The Claims Standards Council

Report by Boleat Consulting

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Foreword

The government has announced its intention to regulate claims management activities. The necessary legislation has been introduced in the current session of Parliament, and the intention is that the regulator should commence its work at the latest by the end of 2006 and be fully operational by April 2007. The Secretary of State will designate a regulator but will retain substantial oversight powers.

The government does not wish to create a new public regulatory body. The Claims Standards Council (CSC), which has been established to provide self-regulation in the sector, is a candidate to be the regulator.

This report assesses and reports on CSC's current position and plans, and identifies what the CSC needs to do in respect of governance, organisation, resources and policies in order to be in a position to be designated as a regulator. The report puts this firmly in the context of development of claims management services across various sectors (in particular personal injury and endowment mis-selling claims) and the Government's proposed legislation contained in the Compensation Bill. I have included some detail about the regulatory framework to help the reader understand the landscape in which regulation is being introduced.

I have drawn on established best practice in regulation and my own direct experience with a number of regulators and have had discussions with relevant stakeholders.

I am grateful to all those who have contributed information and views, in particular the representatives of the CSC.

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Executive summary

Background

1. The claims management industry has developed in response to the ability of consumers to pursue compensation claims on a "no win no fee" basis. The government has announced its intention to regulate claims management activities.

2. Claims management activities are managed in a number of different ways with different organisations being involved. In respect of personal injury cases, lawyers play a significant role, some soliciting claims in the same way as unregulated claims management companies. In the case of endowment business, lawyers are generally bypassed.

The regulatory framework

3. Claims management activities are already subject to both some general and specific legislation and regulation.

4. Establishing a new regulatory body is a complex process. The Hampton Review has provided some useful guidelines.

5. The government currently envisages that claims management activities will be regulated through a private sector "frontline regulator", eventually to be supervised by the Legal Services Board which the government proposes to set up by 2008. The Compensation Bill sets out the framework under which the regulator will operate.

Challenges in establishing a regulator for claims management activities

6. Establishing statutory regulation but delivered on a non government/private body basis will not be easy. This is an innovative approach for which there is no obvious precedent. The diverse and fragmented nature of the industry presents particular difficulties. The intention to exempt solicitors and trades unions from the legislation adds to the problems facing a potential regulator, by reducing the scope of the regulatory regime and the ability to spread overheads widely.

The Claims Standards Council (CSC) today

7. The CSC was established in 2004 and currently has around 170 members. It is run largely by two individuals on a non-profit making basis, not entirely in accordance with its memorandum and articles. It has only modest support from the industry. It is assisted by an Advisory Board. The current subscription rate is £720 a year. The Council undertakes a combination of trade association, regulatory and commercial activities, but has lacked the funds to do the necessary work to establish itself as an effective self-regulatory body.

The Claims Standards Council's plans

8. The Council intends to seek designation as the regulator under the Compensation Act. It recognises that to do this it will have to divest itself of trade association activities, and it is planning to do this.

9. The Council recognises the huge task that it faces and does not yet have a business plan to convert from its current status to an organisation capable of being designated as a regulator.

Converting the Claims Standards Council to a regulator

10. If the Council wishes to be in a position to be designated as a regulator, it must formally make that decision and publish firm plans to divest itself of trade association and commercial activities. It would need to embark on a major programme comprising –

- Introducing new governance arrangements. This should include a new memorandum and articles and appropriate involvement of industry and independent representatives.
- Increasing the membership, in particular to cover the major claims management companies not currently in membership.
- Developing the code of practice and introducing arrangements to ensure that members comply with the code. This will be a major but achievable task which is central to the establishment of any sort of regulatory regime for claims management activities. The code should be capable of being approved under the Office of Fair Trading Approved Codes Scheme.
- Obtaining the resources to implement the programme. The Compensation Bill regulatory impact assessment estimates that the designation of a regulator under the new regime is likely to incur start up costs of £0.5 million. The running costs of a private sector regulator are estimated to be between £1.5 million and £2.1 million a year. If designated, the Council would probably need substantial underwriting from the government or other stakeholders.

11. There are a number risks in establishing a regulator which are capable of having significant financial implications. These include the number of organisations that will be covered by the licensing scheme and the number of those that will seek licences. A second series of risks stems from the government's intention to retain substantial oversight powers over the regulator. These risks need to be understood and managed.

Chapter 1

Background

The development of the claims management industry

1.1 The defining characteristic of claims management companies is that they work on a "no win no fee" basis or live off commissions and referral fees which in turn may depend on a solicitor working on a no win no fee basis. It follows that their existence must depend on legal and regulatory structures that allow such an arrangement to work. Conditional fee agreements (CFAs) were introduced by the Courts and Legal Services Act 1990 and came into effect for personal injury cases in 1995. The Access to Justice Act 1999 permitted recovery of success fees as well as recovery of the premium paid for insurance policies taken out to cover opponent costs from the losing party. This contributed to the rapid growth in the activities of claims management companies for personal injury cases.

1.2 Separately, the requirement of the Financial Services Authority for insurance companies to put in place arrangements to deal with the financial services industry's mis-selling opened up another market opportunity, working on the similar principles as CFAs but without legal action being involved.

1.3 The method of operation of some claims management companies rapidly began to cause concern, accentuated by the collapse of the two largest companies, Claims Direct and the Accident Group, in 2002 and 2003 respectively.

The intentions of the government

1.4 In September 2004, the Better Regulation Task Force (BRTF) published a report, *Better routes for redress*. This examined how the current compensation system worked, and made recommendations on how access to redress might be improved. On 10 November 2004, the government announced its response to the report.

1.5 On claims management companies, BRTF had recommended that the Claims Standards Federation (then the trade association in the sector) should apply to the Office of Fair Trading for approval of its code of practice in which it set out how claims management companies should operate, and that the Federation should work towards to the approval of its code by the OFT by September 2005. If by December 2005 progress was not made then the Department for Constitutional Affairs (DCA) should regulate the sector. In its response, the DCA accepted that the claims management sector should be properly regulated and agreed that it should be given "one last chance to put its own house in order and if it doesn't then we will consider how new formal regulation could be introduced." The government accepted that the successor body to the Claims Standards Federation, the Claims Standards Council (CSC), "appears to provide the opportunity to make significant progress now towards better regulation and to ensure consumer interests are safeguarded".

1.6 In a speech on 22 March 2005, the Lord Chancellor expressed disappointment that despite signs of broad support for the CSC only a small proportion of claims management companies had joined. He went on to say that "claims management companies have failed to demonstrate anything like the commitment that I would hoped to have seen by now". He announced that the government would legislate on claims managers, specifically to bring the claims management sector within the regulatory net through legislation on reforming the

market for legal services. He envisaged a frontline regulator with oversight by the proposed Legal Services Board. That frontline regulator could be the CSC. He said he would welcome proposals from the CSC on how it intended to develop its current role and what it could do to help deliver the watertight regulatory regime that was required.

1.7 On 17 October 2005, the government published a White Paper on regulation of the legal services industry which included more details on the proposed Legal Services Board and the relationship between it and frontline regulators. These requirements are set out in the following chapter and Appendix 1. On 3 November 2005, the government published the Compensation Bill, which sets out the regulatory framework. Again, details are given in the following chapter and Appendix 1.

The industry

1.8 Any attempt to regulate a sector of the economy must begin with an understanding of how that sector operates in the marketplace. If this does not happen then there is a danger of regulation simply causing a change in the nature of the industry, such that malpractices continue outside the ambit of the regulator while the regulatory structure imposes sometimes onerous conditions on those seeking to operate fairly.

1.9 DCA's current working definition of claims management activities, which would therefore fall to be regulated under the legislation, is –

- Seeking out claimants to whom to provide services, by advertising or direct marketing.
- Advice to a claimant on the merits or handling of the claim.
- Making representations (whether in writing, or spoken, and regardless of the body or person to or before which or whom the representations are made) on behalf of a claimant.
- Referral of a claim or claimant's details to a person with a right to conduct litigation.
- Making arrangements for the provision of, or direct selling of, after-the-event insurance to a claimant (but only in so far as not covered in so doing by FSA authorisation).
- Providing, or referral to a provider of, loan arrangements for the purpose of pursuing a claim, to a claimant or a person with a right to conduct litigation
- Enquiring into the circumstances of the claim.
- Carrying out or commissioning investigations into the merits of or foundation for the claim.
- Commissioning expert medical or other opinion for the purpose of pursuing the claim or assessing the quantum of compensation.

1.10 These activities take place in many different markets, each with different characteristics. The areas of major concern, where it is intended that regulation would initially apply, are –

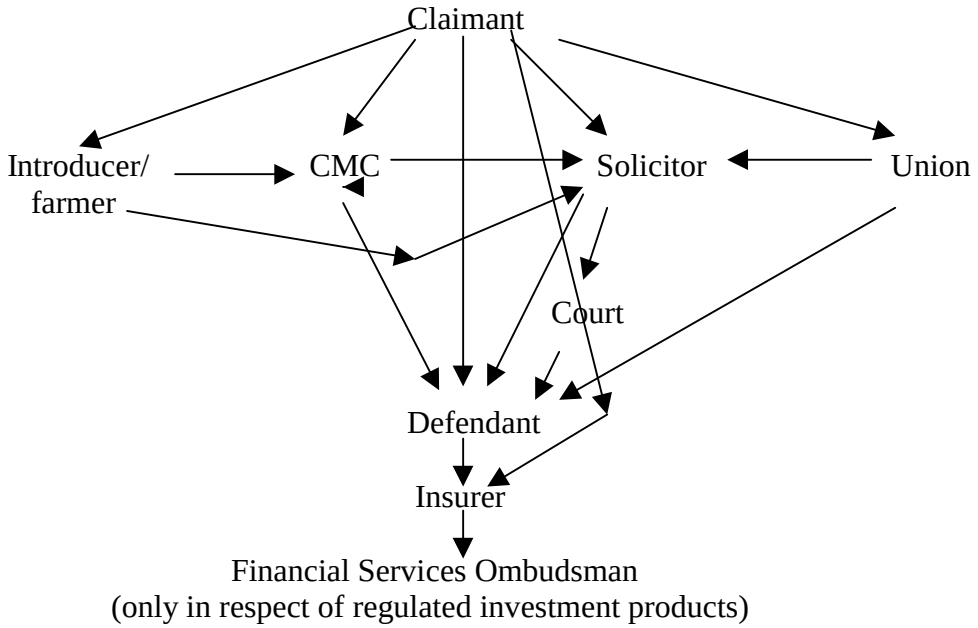
- Personal injury.
- Housing disrepair.
- Mis-selling of certain financial products.
- Criminal injuries compensation.
- Employment law.

1.11 There are several different types of business arrangements that come within the proposed definition of claims management activities. The activities include –

- Directory enquiry services which simply pass people on to a claims management company or a solicitor.
- Casual introducers such as breakdown company and hospital staff.
- Claims farmers who seek claimants and pass them over to a solicitor for a fee but do not do any further work.
- Claims management companies (CMCs), which may also farm claims but which manage the case on behalf of the claimant to varying degrees.
- Rehabilitation farmers, a special type of claims management company that concentrates on arranging rehabilitation services.
- Solicitors or groups of solicitors either directly or through marketing arms.
- Trade unions, which predominantly deal with their members but some of which also provide a wider service.

1.12 The Regulatory Impact Assessment (RIA) which accompanied the Compensation Bill estimated that there are 400-500 companies providing claims management services. However, this figure is very sensitive to the definition used. There are many more casual introducers. The figure also excludes solicitors.

1.13 The following diagram is a simplified representation of the different ways in which businesses is done.



1.14 The dynamics of the market vary considerably between sectors.

Personal injury

1.15 The following table quantifies the market for personal injury claims (the various sources of information give conflicting information; the figures should be taken as no more than rough estimates).

Personal injury claims, 2004

Type	Number	Cost
Road traffic accident	200,000	£4.8bn
Employer's liability	300,000	£1.8bn
General liability	90,000	£0.6bn
Total	590,000	£6.6bn

Source: Datamonitor.

1.16 Of the total number of claims in 2004, Datamonitor provided a further breakdown –

- 50,000 claims were handled through unions, almost entirely employer's liability cases.
- 320,000 cases were covered by before-the-event insurance, which would include almost all road traffic accidents.
- 180,000 cases were handled through after-the-event insurance or by other means.

1.17 Datamonitor also published a list of the largest advertisers in 2003 –

National Accident Helpline	£4.6 million
Injurylawyers4u	£2.2 million
Accident Advice Helpline	£1.9 million
Personal Injury Helpline	£1.7 million
Ashley Ainsworth	£0.8 million
RAC	£0.8 million

1.18 It is helpful to describe briefly the structure of some of the major companies –

- National Accident Helpline is the longest established claims company, having been launched in 2003, and is a referral organisation for a national network of over 100 solicitors, each of which has a defined geographical area of operation.
- Injurylawyers4u was established in November 2002 and is a marketing company founded by Amelans Solicitors. It has a panel of about 180 solicitors.
- RAC Legal Services works through 24 external firms and 45 in-house solicitors. While it obtains some business from its members, it also markets directly to the public and through other intermediaries.
- Accident Line was created in 1994 by the Law Society as a referral service for solicitors and has over 300 lawyers on its panel.

1.19 The first intermediary in many claims cases is someone who merely acts as an introducer, being paid a very modest fee, generally under £100. There are a large number of such introducers including employees of breakdown companies and the health service. Even telephone directory inquiries act in this way. It is likely that there is a great deal of unofficial activity, particularly in health establishments, while, in other cases, the opportunity to earn a referral fee, often paid in cash and with no effective tax liability, is seen as a desirable perk of the job. Claims farmers actively solicit business and may operate on a full time basis. The aggressive aspect of certain claims management activities is generally most evident at this early stage with people being stopped in the street or in hospitals and pressurised to sign a consent form.

1.20 Personal injury claims come to insurance companies through one of three main channels, although the distinction between them is blurred. Introducers may be involved in two of the three channels. The first is from claimant to solicitor to the insurance company.

The solicitor will do an initial assessment as to whether the case has a reasonable chance before deciding whether to proceed. There is little incentive to begin a case if it has no great change of success, although the incentive to continue kicks in as costs have been incurred and therefore there is a wish to continue the case until such time as the lawyer has at least recovered his costs.

1.21 A variation of this channel is where solicitors obtain business through separate marketing arms.

1.22 The second channel is claims that come from claimant to trade union to a solicitor to an insurer. These are fairly similar to claims that come directly from solicitors. The trade union itself will undertake some initial vetting as will the solicitor, although the solicitor also has to be conscious of the need to satisfy his "client", the trade union, and may perhaps be under some pressure to take cases they might rather not.

1.23 The third channel is where a claim is introduced by a claims management company to a solicitor then to the insurer. It is this channel where most of the problems occur. In effect such claims are often initiated by the claims management company which has put in somebody's mind that there is a possibility of them claiming compensation. The claimant has a contractual relationship with the claims management company. The claim typically comes some time after the alleged incident, often between two and three years. This immediately creates its own problems as the cause is difficult to investigate, the extent of any damages difficult to quantify and if the claimant has been suffering pain then the cost is obviously higher the longer the period since the incident.

1.24 Some claims management companies do nothing other than take very brief details and write one letter. They make little or no assessment of the validity of the case. The economics of the business depend on the quantity of business, with cases being pushed through to lawyers with the minimum amount of work. Typically, lawyers will pay £500 per case. Solicitors are supposed to pay referral fees only if they comply with Law Society rules. The relevant rule is set out below –

"**Section 2A: Payments for referrals**

(1) A solicitor must not make any payment to a third party in relation to the introduction of clients to the solicitor, except as permitted below.
(2) Solicitors may enter into agreements under this Section for referrals of clients with introducers who undertake in such agreements to comply with the terms of this Code.
(3) A solicitor may make a payment to a third party introducer only where immediately upon receiving the referral and before accepting instructions to act the solicitor provides the client with all relevant information concerning the referral and, in particular, the amount of any payment.
(4) The solicitor must also be satisfied that the introducer:
    (a) has provided the client with all information relevant to the client concerning the referral before the referral took place and, in particular, the amount of any payment;
    (b) has not acquired the client as a consequence of marketing or publicity or other activities which, if done by a solicitor, would be in breach of any of the Solicitors' Practice Rules and in particular by "cold calling"; and
    (c) does not, under the arrangement, influence or constrain the solicitor's professional judgement in relation to the advice given to the client.

(5) If the solicitor has reason to believe that the introducer is breaching terms of the agreement required by this Section the solicitor must take all reasonable steps to procure that the breach is remedied. If the introducer persists in breaches the solicitor must terminate the agreement in respect of future referrals.
(6) A solicitor must not make a referral payment if at the time of the referral the solicitor intends to act for that person with the benefit of legal aid, or in any criminal proceedings.
(7) For the purpose of sub-section (1) above, a payment includes any other consideration but does not include normal hospitality, proper disbursements or normal business expenses."

1.25 It is clear that this rule is not complied with.

1.26 The solicitor may often not see the client at all, but will rely on information given by the claims management company. Sometimes, even where solicitors do wish to contact the client to obtain further information, this cannot easily be done. It is not unknown for the solicitor to go back to the claims management company and rely on information that they have provided. This means that some of the cases that come to solicitors from claims management companies have little validity.

1.27 The client has agreed to make a claim simply on the basis of "no win no fee", and may have no understanding of the necessary burden of proof and the legal processes that they might be obliged to go through.

1.28 Lawyers have every incentive to run a case that comes from a claims management company. They have already paid their referral fee and as costs start running the only way these can be recovered is by continuing the case until the insurer agrees to pay compensation. The solicitors are also reluctant not to pursue cases passed on by claims management companies as this threatens their relationship with the companies and may result in a reduced flow of new business.

1.29 It may seem that the insurers should deny claims that come with little chance of success in the courts. However, their experience is that in practice it is likely to cost more to defend the claim than it will to pay what might be a fairly modest amount, and the other parties are well aware of this. It may be argued that insurers are succumbing to blackmail, and that by paying when there really is not a strong case they are merely inviting further problems in the future. This may well be true but each insurer is roughly in the same position and in effect they have a captive market. Personal injury claims are made on employer's liability, public liability or motor insurance policies, each of which is compulsory. The effect of an increased number of cases, whether or not these eventually go through the courts, is that insurance premiums are higher all round with the insurers generally making a similar profit on volume turnover. Insurers report that a continually increasing proportion of pay outs to third parties go to lawyers (now about 30-50%).

1.30 It is likely that the ending of Legal Aid for personal injury cases and reliance on conditional fee arrangements and legal expenses insurance to fill the gap has contributed to these developments. With Legal Aid there was some check on the validity of the case from the Legal Aid authorities, which limited the ability of lawyers to pursue hopeless cases. With conditional fee agreements there is often no real check on the validity of the claim when it has been captured and sold to a solicitor by a claims management company. Two of the

parties concerned, the claims management companies themselves and the solicitors, earn additional fees from the business, while the insurance companies who pay out the claims recover their costs through increasing premiums.

Endowment business

1.31 As a result of regulatory action by the Financial Services Authority, life insurance companies are required to tell endowment policy holders if their policies are likely to yield less than they might have anticipated and to invite policy holders to seek compensation if they have been mis-sold. The process for investigating complaints is itself closely monitored by the FSA, and if the claimant is unhappy he has the option of going to the Financial Ombudsman Scheme. As far as the individual is concerned all he has to do is to gather the necessary information and write a standard letter, which helpfully Which? provides through its website.

1.32 Insurance companies estimate that there will be around 1,000,000 endowment compensation claims this year with a typical compensation figure being around £6,000.

1.33 Claims management companies have seen this as a very lucrative business. Basically all they need to do is to gather information and write a single letter on behalf of their clients and then the process follows automatically. Around 30% of claims come through claims management companies who typically take a fee of 25% plus VAT of any compensation. Claims management companies can therefore expect to earn about £400 million (that is 25% of 30% of £6 billion) in 2005.

1.34 There are seven or eight major companies in the market, some of which are linked to firms of lawyers, although there is no legal action. Former employees of insurance companies (some of whom probably mis-sold policies in the first place) are active in some of these companies.

1.35 There is scope for abuse in a number of ways –

- The claimant may not be aware of the actual percentage of the compensation taken by the claims management company.
- The claims management company may never reveal how much compensation has been awarded and take a higher fee than they are entitled to.
- The claims management company may take a higher fee than they initially quoted on the grounds of "additional work".
- Advertising and marketing may use scare tactics.
- Not telling the claimant that an alternative free service is available.

1.36 Insurance companies claim that most of the claims management companies do very little other than write a single letter. They often refuse to provide the additional information needed to assess whether a claim is valid. If they are required to do some work on a claim, then they may well drop it knowing that there is easy money to be made on other cases.

1.37 The industry has tried to deal with this by refusing to deal with claims management companies but this proved not to be workable. Insurers increasingly are moving to pay the policy holder directly, leaving the claims management company to claim their fee from the policy holder.

1.38 Endowment compensation claims are likely to begin falling as most cases of mis-selling have now been dealt with, and there is concern among insurers that the claims management companies will turn their attentions to other potential markets such as contracting out of pensions and generally anything where the Financial Services Ombudsman is at the end of the chain.

Chapter 2

The regulatory framework

2.1 This chapter briefly sets out the context within which a regulatory body for claims management activities will operate. Appendix 1 gives a more detailed description.

Existing legislation

2.2 Claims management activities are subject to both general and fairly specific regulation. The following general consumer legislation is relevant –

- The Trades Descriptions Act 1968.
- The Unfair Contract Terms Act 1977.
- The Supply of Goods and Services Act 1982.
- The Unfair Terms and Consumer Contracts Regulations 1999.
- The Consumer Protection (Distance Selling) Regulations 2000.
- The Electronic Commerce Regulations 2002.
- The Financial Services (Distance Marketing) Regulations 2003.

2.3 In addition, there is also –

- The regulation of advertising by the Advertising Standards Authority.
- Regulating the sale and conduct of after-the-event and before-the-event insurance by the Financial Services Authority.
- Regulation of loans taken out to finance legal activity under the Consumer Credit Act.
- Regulation of solicitors by the Law Society.

Policy on regulation generally – the Hampton Review

2.4 The government has been reviewing regulation generally. The Treasury commissioned Sir Philip Hampton to consider the scope for reducing administrative burdens by promoting more efficient approaches to regulatory inspections and enforcement without compromises regulatory standards or outcomes. Sir Philip's report was published on Budget Day in March 2005 and the conclusions were immediately accepted by the government as a whole. The proposals are now in the process of being implemented.

2.5 The Hampton Report includes a set of principles of regulatory enforcement.

2.6 The report said that a major problem with the current regulatory structure was the problems caused by complexity, in particular overlapping areas of responsibility and small bodies having limited efficiency in the use of resources.

2.7 Hampton concluded that consolidation of regulators should take place around key regulatory themes. One of the themes is "consumer protection and trading standards". The intention was that a new body would bring together the consumer protection work of the Office of Fair Trading with the responsibility of overseeing the work of local authorities on trading standards issues. The Chancellor has announced that the proposal to establish a new body has been abandoned. Rather, the OFT will be given an enhanced role and a Local Better Regulation Office established. As yet there is no detail on these new arrangements.

The Legal Services Board

2.8 A White Paper, published on 17 October 2005, set out plans for an overarching Legal Services Board which would oversee the operation of frontline regulatory bodies such as the Law Society and the Bar Council.

Compensation Bill

2.9 The Compensation Bill was published on 3 November 2005. The main features of the Bill are –

- The provision of claims management services will become a regulated activity unless the provider is exempted from being regulated.
- The Secretary of State for Constitutional Affairs can designate a regulator, establish a regulator or undertake the function of regulator.
- The regulator is given the usual powers but is also expected to increase public awareness of the regulation of claims management services, to encourage competition and to promote good practice.
- The Secretary of State has considerable powers to direct the regulator and will be responsible for making secondary legislation on the regulator's rules and fees.

2.10 It is the intention that the Legal Services Board would take over the oversight role initially proposed for the Secretary of State in respect of claims management services.

Implications of the big picture for the regulation of claims management companies

2.11 This analysis leads to the following conclusions –

- Establishing new regulation for claims management activities has to meet the Hampton test that no existing regulator is capable of taking on the task.
- A specific, and therefore, small regulator of claims management activities will run into the resource constraints identified by the Hampton Review.
- While certain claims management activities can be subjected to legal services regulation, other activities will be subjected to financial services regulation and some activities are subject to general law and regulation.
- A frontline regulator will need significant resources, in particular to put in place professional indemnity arrangements and if necessary arrangements for the compensation scheme.

Chapter 3

Challenges in establishing a regulator for claims management activities

3.1 In addition to the more general points covered in the previous chapter, the task of the Claims Standards Council or any other regulator of claims management activities is made particularly difficult because of the nature of the sector.

3.2 The development of an effective regulatory mechanism from the sort of starting point which the CSC is in would be innovative and challenging. Those self-regulatory organisations that have been created are mostly in financial services and have been developed by well-established and strong trade associations

3.3 The size and nature of the industry is not well understood. Chapter 1 described the various different activities that come within the claims management definition and the different business structures that are used in the marketplace.

3.4 The regulatory impact assessment that accompanies the Compensation Bill estimated that there are perhaps 500 or so companies in the market, but there are significant changes in short periods in market shares and indeed in the companies in the market. Companies start up and close down quickly and change the business they are in and they way that they do business in response to changes in market conditions.

3.5 The final point is that there is extensive malpractice within the claims management sector because of the opportunity for huge returns. Regulation will be designed to remove that malpractice. Those guilty of malpractice will not simply accept this but will fight regulation in any way that they can, and to the extent that they are not able to resist it, will move into other areas or re-organise their activities, taking account of the impact of the regulation. There is always a risk that the introduction of regulation leaves malpractice more or less unchanged, either because it has been displaced to another sector or because business has been reorganised in such a way as to avoid the effects of regulation.

3.6 The first chapter illustrated the various types of business arrangement that come within the proposed definition of claims management activities. There are in fact significant boundary issues that will need to be settled in regulations made under the Compensation Act. Particular issues are –

- It may be unrealistic to expect that casual introducers, such as directory inquiry services or staff employed by breakdown companies, will be regulated under the Act. Either they will need to be exempted or any control over their activities exercised through the regulated organisation.
- Citizens Advice Bureaux and other advice agencies clearly fall within the scope of the Act as do other advice services. The government's current intention is to exempt them.
- Trade unions provide a service not only for their members but also some seek to provide the service more widely. The government's current intention is to exempt them.

- Solicitors play a major role in claims management activities and some operate their own separate claims management companies. The Law Society wishes to see an exemption for solicitors and the question is the terms on which any such exemption may be made, in particular whether there will common conduct of business rules for solicitors and claims management companies. The current intention is to exempt solicitors in so far as they are regulated by the Law Society in respect of their claims management activities.

3.7 The regulator will also need to take account of existing legislation and to work with a number of other regulators, in particular the Financial services Authority.

Chapter 4

The Claims Standards Council today

4.1 This chapter examines the current status of the Claims Standards Council. Before doing so, it sets the scene by describing the various types of industry body and the specific environment within which the Council is seeking to operate.

Regulatory bodies and trade associations

4.2 Three types of organisation are frequently confused –

- A regulatory body is set up by statute with the responsibility and powers to regulate a sector of the economy or a specific activity.
- A self-regulatory body is set up by people within a sector to regulate by agreement activity in that sector.
- Trade associations are set up by organisations within a sector to promote the interests of companies in the sector, generally through representation and related information and advice services.

4.3 Most self-regulatory mechanisms are set up and run by trade associations because they have the necessary membership and resources to do the work. However, there is a general acceptance that having both representative and regulatory functions can cause conflicts.

4.4 Trade associations are not governing bodies of their members. They have powers over their members only if the members agree to that individually by contract, and even then it may be difficult to exercise the powers, particularly in respect of large members.

History

4.5 This brief history of the CSC draws heavily on a draft of its first annual report.

4.6 In 2003, the industry responded to the BRTF inquiry and the Law Society supported initiative to develop codes of practice by amalgamating two representative bodies, the Personal Injury Federation and the Personal Injury Association, into what became known as the Claims Standards Federation (CSF). However, there were deep divisions within the CSF and suspicion of it, as a result of which it had a very small membership. The BRTF report provided the impetus for another industry initiative. In August 2004, the decision was taken to wind up the CSF and a few weeks later the CSC was formed with the aim of testing the industry's appetite for voluntary regulation. Unlike the CSF the CSC was established primarily as a regulator, with trade association functions being secondary.

4.7 The new association began with only a very small number of members and by the end of 2004 membership had increased to just ten. The publication of the BRTF report in September 2004 led to greater interest in the Council, and this was accentuated when a conference was held in Birmingham in February 2005. However, membership was still slow to increase and in March 2005 the government announced its intention to introduce statutory regulation. This has proved to be the real impetus for membership growth (common in trade associations generally, where a strong "enemy" is the main determinant of membership growth). By the end of October 2005, membership had increased to 104 companies, and by the end of October to 173.

Governance

4.8 The CMC is a company limited by guarantee. Paragraph 3 of the memorandum of association sets out its basic objectives –

> "The Claims Standards Council Ltd (hereafter shown as 'the CSC') is the independent self-regulatory body for claims management companies and other entities and individuals involved in the handling of claims where such companies, entities or individuals are not already directly regulated by the Financial Services Authority, Law Society or similar organisation."

4.9 The aims of the CSC are to:

a) Define standards that place and then retain consumer interests at the forefront during the handling of claims;
b) Craft transparent and independently monitored procedures that support delivery of the standards to ensure that clients are consistently dealt with on the basis of decency, probity and fairness;
c) Thoroughly, impartially and speedily respond to complaints about Members from consumers and other industry stakeholders;
d) Ensure that Members comply with both the standards and procedures and to deal appropriately with those who do not;
e) Be actively involved in rigorous research and other feedback to ensure that the organisation remains an exemplar with Members contributing fully to the principles of 'access to justice' and 'justice for all';
f) Engage with other related regulators to ensure that service delivery standards and procedures are invoked seamlessly by different professions and individuals;
and the doing of all such things as are incidental or conducive to the attainment of such aims."

4.10 The articles provide that the "management officers" of the CSC shall comprise a chief executive, a president, two vice presidents and eight other directors all of whom shall be directors on the board of the CSC. It is provided that of the twelve directors the majority must be "assessed by the board to be independent of the CSC". It is further provided that eight of the directors should be appointed as two each from representatives from members, consumer groups, professional organisations such as the Law Society and regulatory bodies such as the FSA.

4.11 The articles go into some detail about roles and responsibilities. Among the provisions are –

- The chief executive is also chairman of the board of directors.
- One of the vice presidents has responsibility for creating and managing the CSC strategy for compliance and standards and the other has a similar role for addressing consumer interests.
- There is provision for organisations to become members of the company which it is assumed applies to those organisations that wish to be members of the CSC. The board has absolute discretion to determine membership.

4.12 The directors of the company are the chief executive, Tony Burns Howell, Andy Wigmore, who in effect managing the day to day running of the association from the offices of a public relations company, and Gavin Kaye, who is the finance director. Administrative support is provided by Health Squared Communications, of which Andy Wigmore is managing director. In effect, Tony Burns Howell and Andy Wigmore provide their services

on a pro bono basis, although some payment is made to Health Squared Communications for services provided.

4.13 It should be noted that the articles have not been complied with in respect of the composition of the directors, primarily because of the difficulty of identifying appropriate people.

4.14 The Council is supported by an advisory council comprising –
Sir Philip Otton, a former Lord Justice of Appeal
Marlene Winfield, a former advisor to Lord Woolf and a member of the Civil Justice Council.
Fraser Whitehead, a solicitor and member of the council of the Law Society.

4.15 These three people provide valuable and expert advice but they are not formally part of the governance of the organisation.

4.16 There is no member involvement in the governance of the Council.

Membership

4.17 Membership currently comprises 173 organisations made up as follows –
109 Claims management companies
41 Solicitors
7 Medico-legal companies
16 Other

4.18 The largest members are the AA and Accident Advice Helpline (both handling over 10,000 personal injury cases a year), Keypoint (handling 50,000 endowment cases a year) and Beresford's which has handled 50,000 claims from coal miners.

4.19 There are currently four sponsor organisations –

- Russell Jones & Walker, a legal firm specialising in personal injury cases and of which Fraser Whitehead is a partner.
- Elision, a software company.
- Andersen Eden, a legal firm specialising in personal injury cases.
- Premex, a provided of medical reports and services to the insurance and legal industries.

4.20 It is not possible to estimate precisely what share of the market CSC members have; a reasonable estimate is between 35% and 50%. Significant non-members include three of the largest advertisers for personal injury business (National Accident Helpline, Injurylawyers4u and RAC). Accident Line, the Law Society's marketing mechanism, is also not a member. In respect of endowment compensation claims only two of the largest six companies are members.

Activities

4.21 The draft annual report of the Council details the following activities in which the Council has recently been involved –

- Developing the code of practice, including discussions with the OFT, with a view to securing OFT approval of the code.

- Developing practical guidelines for advertising and advising members of what is acceptable in this area.
- Consumer education.
- Developing and introducing fast track handling arrangements.
- Promoting rehabilitation.
- Operating an ad hoc complaints system.
- Exposing malpractice.
- Attempts to deal with malpractice by non-members.
- Advising members on the development of statutory regulation.
- Public relations.

4.22 Some of these activities come in the trade association rather than regulatory category. Others are more of a regulatory nature, although they are typical of activities carried out by most large trade associations.

Challenges

4.23 In developing its future work programme the Council faces a number of major challenges –

- It does not have adequate resources.
- To some extent it has been overtaken by the announcement that there will be a statutory regulator which leads some in the industry to believe that they can simply wait until a new regulator is created (as it may not be the CSC) rather than seek to shape how the regulator will work.
- It is not supported by many of the big claims management companies and the supply chain. This is partly because the Council is considered to be too closely aligned with particular commercial interests and to have unsatisfactory governance arrangements.
- There is very limited involvement of claims management companies in the running of the organisation.

Chapter 5

The Claims Standards Council's plans

5.1 The CSC intends to seek designation under the Compensation Act as the regulator for claims management activities. Its website states that it aims to become the statutory regulatory body by -

- Ensuring that a company or individual who provides compensation advice or services for reward in relation to a claim is registered and governed by it.
- Promoting the development of policy and standards, to members as well as to the government, the legal sector and insurance companies.
- Encouraging the adoption of uniform standards and practice that put the consumer at the heart of the process.
- Interacting with other regulatory bodies and related associations.
- Offering advice and guidelines on claims to the consumer.
- Providing the consumer with effective complaints and mediation procedures.
- Managing public relations, best practice guidance, and media exposure.

5.2 The Council has accepted the need to separate regulatory and representative roles. It intends to achieve this by helping to establish a Claims Standards Institute which will be the representative body and which will take on the trade association functions and also responsibility for training of staff. The Council intends to provide some funding to help get the Institute off the ground and members' subscriptions will largely be transferred to the Institute in its work. The current intention is for the Institute to begin operating in January 2006. However, there are no detailed plans for the Institute.

5.3 The Council is planning to complete work on the code of practice early in 2006 so that it can form part of the launched CSC.

Chapter 6

Converting the Claims Standards Council to a regulator

6.1 The remainder of this report draws on the analysis in the previous chapters to set out in detail what the CSC needs to do if it is to be an effective regulator of claims management activities and to be in a position to be designated as the regulator under the forthcoming Compensation Act.

6.2 Previous chapters have demonstrated the size of the task. Self-regulation is always difficult as by definition a self-regulatory body has no teeth and cannot force people or organisations to join. The experience of other sectors is that self-regulation can work only with very strong supply chain support.

6.3 At first sight, the starting point is not very promising. The CSC has 109 claims management companies and 41 firms of solicitors in its membership. This compares with the current estimate that there are around 500 claims management companies. A number of the largest claims management companies are not members. There are some companies who do not believe in the need for regulation and some who rightly see regulation as preventing their ability to earn substantial profits. There are minimal entry requirements and no standards with which members have to comply.

6.4 However, the CSC has substantial knowledge and expertise which are essential to the development of a regulatory mechanism. It also has a fair amount of goodwill towards it although also naturally some opposition.

The requirements in the Compensation Bill

6.5 The Compensation Bill sets out the proposed requirements that a regulator will have to meet if it is to be designated as the regulator for claims management services. The regulator will have to do the following –

- Increase public awareness of the regulation of claims management activities.
- Encourage competition.
- Promote good practice.
- Protect the public through regulation.

6.6 The regulator will be expected to "police the perimeter", that is to take action to prevent people who are not authorised from providing claims management activities.

6.7 The explanatory notes to the Bill state that in deciding whether to designate a regulator, the Secretary of State would consider whether the regulator has an appropriate infrastructure, suitable internal governance arrangements, adequate financial and staffing resources and appropriate regulatory policies.

6.8 The schedule to the Bill covers claims management regulations but none of this is currently mandatory. The explanatory notes give some indication of what DCA would expect the rules to cover. Paragraph 51 of the explanatory notes says: "We envisage that rules would cover (for example) consumer protection (including handling client's money, complaints procedures etc), registration requirements and procedures, advertising,

boundaries/requirements, requirement to have indemnity insurance etc." Paragraph 53 specifically refers to the regulator –

- Making provision for the investigation and consideration of complaints about authorised persons.
- Requiring authorised persons to take out professional indemnity insurance.
- Establishing a compensation scheme to cover any loss to consumers suffered as a result of the actions of authorised persons.

6.9 The key financial point is made in paragraph 70: "It is envisaged that the regulatory costs will be recouped from those regulated by way of a registration and annual fee. However, to deliver the regulatory mechanism before sufficient income from fees is established it is likely that government would need to provide funding to help with the start up costs. The aim would be to achieve a self-financing regime as soon as possible."

6.10 The regulatory impact assessment is based on the assumption that the regulator would regulate around 500 claims management companies and received approximately 550 complaints a year. The estimated costs (which it is stated are extrapolated from cost data provided by the CSC) are –

- One-off set up costs of £0.5 million.
- Staff costs of £1 million to £1.3 million a year (5 management, 30 caseworkers and 5 support staff).
- Accommodation costs of £0.1 million to £0.3 million a year.
- Other running costs of £0.35 million to £0.5 million a year.

6.11 The total operational costs are therefore seen as being between £1.5 million and £2.1 million plus one-off set up costs of £500,000. If there are 500 licensed organisations this would lead to an annual fee of between £3,000 and £4,200.

Clarifying the CSC's role

6.12 The Council has decided that it wished to be designated as the regulator. The previous chapter indicated that the Council intends to split off trade association activities into the Claims Standards Institute.

6.13 Websites are now the public face of organisations. The CSC website needs to reflect what it plans to be. The website is out of date, inaccurate in parts and gives the impression of a commercial organisation, with banner advertisements on most pages.

6.14 More generally the CSC must cease commercial activities such as support for particular providers of goods and services. Sponsorship is not unreasonable but sponsors should not be able to gain any commercial benefit as a result.

6.15 The introduction of proper governance arrangements – covered below – is an essential part of clarifying the CSC's role and positioning it as a regulator.

The four major issues

6.16 There are four major issues that the CMC needs to address, preferably simultaneously, and with some urgency, if it is to be in a position to be designated as the regulator under the Compensation Act -

- Introducing proper governance arrangements.

- Increasing the membership, in particular to cover the major claims management companies that are not already members.
- Developing and securing approval for the code of practice and introducing arrangements to ensure that members comply with the code.
- Obtaining the resources to complete its work programme.

6.17 This chapter concentrates on governance, management and membership, and the following two chapters deal with the code of practice and resources.

Legal structure

6.18 It is appropriate that the CSC is a company limited by guarantee. However, the current memorandum and articles are deficient in a number of respects. The main problem is with the articles –

- The chief executive is also chairman, and there is separately a president whose role seems not at all clear.
- It is stated that eight members of the board of the CSC must be independent of the CSC. This is not possible. Board members cannot be independent of the organisation.
- The constitution of the board requires that two members are appointed by regulatory bodies such as the FSA. It is unlikely that regulatory bodies would be willing to appoint members of the board.
- Vice presidents are given specific roles, which is not appropriate.
- It is not clear who is entitled to become a member of the company.
- While there is provision for an annual meeting there is no time period within which it must be held.
- There is no provision for an annual report or indeed for annual accounts.

6.19 Basically, the articles are too detailed and not realistic in practice. Largely for these reasons they are not currently complied with.

6.20 It would be sensible to start again with a new memorandum and articles. To maintain flexibility and to keep matters as simple as possible, it is suggested that the board of the company and the governing body of the regulatory mechanism be kept separate. This could be done by the following mechanism –

- Having a memorandum that defines the aim of the company simply as being to put in place an effective regulatory mechanism for claims management activities.
- The articles should be standard articles for a company limited by guarantee with as few variations as possible.
- The articles should provide for a Council to be established, with terms and reference and a constitution determined by the board, to have responsibility for establishing and operating a self-regulatory scheme.
- There should be just three or four directors of the company whose functions for the most part would be purely nominal.

6.21 With this mechanism the members of the Claims Standards Council would not also be members of the company and the members of the governing body of the Council would not also be directors of the company. However, it would be necessary for some individuals or an organisation to take responsibility for the operation of the company itself and to provide the

directors. This would normally be done by a trade association but there is currently no association that could perform this role.

6.22 An alternative arrangement is for the directors of the company also to be responsible for the regulatory arrangements, a model that the Mortgage Code Compliance Board used. However, with this model, the regulated institutions still would not be members of the organisation.

6.23 The constitution of the Council itself could be a fairly simple document. The remainder of this section sets out what should be key elements.

6.24 The Council must have a governing body (called an Executive Committee here) which must command confidence among claims management companies, consumer organisations and government. It should comprise –

- An impartial and respected chairman.
- Three or four representatives of the claims management industry.
- An equal number of independent members who would be expected between them to have knowledge and expertise in consumer issues, the legal process and insurance.

6.25 In the normal course of events, the chairman and the independent members would expect to receive a fee.

6.26 There should also be provision for a chief executive who may or may not be a member of the Executive Committee (this is not a substantive point) who would be responsible for managing the work of the Council.

6.27 The functions of the Executive Committee would be –

- To develop a code of practice governing claims management activities and to secure OFT approval for that code.
- To develop a regulatory mechanism for claims management activities of which the code of practice would be the core part.
- To seek support from other organisations involved in the handling of claims, in particular to ensure compliance with the code of practice.
- To establish membership rules, which should include a commitment to comply with the code of practice.
- To implement arrangements for monitoring and ensuring compliance with the code of practice.
- To monitor activity by organisations that are not members but which falls within the scope of the Council and to report to the appropriate authorities contraventions of existing laws, regulations and standards.
- To take all possible steps to seek to ensure that the Council is designated as the regulator for claims management activities under the proposed Compensation Act 2006.
- To seek to encourage all organisations eligible for membership to join the Council.

6.28 The CSC is currently undertaking a number of these functions.

6.29 An outline draft of the terms of reference for the Council is set out in Appendix 2. The draft could easily be adapted if the alternative arrangement of the directors and the

Executive Committee being one and the same were adopted. As a matter of urgency, the CSC should work this up into a full document and should also seek to identify people to serve on the Council.

Management

6.30 As the chapter on resources will explain the task facing the CSC is significant and it cannot be done without adequate resources. The necessary management resources, in particular expertise and experience in regulation and consultation, must be available, perhaps for a limited period, to put the new arrangements in place. A small number of other staff will also be needed together with the usual support arrangements. The CSC needs to move quickly, and it will not do this without appropriate staffing which in turn it will not get unless it has some guaranteed funding.

Membership

6.31 Membership of the CSC has been growing rapidly, a normal reaction when there is the threat of legislation. However, at the moment, in effect anyone can join the CSC. There are minimal meaningful entry requirements, no vetting of members and no standards that have to be complied with. To some extent this is not the impression given from the CSC website. Members are joining for one or more of a number of reasons –

- Because they firmly believe in what the CSC is trying to do and are indicating their support.
- Because they wish to operate according to the highest standards and belong to the CSC to know what those standards are and how they should comply.
- To obtain advice from the CSC on matters such as advertising.
- As a marketing device, even if they intend to continue operating in an inappropriate way.

6.32 When the CSC is relaunched, with a meaningful code of practice, it needs to have already signed up most of the leading companies in the sector as this will help give credibility to the organisation and will encourage others to join. The CSC needs to assess its current membership, identifying the extent and nature of the business of each member, and also it needs to identify perhaps its twenty key targets for membership.

6.33 It needs to be made clear to members that they will have to comply with the revised code, that they will have to certify that they comply with it and that they will be audited against it. From a given time in 2006 those who do not comply must be removed from the list of members. New members should be asked to certify up-front that they comply with the code before they are allowed to join.

6.34 From among the current and new members, the CSC also needs to identify three or four individuals willing to serve on the Executive Committee of the CSC. Ideally, there will also be one or two companies that are prepared to play their part in establishing the limited company and perhaps being a director of it. However, given the jealousies within the industry this might well not be appropriate.

Chapter 7

Code of practice

7.1 An effective code of practice is essential if the CMC is to be a self-regulator and in a position to be an effective statutory regulator. However, voluntary codes of practice are fraught with difficulty; very few succeed. A voluntary code of practice can be effective if it is in practice a condition of doing business and in turn this requires supply chain support; generally an agreement by the major businesses in the supply chain that they will do business only with those companies dealing directly with the public who comply with the code of practice. This is how the advertising code of practice currently operates and this is how the codes of practice for general insurance and mortgage regulation worked prior to the FSA introducing a statutory regime.

The framework for codes of practice generally

7.2 There is now an official mechanism for recognising codes of practice through the Office of Fair Trading approved codes regime. This has taken some time to become effective and as yet only a small number of codes have been approved. However, the framework is generally accepted and there seems little point in producing codes of practice that meet any standards other than those of the OFT.

7.3 The OFT's criteria for approving codes of practice are –

- Code sponsors should have a significant influence on their sector.
- Compliance with the code shall be mandatory on code members.
- Code sponsors must have independent disciplinary procedures.
- Code sponsors must be able to demonstrate that organisations representing consumers, enforcement bodies and advisory services have been consulted throughout the preparation of the code and are consulted in the operation and monitoring of the code.
- The code should include measures directed at the removal or easing of consumer concerns and undesirable trade practices.
- Among the areas that codes should address are advertising, pre-contractual information, clear terms and conditions, delivery and completion dates, cancellation rights, guarantees and warrantees, protection of deposits or prepayments and after sales service.
- Code members must have in place mechanisms for dealing with complaints and a conciliation service must be available.
- There must be a low cost, speedy, responsive, accessible and independent redress scheme.
- The operation of the code should be regularly monitored.
- Code sponsors must develop performance indicators and must regularly assess customer satisfaction.
- There must be a procedure for handling non-compliance by members of the provisions of the code.

7.4 The OFT operates a two stage process. In the first stage the content of a code is approved, that is the OFT accepts that the code addresses the necessary issues and that the appropriate infrastructure is in place to ensure that the code is effective. The more important

second stage is when the code sponsor is able to demonstrate to the OFT's satisfaction that the code is effective in the market place. Code sponsors are not able to indicate that their code is approved until this second stage is completed. Indeed no publicity generally is permitted where only the first stage has been completed.

The CSC code

7.5 Given the advent of statutory regulation it is a legitimate question as to whether the CSC needs to be developing a code of practice which meets the OFT tests or rather whether it should be seeking to develop licence conditions more appropriate to a statutory regulator.

7.6 In practice the two need not be in conflict and there is much to be said for quickly developing a code of practice, the practical experience with which should help to inform the licence conditions. The OFT criteria are a suitable benchmark and attempting to meet those criteria is probably a sensible approach, although it should always be borne in mind that if the timetable for statutory regulation is achieved then this will supersede Stage 2 approval by the OFT. Most of the OFT's requirements will in fact also be requirements for the regulator.

7.7 The CSC has prepared a draft code that seems broadly satisfactory in terms of its content, that is it properly addresses the issues that consumers are concerned about. It goes well above legal requirements in a number of respects –

- A prohibition on aggressive or persistent forms of advertising such as cold calling.
- A number of restrictions on advertising including not offering any inducement for making a claim and not advertising in hospitals and surgeries.
- The provision of written advice on matters as such the risks involved in making a claim in terms of the possibility of loosing and owing money.
- A cooling off period of "a few days".
- A requirement to confirm the status of the company and to explain the relationship with a particular solicitor or a panel of solicitors.
- A requirement to hold money belonging to customers in client accounts.
- A requirement for companies to have a complaints mechanism.
- An independent arbitration scheme.

7.8 Citizens Advice has commented to the OFT on the draft code. The general approach is endorsed. However, Citizens Advice considers that the code remains underdeveloped on important issues of charges, costs, transparency, advice standards and financial security to protect the consumer and that many of its compliance measurements and enforcement tools are in development.

7.9 Citizens Advice considers that the code needs to address sales practices, including advertising, high pressure sales and mis-selling of CFAs by intermediaries and solicitors, misleading advice and the disappointing outcome for clients in terms of costs and awards. It recommends that the consumer code should include a section with a list of behaviours which are unacceptable including –

- Cold calling potential clients.
- Offering advice on the merits of a claim in order to obtain a CFA sale.
- Offering high risk legal insurance products when these are clearly inappropriate for the clients.
- Encouraging clients to sign agreements of which they have limited understanding.

7.10 On advertising and markets, it agrees that advertising in hospitals and other health care settings should be prohibited and that members should not market their services by unsolicited phone calls, email, text messages or letter.

7.11 It also wants a specific prohibition on unqualified intermediaries providing legal advice and a general 14 day cancellation period. The length of any cancellation period is a major issue, and needs careful consideration.

7.12 The CSC is currently discussing its code with the Office of Fair Trading, which has raised the following issues –

- The need to incorporate provisions from the membership code into the consumer code.
- Details of the people who will be involved in the disciplinary procedures.
- The resources available to operate and monitor the code.
- The need to consult a range of relevant bodies.
- The need to incorporate references to the Consumer Credit Act.
- The need for a fourteen day cooling off period.
- Details of the independent redress scheme.
- The development of performance indicators.
- Arrangements for publishing results.
- Arrangements for assessing customer satisfaction.

7.13 There are a number of other provisions in the code which merit careful consideration. At first sight the prohibition on advertising in hospitals and surgeries seems disproportionate. What is clearly improper and what should be banned under the code is unauthorised advertising, in particular by distributing leaflets.

Work to complete stage one of the OFT approved code scheme

7.14 A fair amount of work is needed to complete the first stage of the OFT's scheme. The issues raised by the OFT and Citizens Advice and also by the FSA need to be addressed.

7.15 The enforcement arrangements must be developed into a firm system, with a disciplinary panel and an appeal procedure. There are a number of models that can be used from other codes of practice. A key point is the need to have people to serve on the disciplinary panel.

7.16 Similarly, the arrangements for complaints need to be fully developed. Again, there are models from other codes of practice in respect of internal complaints arrangements. The CSC will need to put in place an independent procedure for where complaints have exhausted internal procedures. This can be done by appointing an independent adjudicator or by arranging a bespoke arbitration scheme.

7.17 The code also needs to be tested by the members as it seems probable that many members have not yet properly examined whether they are complying with the code as it stands.

7.18 The code will undoubtedly need some redrafting. It also needs a considerable amount of tidying up as at present it is rather lost in a longer document which includes some policy analysis and a commercial code. The code also uses "we" to refer at times to a claims

management company and at times to the Claims Standards Council. It would also be helpful for a much shorter summary version of the code to be produced, more readily understood by consumers.

Work to obtain stage two approval

7.19 Far more work will be necessary to obtain stage two approval, which will also be a costly process. Key points which would need to be undertaken are –

- Consulting consumer bodies, enforcement bodies and advisory services about the operation of the code.
- Implementing and publishing the results of performance indicators to demonstrate the effectiveness of the code.
- Assessing consumer satisfaction.
- Publishing an annual report on the operation of the code, including details of complaints.

7.20 In other words it is not sufficient simply to have a code of practice. Unless there is monitoring and enforcement activity the code in itself is worthless and indeed can give a false impression to the public. The nature of any compliance monitoring and enforcement regime is a matter that has to evolve taking account of discussions with the OFT. A fully effective regime would include the following –

- Initially, all subscribers to the code would have to complete a detailed statement confirming that they comply with each provision in the code and, where appropriate, providing the necessary evidence.
- An independent auditing mechanism should be developed which would involve a full audit of each subscriber to the code, say once every two years.
- In addition to dealing with complaints and using these as a trigger for possible enforcement activity, there should be regular surveillance of advertising as this is the means by which claims management companies obtain their business.

7.21 The code as currently drafted claims to have an enforcement mechanism which, on paper, seems reasonable. However, as yet, the mechanism has not been put in place nor have claims management companies been asked formally to confirm that they subscribe to the code. While all the various arrangements do not need to be in place in order to secure stage one of the code approval regime, they do need to be designed at the same time as stage one, resources provided for them and members need to be aware of what will be required of them.

A licence to trade

7.22 The code of practice with OFT approval might give reassurance to the public when they are choosing a claims management company but in itself would not be sufficient to deal with those companies that do not choose to comply with the code and are probably guilty of the most malpractice. Support from the supply chain would be essential to make claims management companies sign up to the code in the first place and secondly comply with it.

7.23 The key point should be the Law Society changing its rules such that solicitors would agree to take business only from claims management companies that subscribe to the code. It is understood that the Law Society has already made a commitment to this effect but only when the code has OFT approval. There is something of a chicken and egg problem here. Claims management companies will commit themselves to the code only if they know that solicitors will take business only from those companies that do comply with the code. This might require a somewhat firmer commitment from the Law Society. It should be noted here

that the Law Society already has fairly strict rules on referral fees but it is clear that these are not enforced. It is also questionable whether the Law Society could, in practice, prevent its members taking business from companies that did not subscribe to the code of practice while this still remains on a voluntary basis.

7.24 Similarly, it would be appropriate if health authorities agreed that they would accept advertising only from claims management companies that subscribe to the code.

Implementation and resources

7.25 It would be a major task to put in place a code of practice that will obtain OFT approval and in effect become a licence to trade. Adequate financing for the project needs to be available up front.

7.26 The starting point should be the commitment from the Law Society and health authorities so that everyone is clear that to a large extent the code of practice would be a licence to trade.

7.27 The work that would need to be done includes –

- Redrafting the code to meet concerns of the OFT and consumer bodies and also shortening and tidying up of the present wording.
- Testing the code with claims management companies to ensure that it is workable in practice rather than simply serving as a marketing device.
- Drafting an initial compliance statement which would also serve as a check list for claims management companies so that they could satisfy themselves that they do comply with the code. The initial compliance statement should be seen as a prototype for the statutory licence application.
- Commissioning an independent audit scheme.
- Stepping-up day to day surveillance of advertising, websites and other marketing material.
- Setting up and running a comprehensive complaints mechanism which should mean ensuring that each code subscriber has their own mechanism and that there is subsequently an arrangement for dealing with complaints where this is exhausted.
- Setting up and running a disciplinary scheme to deal with contraventions of the code.
- Publicising the code through the media and other ways.
- Liaising with the OFT in the process of securing code approval.

Appendix 1

The regulatory framework

1. This appendix sets out the context within which a regulatory body for claims management activities is being created. It describes existing legislation, boundary problems between regulators, the relative importance of enforcement as against new legislation and then the three separate government initiatives on regulation - the Hampton Review on effective regulation, the creation of the Legal Services Board and the Compensation Bill.

Existing legislation

2. Claims management activities are not currently unregulated. They are subject to both general and fairly specific regulation. The following general consumer legislation is relevant –

- The Trades Descriptions Act 1968.
- The Unfair Contract Terms Act 1977.
- The Supply of Goods and Services Act 1982.
- The Unfair Terms and Consumer Contracts Regulations 1999.
- The Consumer Protection (Distance Selling) Regulations 2000.
- The Electronic Commerce Regulations 2002.
- The Financial Services (Distance Marketing) Regulations 2003.

3. In addition, there is also –

- The regulation of advertising by the Advertising Standards Authority.
- Regulating the sale and conduct of after-the-event and before-the-event insurance by the Financial Services Authority.
- Regulation of loans taken out to finance legal activity under the Consumer Credit Act.
- Regulation of solicitors by the Law Society.

Boundary issues

4. There are frequently calls for a "one stop shop", such that consumers are not faced with competing or overlapping regulators in respect of what to them is a single transaction. Governments have accepted such pressure and have created a number of "one stop" regulators. This is of course a contradiction. Any product or service bought by consumers has competitive products or services which may or may not be considered to be within the same marketplace. These products may or may not have the same legal structure. For example, an extended warranty and an insurance policy serve the same basic consumer need but one is classed as an insurance product and the other is not. Similarly, a train and an aircraft are competing products for the consumer but are regulated in different ways. Demands for one stop shops may therefore often be an attempt to cover competing products. However, forward and backward linkages also become important here. The consumer may be dissatisfied with the quality of a product or the selling of it or the after sales services. The demands for one stop shops can therefore extend up and down the supply chain as well as sideways.

5. This is where one stop shops begin to collide with each other. The Financial Services Authority may provide a one stop shop for most financial services but it clashes with the one stop shop for advice in the form of Consumer Direct, local one stop shops run by trading

standards departments of local authorities and one stop shops for products where insurance is a small part, such as holidays and motor cars.

6. In short, the one stop shop is a myth. The real one stop shop can exist only where there is a single "shop", which is no more practical in respect of regulatory matters than it is in respect of retailing. The Hampton Review, considered subsequently, looked at this issue in the context of establishing a single regulator and concluded that it was not practical: "The wide range of areas for inspection in any but the smallest businesses means that a compliance officer or advisor could never understand the full range of regulations and criteria he or she was meant to enforce." The Hampton Review looked at 63 national regulators and concluded that 31 should be consolidated into seven, still leaving 32 acting independently, as well as the many regulators (including those for legal services) which it did not consider at all.

The importance of enforcement

7. The policy making process in Britain is often reactive, either to a single event or to a series of events. There are demands for "something to be done", with a number of parties emphasising the need for legislation to deal with the problem. Paradoxically, the same people often preface their remarks by pointing to the list of illegal acts already being perpetrated as justification for another piece of legislation. There is an argument that a licensing body will at least help to keep track of those operating within a marketplace, and may facilitate the enforcement of existing legislation by existing regulators, although such claims are generally asserted rather than proved. New regulators invariably announce that they will be working closely with regulators in related areas, in particular by adopting either a leading or co-ordinating role. However, each individual regulator continues to have their own targets and methods of working which may well not fit in with what the new regulator wants.

Policy on regulation generally – the Hampton Review

8. The government has been reviewing regulation generally. The Treasury commissioned Sir Philip Hampton to consider the scope for reducing administrative burdens by promoting more efficient approaches to regulatory inspections and enforcement without compromising regulatory standards or outcomes. Sir Philip's report was published on Budget Day in March 2005 and the conclusions were immediately accepted by the government as a whole without any external consultation. The proposals are now in the process of being implemented.

9. The Hampton Review covered all regulatory bodies except a number that were specifically excluded. Legal services were not excluded although the report does not specifically mention them in any respect, and indeed they do not fit in easily to its proposals.

10. The Better Regulation Executive has been created to oversee the implementation of the Hampton reforms and in effect has to approve any new regulator and the regulatory mechanism it puts into place.

11. The Hampton Review emphasises the importance of risk assessments in designing a regulatory framework, particularly in respect of requiring data from regulated institutions and inspection visits. Another important conclusion is that regulators should give "broad reach" advice to those who they regulate.

12. Much of the report is devoted to the regulatory structure. It pointed to the problems of running small regulatory bodies and concluded that: "Regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work."

13. It was also recommended that the administration of new policies and regulators should be based on a set of principles. These are reproduced below.

> **"Principles of regulatory enforcement**
> - Regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most;
> - Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take;
> - All regulations should be written so that they are easily understood, easily implemented, and easily enforced, and all interested parties should be consulted when they are being drafted;
> - No inspection should take place without a reason;
> - Businesses should not have to give unnecessary information, nor give the same piece of information twice;
> - The few businesses that persistently break regulations should be identified quickly, and face proportionate and meaningful sanctions;
> - Regulators should provide authoritative, accessible advice easily and cheaply;
> - When new policies are being developed, explicit consideration should be given to how they can be enforced using existing systems and data to minimise the administrative burden imposed;
> - Regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work; and
> - Regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection."

14. The report said that a major problem with the current regulatory structure was the problems caused by complexity, in particular overlapping areas of responsibility and small bodies having limited efficiency in the use of resources. The organisational problems of small bodies are analysed in paragraphs 4.26 and 4.27 which are reproduced below.

> "4.26 While smaller regulators can create small centres of expertise, they do not benefit from the sharing of experience and expertise that larger organisations can more readily embrace. The complexity of structure at a national level can be seen in the proliferation of small regulators – 31 regulators within the review's remit have fewer than 100 staff, and twelve have fewer than 20. Regulators of that size are unlikely to be able to allocate resources efficiently, and lack political and institutional prominence. Within themselves, they cannot carry out broad risk assessments, or easily understand the cumulative burden of the regulations they are imposing. More broadly, it is difficult for Government to allocate resources to areas of importance if funding for regulation is balkanised among so many different bodies.
>
> 4.27 Further, the existence of a large number of national regulators, with their different cultures, approaches and focus on specific market segments or business activities, significantly inhibits the prospect of introducing a collectively agreed

approach to risk assessment of inspection programmes and form filling requirements. A more consolidated regulatory landscape would allow not only the introduction of a more uniform approach to risk, but also simplify the process of ensuring that the national regulations adopt and mainstream Hampton principles."

15. Hampton concluded that consolidation of regulators should take place around key regulatory themes. One of the themes is "consumer protection and trading standards". The intention was that a new body would bring together the consumer protection work of the Office of Fair Trading with the responsibility of overseeing the work of local authorities on trading standards issues. However, in the Pre Budget Report the Chancellor announced that the proposal to establish a new body had been abandoned. Instead, a Local Better Regulation Office would be established and the OFT would take over the other functions envisaged for the new regulator.

16. These developments are relevant to any decision on the regulation of claims management companies. Some of the issues of concern, in particular misleading advertising and misrepresentation, properly fall within the province of trading standards departments but this is precisely one area where the trading standards service, based as it is in local authorities, is unable to cope and indeed exemplifies the need for a national body.

17. It is also relevant to note here a proposal made by the National Consumer Council, which has some interesting parallels to the claims management issue. The NCC has been concerned for some years about poor standards of work by garages in servicing cars. There is extensive evidence of malpractice, in particular theft (removing good parts and replacing by poor quality parts), obtaining money by deception (charging for work that has not been done), misrepresentation (claiming that work needs to be done when it does not) and in some cases breaches of health and safety law. Such malpractice can be identified only through mystery shopping exercises followed up by well planned and executed prosecutions which aim not only to deal with the particular case but also to serve as a deterrent to others. However, the resources do not currently exist to enable such work to be done. The NCC is proposing that the DTI should have the power to designate a sector where there is malpractice and that all companies operating in the sector should for a period of years pay a levy, the proceeds of which would be used entirely to enforce existing legislation. While this is being put forward with the car servicing industry specifically in mind it clearly could apply to other sectors including claims management companies.

The Legal Services Board

18. A White Paper, published on 17 October 2005, set out plans for an overarching Legal Services Board which would oversee the operation of frontline regulatory bodies such as the Law Society and the Bar Council. The intention is to use the Compensation Bill, which will go through the current session of Parliament, to add claims management activities to the list of what constitutes legal services. Currently, there are seven forms of legal service that are subject to statutory regulatory control –

- The right to conduct litigation.
- The right of audience in the courts.
- The provision of immigration services.
- Probate services.
- Conveyancing.
- Notarial services.
- Acting as a commissioner for oaths.

19. These services differ substantially from each other. Probate services, notarial services and acting as a commissioner for oaths are products in their own right. Conveyancing is merely one part of the house purchase process. The right to conduct litigation and the right of audience in the courts are the final part of a long chain where something has gone wrong, for example a faulty good or service, criminal activity or negligence.

20. The basic proposal is that the Legal Services Board will provide independent oversight of frontline regulators, which must meet standards set by the Board. The Board will also be able to implement voluntary schemes. A single office for legal complaints will also be established to deal with all consumer complaints in respect of legal services.

21. As is the case for regulation generally, it is expected that the legal sector should meet the costs of the new arrangements.

22. Frontline regulators will need to establish to the Legal Services Board that they have appropriate governance arrangements in place, in particular separating regulatory and representative functions. This means that it will not be possible for a trade association or a professional body also to be a regulatory body. In round terms, the new regulatory framework will cost around £80 million a year, with frontline regulators accounting for £46 million. The transition costs of setting up the LSB are estimated at £4 million.

23. Among the powers which the LSB will have over the frontline regulators (FLRs) are –

- Requiring FLRs to provide it with information to carry out its duties.
- To issue regulatory guidance to FLRs.
- To approve fees to be raised by FLRs.
- To set requirements for indemnity insurance arrangements of FLRs and practitioners.
- To set compensation fund requirements.

Compensation Bill

24. The Compensation Bill was published on 3 November 2005. The main features of the Bill are –

- The provision of claims management services will become a regulated activity unless the provider is exempted from being regulated.
- The Secretary of State for Constitutional Affairs can designate a regulator, establish a regulator or undertake the function of regulator.
- The regulator is given the usual powers but is also expected to increase public awareness of the regulation of claims management services, to encourage competition and to promote good practice.
- The Secretary of State has considerable powers to direct the regulator and will be responsible for making secondary legislation on the regulator's rules and fees.

25. In short gives the Secretary of State maximum flexibility in respect of how the regulator will be structured and function, with the longer term intention that oversight of the regulator will shift to the Legal Services Board.

Experience from other regulatory bodies

26. In devising a regulatory mechanism for claims management activities it is helpful to draw on the experience of other regulatory bodies, particularly those recently established. The following conclusions can be drawn –

- It is a mistake to see a new regulatory body as being an answer to any problem on its own. It has to be demonstrated how a new regulator will be able to deal with malpractice in a way that existing regulators cannot.
- Careful preparation is vital. Attempting to do things too quickly or being required to do things in a particular way that then no longer turns out to be appropriate can be damaging to a new regulatory body.
- Regulation will change the nature of the market. It is a mistake to believe that one can introduce meaningful regulation and that the market structure and market practices will remain as previously. Market participants take account of all market factors and this includes regulation. Companies in a market will reorganise their activities to take account of regulation which in many cases means reorganising in a way to avoid regulation.
- There are always boundary disputes. Wherever one draws the line there will always be somebody just on the other side of it, a point that combines with the previous one.
- There are turf wars between regulators and other public bodies, however well these might be managed.
- For the reasons that have already been explained, a one stop shop for regulation is impractical.
- All regulators begin with statements about concentrating on the key issues and not becoming process driven, but at the end of the day most become process driven and often finish up regulating documentation rather than substantive matters.
- The structure of regulation tends to follow the structure of government rather than the structure of a market. This is inevitable to some extent but will inevitably weaken the regulatory impact.
- All legislation which attempts to regulate economic activity has unintended consequences, many of which can easily be forecast in advance.

Appendix 2

Draft Claims Standards Council constitution

Introduction

1. This constitution was adopted by the Council on xxxxx.

Objectives

2. The objectives of the Council are –
    a) To implement a self regulatory scheme for claims management activities which addresses public concerns and to secure OFT approval for such a scheme.
    b) To work with the Department for Constitutional Affairs and others to build on the work of the Council to introduce statutory regulation of claims management activities.
    c) To monitor claims management activities generally and advise the Department for Constitutional Affairs on the development of the market and practices which require a regulatory response.

Membership

3. Any company or individual who provides claims management services is eligible to join and remain a member of the CMC subject to the following conditions –
    a) It agrees to comply with this constitution.
    b) It certifies that it complies with the CMC code of practice.
    c) It meets any training and competence requirements that the Council may require.
    d) It operates an internal complaints system which includes an external complaints arrangement in accordance with rules made by the Council.
    e) It complies with the terms of the monitoring and compliance arrangements for the code introduced by the Council.
    f) It agrees to be bound by the terms of the disciplinary scheme operated by the Council.
    g) It pays subscriptions in accordance with this constitution.

Associateship

4. Any organisation relevant to handling compensation claims but which does not provide claims management activities is eligible to be an associate of the Council on payment of a fee stipulated by the Council.

5. Associates are entitled to have access to all the information and advice services provided by the Council and may participate in activities organised by the Council as the Executive Committee may decide, but may not describe themselves as members of the Council.

Governance

6. The Council shall be governed by an Executive Committee which shall comprise –
    a) A chairman who shall be independent of the claims management industry.
    b) Four people who are active in the provision of claims management services.
    c) Four independent people who between them have expertise in consumer matters, legal matters and insurance matters.

7. The Committee shall elect one of the independent members to be Deputy Chairman whose role will be to deputise for the Chairman when necessary.

8. The members of the Executive Committee shall be appointed by a Nominations Committee which shall comprise –

a) The Chairman.
b) One member of the Committee who is active in claims management activities and one independent member.
c) Two people independent of the claims management industry who shall be nominated by the Chairman.

9. The Executive Committee shall –

a) Determine the code of practice and other membership requirements.
b) Appoint a Disciplinary Committee and determine the terms of the disciplinary arrangements.
c) Determine the monitoring and compliance arrangements.
d) Determine the complaints scheme including an appeal to an independent adjudicator.
e) Monitor the claims management market including advertising and sales practices.
f) Appoint a chief executive.

10. The Executive Committee may determine its method of operation subject to –

a) The quorum for meetings shall be four members.
b) On any of the matters listed in the previous paragraph no vote may be taken unless at least half the members present are independent.
c) In the event of an equality of votes the Chairman shall have a second or casting vote.
d) The Committee shall meet no fewer than five times a year.

Management

11. The Executive Committee shall appoint a Chief Executive who shall be responsible for managing the work of the Council.

12. The Chief Executive may employ staff and agree arrangements with external parties on terms agreed in advance by the Executive Committee.

Code of practice

13. It is a condition of membership that members are bound by the CMC code of practice. The Executive Committee has power to determine the content of the code of practice and in doing so and in considering changes shall –

a) Consult with consumer and other relevant organisations and the Department for Constitutional Affairs.
b) Seek to secure approval of the scheme under the Office of Fair Trading Approved Code Scheme.

Disciplinary scheme

14. The Executive Committee has power to determine this scheme subject to the following conditions –

a) The scheme shall deal with breaches of the code of practice or this constitution.
b) A Disciplinary Committee shall be appointed of people who may or may not be members of the Executive Committee.

c) Each case shall be considered by a panel of three members of the Disciplinary Committee, two of whom shall be independent of the claims management industry.
d) In considering a case, the panel shall hold an oral hearing.
e) Cases shall be referred to the panel by a sub-committee of the Executive Committee based on complaints made to the Council, the results of monitoring activities and other information drawn to the attention of the Council.
f) A disciplinary panel shall have available to it a range of sanctions from a reprimand to expulsion.
g) The arrangements shall include an appeal procedure.

Complaints

15. Members are bound by the terms of the CMC's complaints scheme, the terms of which shall be determined by the Executive Committee but shall include –

a) A requirement for members to have internal claims management procedures.
b) The appointment of an independent adjudicator whose decisions on claims will be binding on members.
c) The publication of statistics and other relevant information resulting from the consideration of complaints.

Finance

16. Members shall pay a fee as may be determined from time to time by the Executive Committee.

17. The Executive Committee shall cause appropriate accounts to be maintained.

18. The Executive Committee shall appoint auditors to the Council.

19. The Executive Committee shall within four months of the end of each year publish an annual report and accounts, copies of which shall be sent to each member of the Council.

Additional membership requirements

20. On applying to become a member of the Council, an individual or organisation shall –

a) Confirm that it complies with the terms of the code of practice and this constitution.
b) Comply at all times with the code of practice.
c) Confirm annually that it has complied with the terms of the code of practice
d) Provide to the Council any information that the Council may request.

Transitional provisions

21. The initial Executive Committee of the Council shall comprise –

…..(chairman)
[four independent members]
[four members representative of claims management activities]

22. The initial Nominations Committee shall comprise –

….(chairman)
….(independent member)
…..(industry member)
[two other members]

23. The annual fee scale shall be –
[ ]

24. The fee for an associate shall be[