EXPLANATORY MEMORANDUM TO

THE COMPENSATION (CLAIMS MANAGEMENT SERVICES) (AMENDMENT) REGULATIONS 2014

2014 No. 3239

1. This explanatory memorandum has been prepared by the Ministry of Justice and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument makes provision for the Claims Management Regulator (CMR) to impose financial penalties on the persons regulated by the CMR ("authorised persons"). In addition, this instrument makes provision restricting an authorised person, in certain circumstances, from surrendering its authorisation without the consent of the CMR.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This instrument amends the Compensation (Claims Management Services) Regulations 2006 (S.I. 2006/3322) ("the 2006 Regulations"). The powers to make regulations to allow the CMR to impose financial penalties were recently introduced by section 139 of the Financial Services (Banking Reform) Act 2013 as an amendment to the Compensation Act 2006. This instrument provides the first use of these powers.

4.2 The instrument is being made to provide the circumstances in which a penalty may be imposed; the processes to be followed by the CMR in determining the amount of, and in imposing, any penalty. It also includes provision on enforcement and collection of the penalty as a debt.

4.3 The instrument also amends and supplements regulation 14 of the 2006 Regulations, which allows a regulated claims management company ("CMC") to surrender its authorisation. The amendments provide for circumstances in which the power to surrender will be restricted if a CMC is being investigated by the CMR, if a CMC has been asked to provide information under a notice under regulation 36 of the 2006 Regulations or if a CMC's behaviour has given rise to a search warrant.

5. Territorial Extent and Application

5.1 This instrument applies to England and Wales.

6. European Convention on Human Rights

6.1 The Minister of State for Justice, Lord Faulks QC, has made the following statement regarding Human Rights:

"In my view the provisions of the Compensation (Claims Management Services) (Amendment) Regulations 2014 are compatible with the Convention rights."

7. Policy background

7.1 The role of the CMR is performed by the Secretary of State for Justice (as a separate Regulator has not been appointed under the Compensation Act 2006) through the Ministry of Justice's Claims Management Regulation Unit. The Secretary of State is directly responsible for regulating the activities of businesses providing regulated claims management services within England & Wales.

7.2 All regulated claims management companies (CMCs) are required to comply with certain conditions of authorisation including adherence to the Conduct of Authorised Persons Rules[1] which are set by the Regulator. At present, non-compliant CMCs can face statutory enforcement action by the CMR which can lead to the variation, suspension or cancellation of their authorisation to provide regulated claims management services.

7.3 Bad practice by a minority of regulated CMCs has created poor outcomes for consumers and defendant businesses, such as financial service providers. Some regulated CMCs have for example submitted claims where no relationship exists between the consumer and the defendant business or have made claims where no relevant product had ever been sold to a consumer. These issues, amongst others, have led to delays in receiving compensation for some consumers who have legitimate claims, and has increased costs for defendant businesses where claims are unsubstantiated.

7.4 During the 2013/14 regulatory year, a total of 198 regulated CMCs had their authorisation cancelled, 2 were suspended and 1 CMC had the terms of their authorisation varied. At the end of March 2014, there were a total of 2,097 CMCs authorised to provide regulated claims management services.

7.5 The variation of authorisation conditions, suspension or cancellation of a regulated CMC's authorisation can be disproportionate to the misconduct in certain cases. In

[1] https://www.gov.uk/claims-management-company-regulations-guidance-and-legislation *(Please note that from 1 Oct the Conduct of Authorised Persons Rules 2013 (2) are to be superseded by the Conduct of Authorised Persons Rules 2014 – Copies of the rules can also be requested via email to claimsmanagementregulation@justice.gsi.gov.uk)*

order to align itself with other comparable regulators, and to provide a more tailored and proportionate enforcement option, the Regulator wishes to expand its enforcement toolkit with the addition of a financial penalties sanction.

7.6 The Instrument sets a maximum amount for any penalty. This maximum has been chosen because it largely mirrors the maximum amount of penalties seen in existence with other similar Regulators. For example, the Financial Conduct Authority currently has a maximum penalty of 20% of turnover for firms under its remit. The maximum amount also takes account of the fact that there are very large firms with considerable means that may be subject to a penalty and that the penalties for these firms must be large enough to be a deterrent. The penalty will be set by reference to an authorised person's turnover to ensure proportionality but also to ensure that the deterrent and punishment level is relative to the size of the business. This will be considered in conjunction with an assessment of the nature and seriousness of a breach to ensure a penalty has maximum effect. The Instrument establishes a fair and transparent procedure for the imposition of a penalty. The procedure is based on the procedure in Part 10 of the 2006 Regulations. The authorised person will be given a detailed notice of the CMR's proposal to impose a penalty and will be given an opportunity to make written submissions. The CMR is obliged to take into account any submissions made. Appeals against a penalty are covered by section 13 of the Compensation Act 2006. The Instrument also provides for the treatment of any unpaid penalty as a debt to ensure that the penalty can ultimately be recovered and to ensure that an authorised person does not simply refuse to pay following the request for payment to the Regulator. This will also ensure that the action of imposing and enforcing a penalty is as robust as possible.

7.7 In addition to this the Instrument provides for a restriction on a CMC from surrendering its authorisation in certain circumstances such as once an investigation has been commenced into its professional conduct. Currently a CMC may surrender its authorisation at any point, even whilst enforcement action is ongoing. This presents the Regulator with operational implications in that its remit does not extend to those businesses once they have surrendered. This new provision would prevent the CMC from surrendering its authorisation and allow the Regulator to impose enforcement action where necessary, which the Regulator could then publish on its website and also to take into account should the CMC apply for another authorisation at a later date. Each of these outcomes would act as a deterrent and would help prevent rogue CMCs from simply re-appearing under a new name.

- ***Consolidation***

7.8 While this instrument is not the first set of amendments to the 2006 Regulations, it is the first significant set of amendments and so the Department does not consider that there is a case for consolidation at the present time.

8. Consultation outcome

8.1 The consultation paper Claims Management Regulation Regulatory Enforcement – Financial Penalties was published on 31 March 2014 and ran for a period of 4 weeks[2]. It invited comments on the proposed expansion of the Regulator's enforcement tools to include a financial penalties scheme. It also asked about the proposals to restrict surrender of authorisations in certain circumstances. All responses to consultation were in support of the implementation of a financial penalties scheme and were in agreement that a restriction on surrender would also need to be put in place in order to ensure that the scheme can operate effectively.

8.2 72% of the responses came from financial services providers, claims management company (CMC) trade bodies and other organisations. 28% of the responses were received direct from regulated CMCs. Broad support for the implementation of a financial penalties policy was received from those that responded to the consultation.

8.3 The final scheme has been subject to amendment following feedback received from the consultation process and further internal analysis. In order to ensure that the Regulator can exercise maximum flexibility and proportionality in deciding an appropriate figure for non-compliant CMCs of all sizes, there will be no minimum penalty level for any CMC - as opposed to the initial proposed minimum of £500 for CMCs declaring turnover below £500k and 0.1% of turnover for CMCs declaring turnover of £500k and above which was set out in the consultation. This will allow the Regulator to fully tailor the appropriate level of penalty once the means of a CMC have been assessed.

9. Guidance

9.1 The claims management regulation enforcement and publication policies are to be updated to include the financial penalties provisions and the new rules on restrictions on surrender. The existing enforcement process will continue to be followed however, the Regulator is now able to consider the imposition of a financial penalty as well as the existing options to vary the authorisation conditions, or to suspend or cancel the authorisation of an authorised person. The updated polices will be sent direct to all regulated CMCs, published online at the regulator's website and will also be covered in the monthly regulatory bulletins which are also published online and sent direct to regulated CMCs accordingly.

10. Impact

10.1 There is no impact on compliant businesses, charities or voluntary bodies.

10.2 The impact on the public sector is minimal. Claims Management Regulation operates on a full cost recovery basis, is self-funding and any administration costs

[2] https://consult.justice.gov.uk/digital-communications/claims-management-regulation

incurred when imposing or enforcing a penalty are to be deducted from the final penalty amount before the remainder is passed to the Consolidated Fund.

10.3 An Impact Assessment has not been prepared for this instrument because it is a low cost measure and is expected to have a minimal impact.

11. Regulating small business

11.1 The legislation applies to small business however, only non-complaint Claims Management Companies (CMCs) classed as small businesses are at risk of being affected. There will be no impact on compliant CMCs employing up to 20 people.

12. Monitoring & review

12.1 The addition of a financial penalties sanction is expected to improve conditions within the regulated claims management industry, providing an additional deterrent from malpractice and more proportionate outcomes when imposing regulatory sanctions on non-compliant CMCs.

12.2 The effectiveness of the new and existing sanctions will continue to be monitored constantly as part of the general operation of the regulatory regime and will be reflected in the published claims management regulation annual review which is publicly available at the end of each regulatory year.

13. Contact

13.1 Mr Ashley Palmer at the Ministry of Justice Tel: 0203 334 6831 or email: ashley.palmer@justice.gsi.gov.uk can answer any queries regarding the instrument.