, there is scope for abuse, such that those not really entitled to compensation are also able to claim it because the burden of risk, hassle or cost is shifted from complainant to defendant. Defendants may prefer to settle rather than contest cases on the grounds that it is cheaper to do so. In the case of financial services companies the onus of proof is shifted from complainant to defendant so defective paperwork can be sufficient to prevent the company defending the claim.

- 8.7 Policy in those two areas has inevitably had a spin off effect more generally by encouraging people to believe that compensation is more readily available than it used to be in the past where it is properly due and, no doubt, in some cases, where it is not due. The general conclusion from this brief theoretical analysis is that access to justice and a compensation culture, where compensation is properly due, is a good thing. However, the promotion of access to justice, at the margin, is inevitably likely to lead to a belief, that can be realised in some cases, that compensation is available when it is not properly due. The public policy challenge is to get the balance right, but within a general principle that the more that “good” access to justice is promoted the greater the scope for a “bad” compensation culture with compensation being sought and paid where it is not properly due.

## 9. Access to Justice in the Personal Injury sector

- 9.1 This section seeks to analyse the extent to which claims management companies and the regulation of them have promoted access to justice in respect of personal injury cases. The analysis is largely confined to road traffic accidents (RTAs), the cause of most personal injury claims and also where there is most data that can be analysed.
- 9.2 There are two key facts relevant to access to justice in respect of personal injury claims following RTAs –
- i. Only a small proportion, about 30%, of those injured in road traffic accidents make an insurance claim.
  - ii. At the same time as there has been a significant and steady reduction in the number of casualties reported to the police as a result of RTAs (by some 28% between 1996 and 2007) there has been a significant increase in hospital admissions as a result of road traffic accidents, motor claims reported to the Compensation Recovery Unit and bodily injury claims in respect of road traffic accidents.
- 9.3 It is clear that there has been an increase in the propensity to claim, that is the proportion of those with a valid claim who actually claim.

### **Factors Determining the Propensity to Claim**

- 9.4 If someone has suffered injury as a result of an RTA then the likelihood of them making a claim will depend on six factors –
- i. The extent of the loss that they have suffered. The greater the loss the more likely they are to claim.
  - ii. The willingness to overcome inertia and actually decide to make a claim.
  - iii. The search costs involved in understanding how to go about making a claim. Most of the commentators on this subject are experts whereas, most claimants seeking to make a personal injury claim do so only once in their lives. The search costs involved in establishing how to make a claim can be very high, particularly for the less sophisticated.
  - iv. The 'hassle' costs in actually making the claim that is providing all of the information needed to support the claim.
  - v. The cost of making a claim, either or both in respect of the amount of damages that will be taken up by necessary costs or the liability in the event of the claim being unsuccessful.
  - vi. The perceived generosity of the claim, if successful.

- 9.5 In much of the comment on this issue, points (ii) to (iv) are ignored because they do not involve payments from one party to another but rather are costs internal to the claimant. In fact the impact of these points is probably far greater than any reasonable monetary estimate. The inertia factor is huge; in many areas (including benefits) people make no effort to claim their entitlements. Inertia is a powerful driving force. Search and hassle costs are unlikely to exceed four hours work which if costed even at £20 an hour is only £80. However, for most people spending four hours on tedious administrative tasks is costed more highly – that is they would be unwilling to spend four hours for a reward of £80, or even for a reward of three or four times that amount.

### **Why the propensity to claim has increased**

- 9.6 These factors have always been true and will always continue to be true. The question is what has caused the costs to reduce or the potential generosity of the claim to increase so as to explain the significant increase in the propensity to claim. Three significant regulatory developments, prior to the introduction of regulation, can be identified here –
- i. In 1999 changes in the Civil Procedure Rules provided for pre-action protocols. The unintended consequence was that preparation of claims was front loaded with the resulting increase in costs.
  - ii. The abolition of legal aid followed by the introduction on 1 April 2000 of the regime for conditional fee agreements under the Access to Justice Act 1999. This provided for the recoverability of success fees and after the event (ATE) premiums which protected the claimant in the event of losing the case. The effect was virtually to eliminate the risk of having to meet costs in the event of a claim failing and at the same time to ensure that damages could be received in full with no costs having to be met. This materially changed the cost/ benefit calculation.
  - iii. The introduction in 2003 of fixed costs for RTA cases, which were based on the costs being allowed at that time.
- 9.7 Another factor cited by some is the lifting in 2004 of the prohibition on solicitors paying referral fees. In practice however, the lifting of the ban was recognising reality. Solicitors were paying referral fees prior to the lifting of the ban but they were doing so in a hidden and opaque way, typically disguised through insurance premiums. The lifting of the ban made referral fees transparent rather than permitting them to be made. There is therefore no reason to expect that this should have led to any increase in the propensity to claim.
- 9.8 The effect of the 1999 and 2000 measures taken together was to make it easier and financially viable for potential claimants to make a claim, but did nothing to contribute to reducing the inertia factor and the substantial search and hassle costs. At the same time, the effect of the reforms was to

make a valid personal injury claim a more valuable commodity that lawyers were prepared to pay for. A small number of perceptive entrepreneurs with marketing experience saw an opportunity here to eliminate the inertia factor and search costs. They did this largely through extensive national advertising on radio and television which created name awareness for themselves, increased awareness of the ability to make a claim and reduced the search and hassle costs to virtually nothing. A second approach was to make arrangements with those with access to people who may have a claim (vehicle repair businesses, mini cab firms, car hire companies, medical professionals etc) and channel those claims to solicitors, receiving a fee for so doing.

- 9.9 The “perceptive entrepreneurs” did not include solicitors who had little expertise in marketing and who, in addition, were constrained by Law Society rules as to how they could solicit business.
- 9.10 These developments can be seen as a predictable market response. It is wrong to see claims management companies somehow being able independently to cause claims to rise. If the same marketing expertise of claims management companies had been available and active in the marketplace without the 1999 and 2000 reforms, it would have been ineffective. Claims management companies have exploited markets that others have created. They are a transmission mechanism rather than causal factor.

### **Are Claims Management Companies Necessary?**

- 9.11 There is an argument that claims management companies are not necessary to help achieve access to justice, that they add no value to the process and that if they did not exist, then the system would operate more effectively. This line of argument was neatly summarised by Lord Justice Jackson, in his report *Review of Civil Litigation Costs: Final Report* (January 2010). Lord Justice Jackson was specifically examining referral fees but these can be taken to be a proxy for the activities of claims management companies which are dependent on referral fees. He said (paragraph 4.9):

“I do not accept that referral fees are necessary for access to justice. Claimants with personal injury claims would be well aware of their right to claim damages, even if claims management companies did not exist. I do not accept that access to justice was denied or restricted prior to 2004, when the ban on referral fees was lifted.”

- 9.12 He went on (paragraph 4.10):
- “The availability and identity of solicitors conducting personal injuries work could be publicised perfectly satisfactorily through the internet, through Law Society advertising, through the APIL website and similar means.”
- 9.13 It could be argued that this analysis is problematic in two respects. The comparison with the position prior to 2004 is questionable because what happened then was the lifting of the ban on referral fees which merely

recognised what had happened in practice, that is, referral fees were being paid but in a covert way, such that they were not called referral fees. It follows that lifting the ban had no effect. Secondly, the analysis doesn't take full account of human nature and the way that markets operate. Using his logic, there would be no need ever for public sector bodies to advertise availability of benefits or to seek out people by other means who are not claiming their benefits on the grounds that all they needed to do was look at a website. Similarly, insurance brokers would become superfluous as individuals would simply go onto the website of say, the Association of British Insurers or the Financial Services Authority, find an insurance company and pay a premium. The argument could be extended to any number of other sectors. It would not be necessary to have travel agents because people could work out for themselves which airline they could use by going onto the internet. It is this attitude that marketing is not necessary, shared by many solicitors, that led to the growth of claims management companies in the first place.

- 9.14 This leads to the related question of what would have happened if there had been no claims management companies. The answer is probably that over a slightly longer period more solicitors would have engaged in exactly the same activity and to the same extent whether acting as individual firms or through cooperative arrangements.

### **The Impact of Regulation**

- 9.15 Given the objectives of Part II of the Compensation Act, then if these were successfully achieved the effect should have been to increase the propensity to claim. As a result of the public being more confident in using claims management companies, it is almost certainly true that this has been the case, although the effect is impossible to quantify. The claims management industry was viewed with some suspicion by lawyers and the media with the well publicised problems of Claims Direct and The Accident Group having a damaging effect across the sector. Regulation helped to make the industry more respectable in the eyes of the public, commentators and solicitors. Claims management companies have not been slow to use the fact that they are 'regulated' as a powerful marketing tool. Regulation has also helped claims management businesses with their relationships with solicitors. Previously, some solicitors may have felt it was 'not the done thing' to deal with claims management businesses which were seen as being rather murky and disreputable. Regulation helped remove this inhibition.
- 9.16 There has been a sharp increase in the number of businesses providing regulated claims management services in respect of personal injury claims, most being introducers rather than full service companies. In June 2007, when regulation began, there were 1,409 authorised businesses with an annual turnover of around £229 million. By June 2009 those numbers had increased to 2,232 with an annual turnover of £287 million. This supports the notion that being able to say that the business is regulated by the Ministry of Justice

is a significant attraction in the marketplace.

- 9.17 There is a general perception that claims management regulation has improved professionalism in the sector, partly by ensuring that contracts etc are in order but also by encouraging some of the more disreputable businesses to leave the market. To the extent that those businesses in the market have become more competent, so access to justice has been increased, although probably only marginally.
- 9.18 Having made these points the impact of regulation is probably small, compared with the other factors. This was the consensus at a workshop on the subject held on 26 March 2010.

### **Fraudulent Claims**

- 9.19 The circumstances that have led to an increase in the ratio of actual claims to potential claims have also caused an increase in the number of fraudulent claims. Fraudulent claims range from large scale organised staged accidents to far more minor whiplash claims done on an individual basis. The cost to an individual of making a small scale fraudulent claim is minimal, the greatest risk simply being that the claim will not be paid, and the burden of proof needed to establish a claim is minimal. There has also been scope for intermediaries to encourage people to claim for very minor injuries and in some cases no doubt to exaggerate the extent of those injuries and even to invent them.

### **Statistics**

- 9.20 In seeking to analyse impact it is always helpful to have hard evidence. Appendix 1 analyses the available statistics on RTAs and insurance claims. This has not been an easy task because the various data use different definitions and timescale. Table 1 below summarises the position. It covers three sets of data –
- i. Claims notified to the Compensation Recovery Unit (CRU). Insurers, and anyone else who makes a compensation payment, is obliged to notify the CRU of claims against them in respect of illness and injury.
  - ii. Injuries recorded by the police. It is possible that this series has been distorted by changes in reporting practice, although it should be noted that the trend in injuries is similar to the trend in deaths, where the figures are not capable of distortion.
  - iii. Bodily injury claims in respect of road traffic accidents made to insurers.

**Table 1 CRU claims, injuries recorded by the police and insurance claims 1996 - 2008**

Year	CRU Motor claims	Injuries recorded by police	Bodily injury insurance claims	Insurance claims/CRU claims %	Insurance claims/ police records %
1996		317,000	100,000		32
1997		324,000	127,000		39
1998		322,000	160,000		50
1999		317,000	165,000		52
2000	402,000	317,000	171,000	43	54
2001	400,000	310,000	185,000	46	60
2002	399,000	299,000	204,000	51	69
2003	374,000	287,000	220,000	59	77
2004	403,000	268,000	238,000	59	89
2005	460,000	255,000	256,000	56	100
2006	519,000	245,000	258,000	50	103
2007	552,000	228,000			
2008	625,000				

Source: Appendix 1.

9.21 At first sight these trends are difficult to explain. That injuries reported to the police have declined steadily, particularly since 2000, is clear. The CRU figures are in respect of claims notified, not settled, and in an increasing proportion no treatment is recorded. The 55% increase in notifications to the CRU between 2004 and 2008 seems difficult to explain. It is perhaps worth noting that claims reported to the CRU in respect of the two other main categories of claim have fallen between 200/01 and 2008/09, by 26% in respect of employer liability and 8% in respect of public liability. The insurance figures are difficult to analyse because the reported figures relate to claims settled, and settling a claim can sometimes takes years. The alternative approaches to calculating the figure are examined in Appendix 1. However the calculation is done, that there has been a clear upward trend in beyond dispute.

### Other research

9.22 A number of consultants' reports help to explain the rising trend in bodily injury claims in relation to potential claims. A report by Oxera Consulting Ltd, *Marketing costs for personally injury claims* (ABI Research Paper 15, 2009) commented –

“This section concludes that legal fees charged by claimants’ solicitors are not subject to sufficient market constraints; therefore, the expenses incurred in marketing are not constrained by the claimant’s willingness to pay. Within this structure, referral fees paid by solicitors (or the level of marketing costs they are willing to incur in-house) are likely to be the residual between the costs of actually executing the case and the costs that can be recovered via the administrative procedure from the defendants.

Both theory and practice indicate that, under the prevailing system, marketing costs will expand to take up the difference between the costs incurred by solicitors in actually executing the case and the costs they can recover. This is likely to induce a higher level of marketing spend than what would be observed in competitive markets where prices and costs are subject to a market constraint.”

9.23 It is reasonable to conclude that increased marketing spend in a market where only a small proportion of people claim is likely to increase that proportion.

9.24 Two Watson Wyatt consultants, Ryan Warren and Jenny Wong, writing in *The Journal* (Dec 2009, Jan 2010) commented:

“Reasons for the increasing proportion of third party claims may include a greater focus from credit hire companies and accident management companies on identifying other persons who may have been involved in an accident and referring them to personal injury lawyers.”

9.25 The consultants, EMB, in their February 2010 briefing noted an increase in the number of claimants per claim. They attribute the general increase in claims costs to a range of factors including:

“increases in third party claims farming, recessionary effects including increased fraudulent activity that cost the general insurance industry around £360 million in 2008 and increased used of periodic payment orders

9.26 Two reports published when the work for this report was nearing completion provide valuable and useful evidence on the access to justice point. Charles River Associates in a report for the Legal Services Board (*Cost benefit analysis of policy options related to referral fees in legal services*, May 2010) examined the impact of referral fees in three sectors. Their conclusions on personal injury were –

“Personal injury is the area of law in which referral fees are most prevalent and where the majority of cases are referred by introducers such as C claims Management Companies (CMCs), insurance companies (for road traffic accidents) and trade unions (for employer liability cases).

The payment of referral fees was found to be an important element (although not the only element) in gaining access to CMC and insurer lists or panels and there was clear evidence that lawyers who pay referral fees receive more work than those that do not. Competition to access these panels has led referral

fees to increase from around £250 per case in 2004 to around £800 per case today. We also found evidence that the level of referral fees paid today was linked to the services provided by introducers as well as to issues such as economies of scale and bargaining power.

There was no evidence that increases in referral fees had led to an increase in the price of legal services. Price does not play a strong role in personal injury cases because of the prevalence of “no-win-no-fee” agreements, but the majority of motor cases go through prescribed cost and fast track regimes in which legal fees are regulated.

There was also no evidence that referral fees were causing consumer detriment through a reduction in the quality of services:

- Success ratios for motor claims remained constant over time at over 90% although interviewees indicated that liability was often clear and therefore quality could not be judged on success ratios alone.
- Information is readily available on the value that different types of standard claims should receive and there was no evidence that increases in referral fees were leading solicitors to under-settle so as to save themselves costs.

Furthermore, arrangements between large introducers and large solicitors usually have service level agreements associated to them in which lawyers must meet certain requirements typically related to communication and speed of response. In part these agreements are in place to help protect the reputation of introducers. Evidence is available on very high customer satisfaction levels and there are very few complaints made related to referral fees.

Referral fees have helped to facilitate the growth of CMC and insurer referrals through providing an income stream that can be used for both marketing and investment in technology to manage the claims process. Consumer evidence has supported the link between marketing and making additional claims which would not otherwise have arisen. There is no evidence that this has led to a deterioration of cases since success rates have remained constant. The increase in the number of claims has probably led to higher insurance prices although this has been partly offset by referral fee income. It is difficult to describe this as causing consumer detriment where consumers have valid claims. We note that concerns about some fraudulent claims have causes other than referral fees namely the (non-)verifiable nature of some claims.”

9.27 The second report was by the Legal Services Consumer Panel (*Referral arrangements*, May 2010). Its conclusions on access to justice in the personal injury sector were –

“In the case of conveyancing, virtually all consumers need a lawyer and thus will find one eventually, although introducers may help them to do so more efficiently.

However, for personal injuries, introducers may improve access to justice by increasing awareness of the right of those who have suffered accidents to claim compensation and by facilitating the claims process. Even some opponents of referral fees accept that claims management companies have brought more people into the justice system, although they argue that people now know they can make a claim so that this benefit no longer applies, and that relentless marketing fuels an unhealthy “compensation culture”.

The debate takes place against a backdrop of significant unmet legal need, particularly among the socially excluded. Consumers’ ability to access justice is highly dependent on how effectively they are connected to legal advice. The advice sector cannot fill the gap alone and is, by its nature, a reactive service. By contrast, commercial introducers reach out to the public through marketing.

The Panels consumer research shows that people value the activities of claims management companies. Road traffic accident claims data also suggests that permitting payment of referral fees to claims management companies has contributed to more people bringing claims. This would suggest a positive impact on access to justice.

In the consumer research, even among personal injury claimants there was an undercurrent of hostility towards the so-called “compensation culture”. Participants had the view that people with more serious injuries were already intent on making claims. Those with less severe injuries were helped by introducers (mainly claims management companies) to bring claims. However, insurers settle over 90% of road traffic accident claims; this seems to suggest that referral fees have not led to invalid claims, at least on any great scale.”

## General Conclusions

9.28 This analysis leads to four general conclusions –

- i. A major reason for the increase in the proportion of actual claims to the number of potential claims is the reforms to the claims process introduced in 1999 and 2000.
- ii. Claims management companies were not an independent factor in increasing the number of claims, but rather were the means by which a market opportunity was exploited.
- iii. Regulation has further enhanced access to justice and the business of claims management companies by giving them greater respectability and credibility.
- iv. It is impossible to quantify the various effects, but the reforms to the claims process in 1999 and 2000 almost certainly are much greater than the impact of regulation. In this context it will be interesting to see the effects on the market from the more recent changes to the RTA claims process.

9.29 The available statistics do not provide any conclusive evidence on the extent of the impact of either claims management companies or the regulation of them. However, the two reports published in May 2010 support the view that claims management companies have increased the proportion of those eligible to claim who do so and that claims management companies play a significant role in increasing access to justice.

## Appendix

### Road traffic accidents, reported injuries and personal injury claims

- A1. This appendix examines the available evidence on trends in road traffic accidents, casualties reported by the police, notifications to the Compensation Recovery Unit and personal injury claims to insurance companies. This is not an easy task as the statistics do not lend themselves to easy comparisons.
- A2. The following data are examined –
- Survey data on the proportion of potential claims that become actual claims. The lower the starting point, obviously the greater the scope for an increase in the proportion.
  - Statistics on the relationship between the number of motor accidents (as a good proxy for the number of potential claims), claims notified to the Compensation Recovery Unit and claims made to insurance companies.

#### Survey data

- A3. The Department for Transport's (DfT) National Travel Survey gave a best estimate for the annual number of road casualties as 800,000, of which 350,000 attend hospital. 80,000 are seriously injured and 720,000 as slightly injured. Bodily injury claims resulting from motor accidents are running at about 250,000 a year, 30% of the number of casualties and 65% of the number of people who attend hospital. At first sight this suggests that a high proportion of people who are injured in motor accidents do not make a personal injury claim. The DfT has estimated the casualty related costs of reported accidents at about £9 billion a year; the total cost of insurance claims is around £1.5 billion a year, again suggesting that actual claims are a relatively small proportion of potential claims. The figures suggest that there is substantial scope for genuine claims to increase.

#### Motor accidents and compensation claims

- A4. The DfT publication, Reported Road Casualties – Great Britain: 2008 (<http://www.dft.gov.uk/adobepdf/162469/221412/221549/227755/rrcgb2008.pdf>) contains comprehensive statistics and analysis on reported road accidents and other relevant information. The report shows a steady reduction in casualties reported in police reports. Between 1996 and 2000 reported injuries were in a narrow range of 317,000 – 324,000; by 2005 the figure had fallen to 268,000 and by 2008 there had been a further fall to 228,000. However, it is known that only a proportion of all accidents are reported to the police, and

also changes in reporting practices can partly explain year-to-year variations. But the downward trend is very clear, a fall of around 30% over 10 years. This is supported by the figures for deaths (all of which are reported to the police), which fell by 26% over the same ten year period.

- A5. However, other data has moved in the opposite direction. Between 1995/96 and 2007/08 the number of seriously injured according to police records fell by over 30% from 38,000 to 25,000, but the number of road traffic casualty admissions to hospitals increased by 18% from 34,000 to 40,000.
- A6. Compensation Recovery Unit motor liability claims have also moved in the opposite direction to casualties reported to the police. The following table shows the data.

#### **CRU Motor Claims and Injuries Recorded By the Police, 2000/2001 - 2008/2009**

Year	CRU Motor claims	Of which no treatment recorded	Injuries recorded by Police
2000/01	402,000		314,000
2001/02	401,000		306,000
2002/03	399,000	214,000	296,000
2003/04	374,000	221,000	285,000
2004/05	403,000	244,000	274,000
2005/06	460,000	279,000	265,000
2006/07	519,000	335,000	255,000
2007/08	552,000	370,000	242,000
2008/09	625,000		224,000
2008/09 2000/01	55%		-29%

Note:

1. The "no treatment recorded" column is taken from a different source and may not be entirely compatible with the total CRU motor claims figures.
2. The 2000/01, 2001/02 and 2008/09 figures for injuries recorded by the police are extrapolations from the calendar year data.

- A7. The table shows that while injuries recorded by the police fell by 29% between 2000/01 and 2008/09, CRU claims increased by 55%. There was a further 13% increase in CRU motor claims in 2008/09. It is perhaps also significant that the number of CRU claims where there was hospital treatment actually fell marginally over the period while the number where no treatment was recorded increased sharply. The proportion of CRU claims where no treatment was recorded increased from 55% in 2002/03 to 69% in 2007/08.

- A8. This is not the place for a detailed analysis of the sharply diverging trends of road deaths and injuries recorded by the police on the one hand and admissions to hospital and CRU claims on the other. An article by Matthew Tranter in *Reported Road Casualties - Great Britain: 2008* seeks to do so. While it is to be expected that the total number of injuries will be much higher than the number reported to the police, the diverging trends are far more difficult to explain.

### Claims notified to insurance companies

- A9. Insurance company data is difficult to use because claims can take some time to settle and final information on claims made in any one year is only available only many years later. The table below, provided by the ABI, illustrates this point.

### ABI Bodily Injury Claim Statistics

Accident Year	Cumulative number of claims settled in each year of account						
	2002	2003	2004	2005	2006	2007	2008
2002	13,200	83,500	137,100	167,200	183,800	193,600	201,400
2003		19,300	108,200	165,600	197,200	215,700	229,600
2004			26,200	120,200	180,400	214,300	241,600
2005				27,400	127,300	195,100	241,100
2006					31,700	144,400	226,000
2007						39,800	174,900
2008							51,100
	<b>13,200</b>	<b>102,800</b>	<b>271,500</b>	<b>480,400</b>	<b>720,400</b>	<b>1,002,900</b>	<b>1,365,700</b>

- A10. The table shows for example that there were 241,100 claims in the 2005 year but even as late as the end of 2007 only 195,000 had been settled. This time lag means that it is very difficult to estimate the actual number of claims until some years later. However, extrapolating past experience suggests that reasonable minimum estimates for the number of claims are –

2002	201,000
2003	245,000
2004	255,000
2005	268,000
2006	272,000
2007	290,000 +

The table shows a 44% increase between 2002 and 2007.

A11. There is an alternative and as it more consistent probably more reliable, source of figures in Fourth UK Bodily Injury Awards Study (IUA, 2007). This reports the total claims numbers as follows –

1996	100,000
1997	127,000
1998	160,000
1999	165,000
2000	171,000
2001	185,000
2002	204,000
2003	220,000
2004	238,000
2005	256,000
2006	258,000

### Conclusion

A13. The statistical evidence seems clear: there has been a significant increase in people making personal injury claims as a result of road traffic accidents in relation to the number of people who have grounds for a claim. The following table brings the key data together.

Year	CRU Motor claims	Injuries recorded by Police	Bodily injury insurance claims	Insurance claims/police records %
1996		317,000	100,000	32
1997		324,000	127,000	39
1998		322,000	160,000	50
1999		317,000	165,000	52
2000	402,000	317,000	171,000	54
2001	400,000	310,000	185,000	60
2002	399,000	299,000	203,000	69
2003	374,000	287,000	220,000	77
2004	403,000	268,000	238,000	89
2005	460,000	255,000	256,000	100
2006	519,000	245,000	258,000	103
2007	552,000	228,000		
2008	625,000			

Note: The CRU figures are for financial years.

A14. The table confirms the significant increase in the number of claims in relation to the number of reported accidents.

## 10. Access to Justice in Financial Services

- 10.1 Examining the role of claims management companies in increasing access to justice in respect of financial services and products is relevant in respect of a point that is commonly made by banks and insurance companies. They have argued that there is no need for claims management companies because people are treated identically if they go directly to the financial services businesses, a point reinforced by the Financial Ombudsman Service (FOS) who equally says that there is no need for businesses to use intermediaries – they can go directly to the FOS.
- 10.2 Financial services claims are different from personal injury claims, particularly because the claims are against businesses regulated by the Financial Services Authority (FSA) in respect of regulated activities and where the FOS is available as a backup. The market for claims depends essentially on regulatory actions in respect of mis-selling and handling complaints, in much the same way as the market for personal injury claims has depended on regulatory action on how claims are handled. Financial service claims can typically be divided into three categories in respect of the scope for claims management activities –
- i. Those products where the financial regulator orders a proactive review of all cases within defined criteria. This greatly reduces the scope for claims management companies because the cases have to be reviewed anyway.
  - ii. Where the financial regulator says nothing other than that there has been some mis-selling, which gives some scope for claims management companies although establishing the validity of the claim is not easy.
  - iii. Where the financial regulator says that there has been mis-selling does not require a pro-active review but rather prescribes how any complaints must be handled, a formula that gives huge scope for claims management companies.
- 10.3 One cannot expect financial services businesses to actively seek to encourage people to make claims against themselves, and generally they will do no more than is required by their Regulator. Claims management companies have sought to go much further by actively seeking out, and in some cases helping to frame claims so as to reduce the costs to the customer, (i.e. the inertia, search and hassle costs), but not without an expense to the customer. The claims management company typically takes 25% of the total amount awarded.
- 10.4 Initially virtually all claims management services in financial services were in respect of endowment mis-selling, a category of business that came firmly within category (iii) above. All that claims management companies had to do after seeking out potential claimants was effectively to write one letter and normally that was sufficient to start the review process. Endowment business is time limited and finite; the volume of business has fallen by over 90% from its peak.

- 10.5 Subsequently, as Chapter 5 explained, some claims management businesses and some new businesses have looked to other potential markets, again with a view to seeking out claimants. Three main markets have emerged –
- i. Unfair bank charges – claims largely ended by the outcome of the court action between the Office of Fair Trading (OFT) and the banks.
  - ii. Unenforceable terms in consumer credit agreements (UCCA), one area where claims management businesses have sought to pursue claims for compensation on somewhat shaky foundations, and which again has largely been ended as a result of court decision.
  - iii. Payment protection insurance (PPI), which has similarities with the endowment business.
- 10.6 It is arguable that in some cases, far from promoting access to justice, claims management companies have done the opposite by encouraging people to believe that financial liabilities could be discarded on specious grounds. This was true in respect of many UCCA claims and to a lesser extent bank charge claims.
- 10.7 However, more generally it is the case that claims management companies have encouraged people to make valid claims who would not otherwise have done so. They have done this through extensive advertising, and having encouraged customers to contact them, have then removed the hassle factor.
- 10.8 This was true in respect of endowment claims. Insurance companies report that roughly 50% of complaints come to them directly and the other 50% come through claims management companies. It is implausible to believe that the cases that came through claims management companies would otherwise have been made directly to insurance companies. Indeed, it is arguable that the marketing and awareness raising by claims management companies contributed to the absolute number of claims made directly to insurance companies and intermediaries.
- 10.9 Claims management companies have played an even more significant role in respect of PPI claims. Generally, customers who buy PPI are less sophisticated and many do not realise they have bought it at all. There has been a huge increase in PPI cases going to the FOS, the best indicator of the total volume of business. It is unlikely that the majority of these cases would have been initiated without the activities of claims management companies. The number of PPI complaints received by the FOS has increased from 1,832 in 2006/07 to 10,652 in 2007/08, 31,066 in 2008/09 and 49,196 in 2009/10. The proportion where a claims management company was involved has increased steadily to 74%. And it should be noted that the proportion of PPI complaints upheld by the FOS in the year to 31 March 2010 was 94%.
- 10.10 In the 2008/09 report of the FOS, the Chief Ombudsman commented on the point as to whether claims management companies have increased the number of people making valid claims –

“One of the significant drivers of consumer complaints is the now substantially increased number and activity of claims-management companies, encouraging disadvantaged consumers to complain. The Ministry of Justice reports that it has authorised over 900 of these companies to trade in the areas of financial products and services. And apparently the number of companies applying for authorisation has been growing rapidly during the past year. No figures are available for the number of complaints these companies have made on behalf of their clients – or the extent to which the companies have given their clients appropriate advice.

The vast majority of claims-management companies operate in well-trodden territory where consumer detriment has been already identified. So they are a symptom of the problem and not its cause.

Consumers can make a complaint direct to a business – or to the ombudsman service – free of charge. If they make their complaint through a claims-management company, on the other hand, that company will charge a fee – usually a percentage of any compensation awarded. These fees have been criticised as being disproportionate – especially in relation to the effort or expertise that some claims management companies actually deploy. So it is questionable what advantage consumers gain by using such companies.

But it is also undeniable that the marketing activities of claims-management companies have succeeded in identifying a very large number of consumers who have suffered loss. And this has resulted in many people being paid redress when they would otherwise have received nothing. Indeed, over half of the complaints we received during the year about payment-protection insurance (PPI) were brought to us on behalf of consumers by claims-management companies. And, as we report in this *annual review*, we upheld a very high proportion of these cases. So it is clear that the wider system is not working as it should.”

10.11 The report subsequently made the following comment –

“The substantial increase in complaints about PPI – and the exceptionally high proportion (89% of cases) where the outcome is changed in favour of the consumer following our intervention – suggests there is still a widespread problem involving businesses rejecting complaints that they know, or should know, we will uphold. This only adds to the inconvenience suffered by consumers. And it gives rise to concern about the treatment of those who, for whatever reason, decide not to “appeal” their complaint to the ombudsman service.”

10.12 The FSA report, *Review of complaint handling in banking groups* (April 2010) provides further evidence on the quality of complaint handling by banks. The review, which specifically did not include PPI complaints or complaints about unauthorised overdrafts, concluded –

“3.4 Overall, we assessed 18% of cases as resulting in an unfair outcome for the complainant. These were where the assessor identified one of the following:

- the decision on the outcome of the complaint was in our view incorrect; and/or
- any redress and/or remedial action offered (including for any distress and inconvenience suffered) was in our view inadequate or not paid when it should have been.

3.5 Overall, 36% of cases showed evidence of poor quality complaint handling in areas such as quality of investigation, quality of correspondence and use of the two-stage process.”

10.13 The FSA consultation paper, *The assessment of redress of payment protection insurance complaints* (March 2010) provides further evidence on the quality of complaint handling by financial institutions –

“We conducted complaint file reviews of three large firms’ PPI complaint handling, which found poor results. We viewed these results in light of: the more general evidence (discussed above) that was accumulating about poor sales standards; and the data and intelligence we had, from the FOS and elsewhere, which indicated poor PPI complaint handling by firms to be likely.

We also viewed these PPI complaint handling concerns in the context of our concerns about the fairness of firms’ handling of complaints more generally (concerns that were themselves prompted by, for example, communications from the FOS, our own supervisory work, and our intensifying analysis of the complaints data reported to us by firms).

We decided, after careful consideration, that it would not be the best use of resource, or in consumers’ best interests, to conduct further firm specific evidence-gathering on PPI complaint handling at that stage. (Our decision also has to be seen in the wider context of the very considerable thematic and enforcement messages given, as well as the resource we had already expended on PPI more broadly (primarily on firms’ selling practices), and the growing other demands upon our resource arising from the intensifying prudential difficulties that emerged through 2008.)

Therefore, we moved directly to discuss with industry and other stakeholders how improvements in PPI complaint handling might be achieved. But that dialogue, and supporting correspondence around it, did nothing to reassure us about firms’ approaches to either PPI sales or the assessment of PPI sales complaints. Indeed, these discussions made us *more* concerned.

Such dialogue confirmed us in our view that the significant difference in consumer outcomes between PPI complaints to firms and those referred to the FOS probably meant that many of that majority of complainants who were complaining to firms about their PPI sales, but not persisting to FOS, were not getting fair outcomes from their complaints. So, we remain of the view that our own firm specific evidence gathering on PPI complaint handling and the overall evidence clearly indicates a more or less general problem with PPI complaint handling.”

10.14 As for personal injury claims it is probably the case that claims management regulation has given claimants greater confidence to use claims management companies. People are reassured by the concept that a business is regulated and perhaps more so when the regulator is stated to be the Ministry of Justice. In this context, use of “regulated by the Ministry of Justice” has not only helped legitimate businesses gain more credibility but has probably helped some less reputable businesses.

### **The impact of regulation**

10.15 Initially the areas of malpractice in this sector were misleading advertising and unsubstantiated claims in respect of endowment business, although in themselves these did not cause consumer detriment. More recently there has been more serious malpractice through some companies wrongly encouraging people to believe that it is easy to wipe out credit card debts and by advance fees being levied in respect of services that might not be delivered. Claims management regulation has had a significant effect in reducing the scope for such malpractice.

### **General conclusions**

10.16 This analysis leads to five general conclusions –

- i. The market for financial claims was created by regulatory action in respect of endowment mis-selling.
- ii. As with personal injury, claims management companies have largely eliminated the inertia, search and hassle costs for potential claimants, at the expense of taking a significant proportion of their compensation.
- iii. The activities of claims management companies have resulted in more people being able to claims legitimate compensation in respect of endowment mis-selling.
- iv. The PPI claims market would be much smaller without claims management companies, as many of those people to whom the product has been mis-sold are not even aware that they have the product.
- v. In the financial services market claims management companies have made a significant contribution to increasing access to justice; regulation has assisted this process by limited the scope for malpractice by claims management companies.

## 11. The Market for Claims Management Services

- 11.1 The regulatory impact assessment for the Compensation Bill, published in November 2005, noted that there were no exact figures on the number of companies operating in the claims management market but quoted the Claims Standards Council is estimating that there were about 400 companies in 2005. The regulatory impact assessment based its calculations on the new regulatory authority regulating about 500 companies. In the event, the number has proved to be much higher than this and has also continued to grow rapidly.
- 11.2 The Regulator collects data from individual businesses for regulatory purposes rather than for statistical purposes, which means that aggregate data is not sufficiently reliable to make precise indications of the market trends. However, the data are sufficient to give broad orders of magnitude. Table 2 shows the key data on the size of the claims management market.

**Table 2 Authorised claims management businesses**

Sector	June 2008		June 2009		March 2010	
	Number of businesses	Turnover £m	Number of businesses	Turnover £m	Number of businesses	Turnover £m
Personal injury	1,409	229	2,232	287	2,478	248
Criminal injuries	422	1	769	2	832	1
Industrial injuries	200	1	488	3	550	1
Employment	234	4	453	4	490	13
Finance	422	45	1,126	65	1,170	104
Housing disrepair	83	-	233	-	256	3
<b>Total</b>	<b>2,004</b>	<b>280</b>	<b>2,415</b>	<b>361</b>	<b>3,172</b>	<b>370</b>

Notes:

1. The figures for the individual sectors are for businesses that reported turnover in that sector on the application or renewal forms and do not include businesses that indicated that they intended to operate in the sector but which did not have any turnover. The total number of businesses is the total of all authorised businesses and does not equal the sum of the figures for the individual sectors.
2. The figures for turnover are a mixture of reported actual turnover in the year to the previous September and forecast turnover the current year.
3. The figures for March 2010 probably overstate the number of businesses as the renewal process is not complete and more businesses are expected either to surrender their authorisation or to have their authorisation cancelled.

11.3 Allowing for these qualifications, the main trends are –

- A sharp increase in the total number of authorised businesses with a much smaller increase in the number of businesses reporting actual turnover;
- between 2007 and 2009 a significant increase in turnover for personal injury business, followed by a levelling off (the figures are not robust enough yet to conclude that there has actually been a fall since June 2009);
- an increase in the turnover in the financial services sector reflecting the increased activities in PPI and some UCCA claims areas; and
- the tiny size of the other four sectors: criminal injuries, Industrial Injuries Disablement Benefit, employment claims and housing disrepair.

11.4 One of the unexpected developments since the advent of regulation has been the rapid growth in the number of businesses wanting to enter the market and seek authorisation. Table 3 shows the data.

**Table 3 Number of businesses authorised**

Period	Personal Injury	Financial Services	Total
2007 Q1	394	89	428
2007 Q2	660	216	830
2007 Q3	219	131	326
2007 Q4	122	36	146
<b>Year</b>	<b>1,395</b>	<b>472</b>	<b>1,730</b>
2008 Q1	133	45	159
2008 Q2	136	53	167
2008 Q3	209	121	285
2008 Q4	260	220	398
<b>Year</b>	<b>738</b>	<b>439</b>	<b>1,009</b>
2009 Q1	184	139	285
2009 Q2	288	221	445
2009 Q3	222	89	240
2009 Q4	198	84	260
<b>Year</b>	<b>892</b>	<b>533</b>	<b>1230</b>
2010 Q1	159	67	212

Note:

The total column shows the number of businesses authorised. The figures in the personal injury and financial services columns show the number of businesses that stated an intention to operate in the respective markets. The total column is not equal to the sum of the other columns because some businesses said they intended to operate in both markets and some also intended to operate only in one of the other markets, particular employment claims.

- 11.5 It was originally anticipated that after the initial surge of applications the number would then fall to a very modest level. The number of businesses authorised did indeed fall after the initial surge – to a higher than expected level of 146 in the fourth quarter of 2007. However, it has then risen dramatically to a peak of 445 in the second quarter of 2009. It then fell back a little. The reasons for these trends seem to include –
- Businesses in related markets (such as insurance brokers) realising that they could usefully get some additional business, particularly from existing clients, by offering claims management services.
  - People working for authorised businesses realising that this was a straightforward business to move into to, so branching out and setting up their own.
  - Some informal, and in some cases more formal, franchise or agency arrangements where introducers or salesmen are being helped in setting up their own businesses.
  - Businesses setting up new businesses as a fallback in case regulatory action was taken against the original business.
  - In the case of personal injury business, intermediaries that previously had traded as exempt introducers, rightly or wrongly, deciding, perhaps encouraged by the authorised businesses they passed cases to, that it would be advantageous to them to seek authorisation in their own right.
  - A special factor in respect of financial services activity was the widespread belief, which turned out to be unfounded, that there was good business to be done by dealing with bank charges and unenforceable terms in consumer credit agreements (UCCA) cases. This explains the surge in the number of businesses being authorised in the financial services sector from the middle of 2008.
- 11.6 A supplementary information form was introduced in August 2010 for applicants intending to do business in the financial services sector. This has led to a sharp decline in the number of businesses seeking authorisation, a trend that has been accentuated by court cases which have had the effect of severely limiting the scope for claims management activities in respect of bank charges and UCCA cases. This is considered in the following chapter.

## 12. Evolution of the Regulatory Regime

- 12.1 This chapter brings together some of the analysis in previous chapters together with the theoretical analysis of the evolution of regulatory regimes as set out in Chapter 2. In just three years the market for claims management services has changed significantly and the regulatory regime has also evolved. The time is now right to analyse this evolution.
- 12.2 The necessary preparatory work was done prior to regulation being implemented. The market was researched, although this was far from easy given the nature of the market and the lack of data. There was extensive consultation with all relevant stakeholders. Regulation was put in place very quickly therefore reducing the scope for businesses to reorganise their activities so as to avoid the intended effects of regulation.
- 12.3 As this, and previous, impact reports have made clear, the overt malpractice identified at the beginning of the process has largely been dealt with effectively.
- 12.4 The most significant unexpected development has been the rapid expansion in the number of businesses seeking authorisation. The reasons for this have been analysed in Chapter 11. They include businesses in related markets seeing an opportunity to expand into claims management regulation, people branching out from existing businesses and to a limited extent businesses setting up new businesses to protect themselves in the event of regulatory action. It is possible that regulation has contributed to this trend by raising the profile of the claims management industry and giving some credibility to businesses in the sector.
- 12.5 As an aside it might be noted that the regulator has coped effectively with the huge expansion in the number of businesses seeking authorisation. This has been a challenging task which, at times, has threatened to be overwhelming. However, the necessary resources have been made available to handle the increased volume of authorisation and renewal business. There have been no significant financial implications as the application and renewal fees have been sufficient to cover costs.
- 12.6 Overt malpractice has now largely been replaced by more subtle malpractice, in particular misleading statements in advertisements and websites have been replaced by misleading statements in some individual contracts, and with a risk developing of businesses taking more money up-front for services which may not be delivered in the future.
- 12.7 The focus of regulatory work has switched from personal injury business to financial services business.

- 12.8 As in so many other areas, many of the biggest regulatory challenges have been in areas where other regulators or enforcement bodies also have a role. These have included the Solicitors Regulation Authority (SRA) in respect of all personal injury business, the police in respect of dealing with staged accidents, the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS) in respect of all financial service claims and the Office of Fair Trading (OFT) in respect of unfair terms in consumer agreement (UCCA) claims. The Claims Management Regulator has therefore had to develop effective working relationships with all of these bodies. On the whole, it has done this rather well although it has not been an easy task. The Regulator is tiny compared with all of the other bodies and is an integral part of the government body rather than a stand alone organisation.
- 12.9 It is always tempting for some commentators to say that what is needed is a single overarching regulator covering the whole of a particular area of business. This may sound plausible but is unrealistic. Business is not divided into neat, watertight activities but rather in any line of activity there tends to be a large number of businesses some of which are specialist but others of which are diversified. For example, an independent financial advisor might be handling personal injury claims as a side line. The only way that a single regulator could cover both activities would be for the FSA to merge with the SRA and to take over claims management regulation. However, this would still leave some companies engaged in activities where the OFT has some relevance so the single overarching regulator would need to embrace the OFT as well. There will never be a single regulator unless there was only one regulator for all activity in the country, and even this would fail to deal with businesses that operate internationally. The task for policy makers is to produce the most effective regulatory structure given market conditions, and the task for regulators is to make that structure work by cooperating where appropriate and ensuring that for each area of activity there is a lead regulator.
- 12.10 The Claims Management Regulator has had to become smarter in its method of operation, and also more focussed on areas of most significant detriment. Initially, it gathered intelligence primarily through its own activities combined with tip-offs from other regulators and authorised businesses. Increasingly, the most valuable source of intelligence, particularly in respect of covert malpractice, has been complaints from consumers. The Regulator does not go out of its way to advertise the fact that it deals with complaints. What has been found however, is that where customers have cause for complaint they will do a quick search on the internet and discover the Ministry of Justice acting as Claims Management Regulator, perhaps through a reference on the website of the business about which they are concerned, and they will make a complaint. Particularly in respect of UCCA claims, the number and type of complaints reaching the Regulator have proved to be a good indication of the need for regulatory action.

- 12.11 Particularly where up front fees are taken, the Regulator has to be able to move quickly, often on the basis of incomplete information and sometimes in conjunction with other regulators. This has proved to be a very challenging task and arguably dealing with some of the abuses in respect of UCCA claims could have been handled more promptly by the regulators more effectively together. However, the right action was taken and the necessary working relationships are now in place to deal with such issues promptly.
- 12.12 One important point has come from the experience of the first few years. The vast majority of authorised businesses are doing work where there is very little scope for significant consumer detriment. This applies particularly to businesses that just introduce personal injury cases to other claims management businesses or directly to solicitors. At the other extreme, some businesses handling UCCA claims have posed a risk to consumers, potentially by misleading them as to the prospects of being able to write off their debts and also by taking significant upfront fees. The regulatory system cannot treat these two types of business equally. A significant step was taken in August 2009 when a supplementary information form was introduced for businesses in the financial sector. Enforcement work has also concentrated more heavily on businesses that pose a significant threat to the public rather than businesses which are not complying with detailed provisions in the rules which in themselves are not serious.
- 12.13 Generally, the regulatory regime seems to have evolved appropriately in accordance with the changing market and the experience and information it has gained as a regulator.

## 13. Overall Assessment

### Removing malpractice

- 13.1 The regulatory regime for claims management activities is considered to have had a significant effect in removing malpractice within three years of the Compensation Act 2006 being implemented. Specifically –
- cold calling in person has been significantly reduced;
  - unauthorised marketing in hospitals has been largely eliminated;
  - significant progress has been made in co-operative working arrangements to deal with fraudulent motor accident claims;
  - misleading use of the expression “no win-no fee” has largely been eliminated;
  - misleading claims on websites have been almost entirely removed and rules requiring websites to give a physical address are being complied with;
  - what little malpractice there was in respect of handling endowment claims has largely been removed; and
  - the scope for malpractice among claims handlers dealing with bank charges and UCCA claims has been significantly reduced.
- 13.2 These achievements have been secured a very modest cost. The total cost of regulation in 2009/10 was £2.3 million, entirely financed by fees made by authorised businesses.

### Increasing access to justice

- 13.3 There is little doubt that claims management companies have increased access to justice. Without their marketing and claims handling work a significant number of people who would not otherwise have done so have obtained compensation which was properly due. However, at the margin the increased “access to justice” has led to a belief in some quarters that compensation can be obtained when it is not properly due.
- 13.4 Regulation has had no more than a marginal effect on increasing access to justice, and that effect has been swamped by the impact of claims management companies themselves. However, by reducing the scope for malpractice in the market and by the seal of respectability that regulation gives at the margin, regulation has made people more confident about using claims management companies.

### **An external view**

- 13.5 The succession of impact reports on claims management regulation have been written by someone involved in setting up and operating the regulatory regime. Ideally, a completely independent assessment is needed. It is therefore appropriate to note that claims management regulation was chosen as a case study for the Better Regulation Executive project, *Better Regulation, Better Benefits*. The following extracts are taken from the case study report, *Better Regulation, Better: Getting the Balance Right Case Studies*, (Department for Business, Innovation and Skills (BIS) October 2009):

‘Claims management regulation is a good example of how regulation can be introduced quickly, efficiently and at low cost, with the support of the industry concerned, to protect consumers.

Darren Werth, Chairman of the Claims Standards Council said:

“Claims Management Regulation has cleaned up the industry very effectively and very quickly.”

Andy Wigmore, Policy Director of the Claims Standards Council agreed:

“We were getting 100 complaints a day from A&E departments (about ambulance chasers). Within three months of the regulation coming in, these had stopped.” Good stakeholder engagement has strengthened the regulation and ensured industry support... This regulation has teeth – it is not just regulation for regulation’s sake and this only happened because of the engagement with stakeholders. The nucleus of this regulation is the Regulatory Consultative Group which has given the regulator the opportunity to see and listen with amazing clarity. With any regulation you will get stakeholders who want to engage – this means you get regulation you can do something with.”

### **Consumers have benefited**

The regulation seems to have had a quick and effective impact on raising standards in the industry. It has also benefited consumers. Following the abolition of legal aid, Citizens Advice Bureaux handled over 130,000 enquiries about personal injury claims: it says the regulation has made a big difference to the market and to consumer experience. Citizens Advice collated reports from across its bureaux of experiences with claims management companies and since the legislation was introduced it has seen a drop in numbers of people seeking support from 873 in 2006-7, to 531 in 2008-9.

“Overall this has been a successful regulatory intervention done quickly and effectively.”

James Sandbach, Citizens Advice (Author of *No Win, No Fee, No Chance for Citizens Advice*, December 2004)

### **Claims management regulation has not solved the whole problem**

Some have questioned why this regulation was necessary. But those involved state that the system had created an environment where consumers became a commodity and this led to a high degree of malpractice. Much of this has been addressed through the regulation.

A main challenge with the regulation is displacement activity – companies are continually trying to find a way around the law. A review carried out for the Ministry of Justice (MoJ) one year following implementation suggested that some activity had moved to solicitors who brought procurement activities in-house to avoid claims management regulation. The MoJ works closely with the SRA to tackle these issues but cannot use its enforcement processes to address it directly. The regulator also has to keep alert to new markets. At the time of writing there is a new wave of claims activity, due to provisions in the Consumer Credit Act allowing consumers to challenge their credit agreements. Some claims management companies are advertising to say they can take this up on behalf of consumers, requesting up front fees from consumers – for something consumers can easily do themselves. There is also a particular issue where solicitors charge fees to consumers up front.

### **The 'net' benefit is difficult to measure**

It is difficult to quantify the benefits of claims management regulation as no monetary value has been given to the improvements described above. The original estimate of costs to business were for the authorisation fees – estimated at £3000 – £4200 a year – plus additional policy costs of between £0 – £5000 a year, depending on the services already provided by the business. This was on the basis of 500 companies becoming authorised leading to a total estimated cost to business of between £1.5 million – £4.6 million, depending on size and level of activity. Actual figures are likely to be different although no current cost data exists. This is due to the greater number of companies who have registered and the basis for fees calculation based on turnover. These, plus the operating costs, are relatively low but without the estimate on benefits, we cannot give a value to the 'net' benefit.

### **Some key features have ensured the creation of a successful model of regulation**

Despite the challenges, on balance the regulation is effective, particularly as the sector has expanded on a greater scale than was originally anticipated, and it has met the original aims of raising standards and protecting consumers. So far there have been no prosecutions and the MoJ sees this as a positive result. In line with better regulation principles, it takes a targeted approach and encourages compliance rather than taking a punitive approach. This does not mean it is not tough: at the time of writing over 100 businesses have had their authorisation cancelled and nine businesses are currently suspended (the majority due to failure to complete the 2008 or 2009 renewals processes

but with a rising number due to serious breaches of the conditions of authorisation) and it pursues companies it thinks may be acting illegally.

The key success factors of this model include:

- the use of existing structures to create a regulator framework that could come into effect quickly and cheaply;
- the partnership working;
- the sliding scale of fees;
- an understanding the market;
- the early, meaningful consultation and engagement of stakeholders; and
- keeping the administrative burden to a minimum.

In addition, this is one of the few areas of regulation where regular post implementation reviews are carried out on a range of issues. The first review, commissioned by the MoJ, confirmed the reduction in malpractice, aggressive advertising and cold calling in person described above. It also made recommendations for more work to be done in a number of areas including regular surveillance of websites, eliminating unauthorised activity and working with other agencies to reduce crime in the sector.'

## 14. Future work

14.1 This chapter suggests a number of issues that might usefully be considered by the Regulator. These build on the work that the Regulator has been doing and the way that the regulatory regime has evolved, as described in the chapter 12.

### **Differentiating Businesses**

14.2 The regulatory regime has always had some differentiation between businesses, and that differentiation has increased over time and currently comprises –

- businesses that hold client funds must do so in client accounts;
- businesses that represent clients in personal injury cases are required to have professional indemnity insurance; and
- businesses seeking authorisation for financial services claims must complete a supplementary information form.

14.3 There is scope for the Regulator to introduce more differentiation between businesses whether authorised or seeking to be authorised. The criterion on which this must be based is the potential risk to consumers. Where businesses are acting purely as intermediaries, passing on claims from one person to another, there is little risk and little need for an intrusive regulatory regime. However, there are some activities or practices that are inherently high risk regardless of which sector they are in. These include where clients are required to pay a significant upfront fee, and where businesses provide advice on the legality of contracts.

14.4 Consideration could be given to requiring businesses engaged in high risk activities to furnish a statement of competence with their application, demonstrating that they have the necessary skills, experience and resources to handle the business they are planning to undertake. There is a useful analogy for this in the OFT regime for consumer credit businesses. It would be possible to go beyond statements of competence and require competency tests and even qualifications, but this would take some years to put into place and would also seem disproportionate, given the tiny size of the market.

14.5 There may be also be a case for the Regulator to raise the bar for businesses that are already authorised. Currently, there is a slightly anomalous position in that a new a business seeking to get into the UCCA market and which might pose a significant threat to consumers has to go through significant hoops in order to be authorised. By contrast, an existing business that merely introduces personal injury claims to lawyers could move into this new market immediately without the checks being applied before they do so, although there is no evidence that this has happened. Those intent on malpractice in high risk areas

could find this an easy route into the market. The Regulator could consider whether it can introduce additional requirements for existing businesses undertaking high risk activities as a condition of the remaining authorised.

### **Dealing with Misleading Information**

14.6 It has been observed that to the extent that consumers are given misleading information, this now tends to be on an individual basis in individual phone calls or face- to-face meetings rather than in advertising. This is clearly more difficult for the regulator to tackle. There are two measures that might usefully be considered:-

- Where businesses make outward phone calls to consumers, there could be a requirement that all such calls are recorded and that recordings should be retained for a given period of years and made available on request to the regulator. Some regulators have such a requirement. It is not expensive to implement and for their own internal purposes many businesses record telephone calls. There remains a risk that in addition to monitored calls some sales staff with or without the encouragement of the management of their business will make calls outside of the formal system at which misleading information can be given.
- There may be a need for some more mystery shopping where the regulator has prime facie evidence that a business does give misleading information. This is fairly complex to set up but sometimes is the only real means of dealing with some businesses.

### **Approach to authorisation**

14.7 Currently, the authorisation procedures lean towards helping applicants whose application forms are unsatisfactory. While this was justified originally (and is a recommended approach under the Regulator's Compliance Code<sup>1</sup>), when the regulatory regime was new, given that the regulation of claims management companies is now well established and understood, the time is right for a review of the approach. Claims management businesses purport to be able to help people claim what is their entitlement from insurance companies, financial services businesses and other organisations. This requires a degree of competence and care. If such businesses are unable to complete an application form for authorisation then their ability to provide a fully competent service to their customers may be in question. The current practice can also lead to higher costs for the Regulator both in bringing businesses to compliance initially and subsequently in monitoring the activities of such businesses. Consideration could be given to modifying the current approach in two ways –

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<sup>1</sup> <http://www.berr.gov.uk/policies/better-regulation/improving-regulatory-delivery/implementing-principles-of-better-regulation/the-regulators-compliance-code>

- Where an application is incomplete or inconsistent the Regulator could do no more than indicate where it is incomplete or inconsistent and not engage in an iterative process. Applicants could be advised that they can seek professional help in making an application. This approach would help weed out the incompetent and raise the hurdles for all.
- Where an application raises significant regulatory concerns it needs to be handled appropriately. Tactics might include asking the applicant to demonstrate suitability and competency, visiting the premises of the applicant and interviewing directors and staff, asking the applicant to visit the Regulator for an interview, making more extensive background enquiries and requiring the applicant to produce a business plan. These steps have been deployed in individual cases, and there is scope to build on this experience.

### **Use of the expression Regulated by the Ministry of Justice**

- 14.8 The rules to which claims management businesses are subject do not require them to state that they are authorised but if they do state this, they have to use a prescribed form of wording: “regulated in respect of regulated claims management businesses by the Ministry of Justice”. In order to comply with EU law there must also be a reference to the Regulator on the websites of claims management businesses. With the benefit of experience this requirement could be reconsidered to help ensure undue comfort is not given to consumers by some businesses trying to exploit the fact that they are regulated by the Ministry of Justice; there have been reports of businesses saying on the telephone that they are working on behalf of the Ministry of Justice. This badge of respectability has the potential to be abused. Some other regulators have similar requirements, but also have more onerous regulatory requirements, the FSA being a good example. In contrast, the OFT prohibits credit brokers from saying in advertisements that they are regulated by the OFT, but does require them simply to state their consumer credit registration number. The Claims Management Regulator could consider whether it should change its requirement to one more similar to that operated by the OFT. It is recognised that there would need to be some lead-in time before this could be introduced.

### **Anticipate Problems**

- 14.9 Regulators now cannot be simply reactive. The financial crisis of the last few years has demonstrated this with there now being a general acceptance of the need for “macro prudential” regulation. Using available intelligence from complaints, market analysis and information from other regulators and enforcement bodies, regulators need to be even more forward looking, assessing what risks might emerge in the immediate future and ensuring that there are systems in place to deal with those risks. This will also require more

extensive cooperation with other regulators given that the main problems areas are where more than one regulator is involved. Good management information is needed to ensure there is a clear handle on what is happening in the market place.

### **Concentrate Enforcement Activity**

- 14.10 The Regulator already concentrates enforcement activity on areas where there is likely to be greatest risk to consumers. This practice needs to continue and perhaps consideration could be given to extending it. This could involve reducing the regulatory burden on some businesses.



