



Ministry of  
**JUSTICE**

**Claims Management Services Regulation**

**Impact of Regulation**

**Initial Assessment**

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# Ministry of Justice

## Claims management regulation

### Impact of Regulation – Initial Assessment

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## Introduction

The Compensation Act 2006, providing for the regulation of claims management services, received Royal Assent on 25 July 2006. The Act was commenced; the regulatory regime including the regulations and rules were quickly put in place; applications for authorisation were invited from 30 November 2006; and the prohibition on providing regulated claims management services without authorisation was commenced on 23 April 2007.

This paper provides an initial assessment of the impact of regulation. It is being written a little over three months after the commencement of full regulation. This is long enough to enable some meaningful conclusions to be drawn. The approach has been to take the objectives of regulation, quantified to an extent in a Baseline Study as the starting point. A tentative assessment is then made of the initial impact of regulation in each of the sectors subject to regulation.

A second evaluation of the impact of regulation will be completed by the end of 2007.

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# 1. Executive summary

## Background

1. There has been significant malpractice in the provision of claims management services, particularly in relation to personal injury cases. The Compensation Act 2006 provides for the regulation of claims management services in respect of personal injury, criminal injuries compensation, Industrial Injuries Disablement Benefit, employment, housing disrepair and financial products and services.
2. The Secretary of State for Justice is formally the Regulator; an outsider was brought in as a temporary civil servant and made the first Head of Claims Management Regulation; and authorisation, monitoring and compliance work is handled by a Monitoring and Compliance Unit, provided by Staffordshire County Council Trading Standards Unit under contract to and under the management of the Department.

## The objectives of regulation

3. The overriding objective has been to increase the protection of consumers of claims management services, in particular -
  - To tackle practices that have led to misperceptions and false expectations of compensation claims.
  - To improve the efficiency and effectiveness of the system for those who have valid claims.

## The approach

4. The approach to achieving the objectives has been -
  - Understanding the market.
  - Understanding the effects of regulation.
  - Identifying how regulation can be effective, in particular “pressure points”.
  - Drafting Rules of Conduct that address malpractice.
  - Devising authorisation and compliance procedures to ensure that the Rules of Conduct are complied with.
  - Working in partnership with other enforcement agencies.
5. Different approaches have been needed for the different markets; the approaches in the two principal markets - personal injury and financial services claims - have been very different.
6. A Baseline Study, published in April 2007, set out an analysis of the markets and the approach that would be adopted.

## The authorisation process

7. The authorisation process has worked well. There were no significant problems with the application form or the technology. Feedback from applicants indicated broad satisfaction with the arrangements. The process has made a significant contribution to meeting the objectives of the legislation –
  - Claims management businesses realise that this is a serious regulatory regime that is likely to be enforced.
  - Deficiencies in websites and contracts have largely been addressed. In itself this means that much of the malpractice in respect of endowment claims has already been dealt with.
  - A significant amount of information has been gathered on businesses that might seek to trade without authorisation.
  - Authorised businesses that pose some risk to the achievement of the regulatory objectives have been identified.

8. The process provided the necessary platform on which monitoring and compliance work can be effective.

9. One significant lesson was that many applications were of a very poor quality. Perhaps the degree of this could have been anticipated given that the businesses to which regulation was being applied had little or no previous experience of regulation. More account could also have been taken of the nature of the applicants.

### **Personal injury**

10. The Baseline Study identified five principal problems – misleading advertising; improper acquisition of business; opaque contracts; cases being run for the benefit of the intermediary not the client; and fraud. The Rules of Conduct banned cold calling in person, required any other cold calling to be in accordance with industry codes and prohibited business being acquired in a way that would put the solicitor to whom the business was passed in contravention of the rules governing solicitors' conduct.

11. Misleading use of the expression "no win no fee" and other misleading advertising have largely been dealt with in the authorisation process.

12. A small number of businesses that actively engaged in cold calling were identified and action has been taken to ensure that they comply with the Rules. A close working relationship with the Solicitors Regulation Authority (SRA) has been essential for this to be achieved. This has achieved reasonable success but there is still more work to be done.

13. Vigorous action has been taken against unauthorised marketing in hospitals. It is estimated that the amount of such marketing in hospitals has been reduced by about 90%.

14. There remains a significant amount of work to "clean up" selling practices.

### **Personal injury – contrived accidents**

15. Contrived accidents lead to false insurance claims, predominantly personal injury, in excess of £200 million a year and are connected with other criminal activity. While insurance fraud was on the agenda when the legislation was enacted, contrived accidents were not. When its importance was realised, a strategy was developed involving co-operation with the SRA, the Insurance Fraud Bureau, the Insurance Fraud Investigators Group and the City of London Police. Work is at an early stage but seems capable of having a significant impact on the problem.

### **Criminal injuries compensation**

16. Criminal injuries compensation is a very small market (under £1 million a year) for claims management businesses. Some intermediaries have sought to give the impression that they are part of the official process and have also used unfair contracts. These issues have largely been addressed through the authorisation process.

### **Industrial Injuries Disablement Benefit**

17. Industrial Injuries Disablement Benefit is also a small market (under £1 million a year). Most businesses are also in the personal injury market. There has been limited malpractice and this will have been partly addressed in the authorisation procedure.

## **Employment issues**

18. Claims management companies have a small role in the employment market. This has not been a priority area for the first phase of regulation. The main issue in this sector appears to be quality of service.

## **Endowment claims**

19. This is a large market with a turnover of about £75 million a year. The main problem areas have been misleading information on websites, in particular the use of scare tactics, and contracts that are weighted against the consumer. These issues have largely been dealt with through the authorisation process. The complaints rules established under claims management regulation should deal with most remaining malpractice.

## **Other financial products**

20. Reclaiming bank charges, alleged to be unfair, became a big market as the regulatory regime was being implemented. Malpractice is similar to that in the endowment market and has largely been addressed through the authorisation process.

21. No significant market has developed in respect of other financial products.

## **Housing disrepair**

21. The market seems very small and local in nature. The strategy is to work with social landlords who perceive this as being a significant problem.

## **Conclusions and future work**

22. The regulatory regime for claims management activities is considered to have had a significant effect in reducing malpractice less than one year after the Compensation Act 2006 received Royal Assent. Specifically –

- Cold calling in person has been significantly reduced.
- Unauthorised marketing in hospitals has been reduced by about 90%.
- A joint approach is in place with the SRA to reduce other malpractice in the acquisition of personal injury claims.
- An effective short-term strategy has been developed for dealing with contrived accidents; the Department is also taking a co-ordinating role for the various enforcement agencies and the insurance industry.
- Malpractice by companies handling claims against the Criminal Injuries Compensation Authority has been significantly reduced, including through some companies voluntarily leaving the market.
- Misleading use of the expression “no win no win” has largely been eliminated.
- Misleading claims on websites have been almost entirely removed and rules requiring websites to give a physical address are being complied with.
- The malpractice there was in respect of handling endowment claims has largely been removed.

23. There also remains much work to be done, in particular –

- Regular surveillance of websites to ensure that bad practices do not return.
- Eliminating all cold calling in person.
- Implementing the short term strategy on contrived accidents and developing a longer term strategy with partner agencies.

- Ensuring that the “exempt introducer” concept is not abused and beginning to deal with the unseen malpractice in the acquisition of personal injury claims, including ensuring full compliance with the SRA rules and the Rules of Conduct throughout the supply chain to solicitors.
- Seeking to ameliorate the regulatory burden on small businesses, particularly those where regulated activities are a small part of their total business.
- Ensuring that the regular closing down and creation of businesses is not used as a means of prolonging malpractice.

24. The following table is reproduced from the Baseline Study (April 2007) with the addition of a final column on the right summarising impact.

<b>Market sector</b>	<b>No of businesses</b>	<b>Estimated annual size of market</b>	<b>Malpractice</b>	<b>Prognosis</b>	<b>Impact July 2007</b>
Personal injury	1,128	£190m	Aggressive selling. Marketing in hospitals. Misleading contracts. Involvement in fraud.	Most difficult sector. Regulatory arbitrage and attempts to get round regulation are certain.	Marketing in hospitals and misleading contracts largely dealt with. Arrangements in place to deal with aggressive selling and fraud.
Criminal injuries compensation	340	£1m	Claimants deceived into thinking they are dealing with CICA.	Good	Significant; problem largely dealt with.
Industrial injuries disablement benefit	165	£1m	Claimants deceived into using intermediary.	Good	Probably significant but evidence still being gathered.
Employment matters	130	£2m	Claimants deceived into using an intermediary.	Difficulty will be identifying malpractice.	Some evidence of poor quality advice and representation.
Endowment mi-selling	176	£75m	Scare selling tactics. Clients dropped if cases difficult.	Good, but a large sector to tackle.	Significant; malpractice largely eliminated.
Other financial products		£1m	Claimants deceived into dealing with an intermediary.	Should be able to prevent malpractice being developed on a significant scale.	Malpractice prevented from being developed in respect of bank charges.
Housing disrepair	65	£1m	Aggressive selling.	Local in nature, so problem will be to identify.	Evidence being gathered.
<b>Total</b>	<b>1,256<sup>2</sup></b>	<b>£271m</b>			

<sup>2</sup> Total is the total number of authorised businesses. Figures above the total shows the number of businesses active in each sector. Many businesses provide services in more than one sector.

## 2. Background

### The need for claims management regulation

2.1 Over the last ten or so years a small industry has grown up of businesses that help people obtain compensation. This has been influenced by government policy initiatives – the introduction of conditional fee arrangements and the requirement on insurance companies to respond in a particular way to complaints about the mis-selling of endowment policies.

2.2 Whilst solicitors are the principal providers of claims management services, the traditional culture of the legal profession, combined with the professional regulation to which solicitors are subject, allowed new entrants into the market who were subject to no regulation at all. Standards have varied from very good to very poor, but with no mechanism for excesses at the poor end of the scale to be addressed.

2.3 In the personal injury sector four main types of malpractice have been identified –

- a) Misleading advertising, in particular suggestions that making a claim is easy and that large amounts of compensation can be quickly obtained.
- b) Opaque and unfair contracts that conceal the nature of the arrangement between client and claims management business and may also conceal costs that have to be paid.
- c) Cases being run for the benefit of intermediaries not the client.
- d) Outright fraud, particularly as a result of staged accidents.

2.4 The malpractice contributed to the two largest businesses, Claims Direct and The Accident Group, failing in 2003/04.

2.5 Similar malpractice could be found, on a lesser scale, in respect of claims for Industrial Injuries Disablement Benefit, criminal injuries compensation and housing disrepair.

2.6 In respect of endowment claims, malpractice has largely been misleading advertising, stressing how difficult it was for people to claim compensation directly, and opaque and unfair contracts.

2.7 The government initially responded to concerns about malpractice by seeking self-regulation from the industry. When it became clear that this could not be delivered, the government decided to legislate.

### The Compensation Act 2006

2.8 The Compensation Act 2006 became law on 25 July 2006. The Act and subsequent secondary legislation subject the following activities to regulation -

- (a) advertising for, or otherwise seeking out (for example, by canvassing or direct marketing), persons who may have a cause of action;
- (b) advising persons on the merits or handling of causes of action;
- (c) making representations on behalf of claimants;
- (d) referring details of potential claims or potential claimants to other persons, including persons having the right to conduct litigation;
- (e) investigating, or commissioning the investigation of, the circumstances of, the merits of, or the foundations for, potential claims, with a view to the use of the results in pursuing the claim.

2.9 Claims in respect of the following are covered -

- (a) personal injuries;
- (b) criminal injuries compensation;
- (c) Industrial Injuries Disablement Benefit;
- (d) employment;
- (e) housing disrepair;
- (f) financial products and services.

- 2.10 A number of businesses are exempt from the need to be authorised under the Act –
- (a) legal professionals;
  - (b) independent trade unions;
  - (c) insurance companies, insurance brokers and IFAs providing a claims management service who are regulated under the Financial Services and Markets Act 2000;
  - (d) charities and advice agencies providing a service free of charge;
  - (e) certain very small scale introducers although they need to comply with the rules on advertising, marketing and soliciting business.

### **The regulatory structure**

2.11 The time period from drafting the legislation to Royal Assent was very brief. At the time the legislation was drafted no decision had been taken as to the regulatory structure. The legislation accordingly allowed any option. The Secretary of State could establish a new regulatory body, designate an existing regulatory body to be the regulator or be the regulator himself. Initially, it was hoped that a trade body, the Claims Standards Council, could be the Regulator. This was evaluated and the result was that this was not a realistic option. Existing regulators were considered but none were both willing and able. This left direct regulation by the Secretary of State as the only option.

2.12 An innovative structure was developed. While the Secretary of State was formally the Regulator, an external expert (the author of this report) was brought in as a temporary civil servant to be Head of Claims Management Regulation and exercise the powers on behalf of the Secretary of State. The purpose was to have an identified Head who would have a public profile above that normally associated with individual civil servants (and similar to that of the heads of NDPBs), in the first year of operation. Much of the regulatory work was seen to be similar to that undertaken by local authority trading standards departments. It was considered that using such a service would enable the regulatory regime to be up and running as quickly as possible. Staffordshire County Council was selected, after an open tender process, to provide monitoring and compliance services under contract to the Department. It was appointed at the beginning of September 2006 and was in a position to deal with applications for authorisation within three months. The Monitoring and Compliance Unit (MCU) reports directly to the Ministry of Justice and all regulatory decisions are made by the Department.

2.13 The final part of the regulatory structure is the non statutory Regulatory Consultative Group. This Group comprises representatives of relevant major stakeholders including claims management businesses, other regulators, trade associations and consumer organisations. It has proved to be a very effective body in the consultation process, in particular by providing a forum in which all the parties are represented and are prepared to defend and argue their views. The Group has also helped to ensure support for the regulatory regime. This is not surprising. People are more likely to support something that they have been involved in and where they have had the chance to hear and debate the views of other stakeholders, than where they have only had a dialogue with the government department.

### **The objectives of regulation**

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

“This proposal aims to provide better safeguards for consumers of claims management services. It is designed to encourage the provision of quality services, to enhance consumer protection and to provide consumers with a clear route to redress. In particular, the proposal aims to improve the effectiveness and efficiency of the system for those who have a genuine claim to compensation, and to tackle practices that have helped to spread the misperceptions and false expectations of compensation claims amongst consumers. This will help to build consumer confidence and promote effective competition within the sector, whilst ensuring that the sector will be able to contribute effectively to the widening of access to justice.”

### 3. The approach

3.1 Success in any field depends on having the right strategy. The success of claims management regulation depended largely on the work carried out between June and October 2006 in developing the structure, writing the rules and planning enforcement.

#### **Understanding of the market**

3.2 The first essential for regulating a market is to understand it. This was not easy in respect of claims management services. The overall market is small and not well documented. Also there are, in effect, a number of different markets with little in common in respect of either issues or market participants. The approach was to talk to relevant people, both in bilateral meetings and at a series of consultation meetings and to apply basic analytical tools to understand the dynamics of the market.

#### **Understanding of the effects of regulation**

3.3 There are a number of predictable effects of regulation in any sector –

- If possible, businesses will legitimately be restructured to avoid the need to be regulated.
- Existing businesses, particularly where they have been engaged in malpractice, will be closed down and new businesses started.
- Businesses will look for loopholes to exploit and will generally succeed.
- There will be the potential for turf wars between regulators or a clash of regulatory approaches, which again some businesses will seek to exploit.
- Government departments and regulators generally miss deadlines they set and take longer to implement regulation than they said or than was reasonable to expect.
- In order to get legislation through Parliament, departments sometimes have to agree to put certain provisions on the face of the legislation or to agree to introduce secondary legislation that in retrospect is inappropriate and which hinders the achievement of the objectives of the legislation.
- The consultation process will not be fully effective because most of those responding have vested interests and the views of some groups, particularly consumers, will not be represented at all. As a result regulations often fail to achieve their desired purpose.

3.4 These factors were consciously on board throughout the process. The primary legislation was relatively simple and flexible, providing sufficient scope for Regulations and Rules to be used (and amended quickly) to respond to and deal with most developments - and changes have been made where needed. There was a very effective consultation process involving formal consultation exercises, bilateral meetings with major stakeholders, regional meetings and round table discussions at the Regulatory Consultative Group. As a result there has been a broad measure of agreement on every major decision.

3.5 The ambitious timetable was met. This preserved the momentum, helping to ensure that Regulations and Rules would not be out of date by the time that they were implemented.

#### **Identifying how regulation can be effective, in particular “pressure points”**

3.6 Broadly speaking regulators can try a broad brush or targeted approach. The broad brush approach is expensive, time consuming and generally ineffective. A targeted approach is better, but only if the targets are properly identified and the action efficiently delivered. The Department could not hope to monitor and enforce rules by individually monitoring a few thousand businesses. The approach has been to identify how regulation can most effectively be implemented. The Department identified websites as a target across the board, simply because they are a major marketing channel and cannot be concealed. In individual markets the approach has been to seek to make it difficult for those engaging in malpractice to do business as well as seeking to enforce Rules of conduct on them. Specifically –

- At the end of every personal injury claim is a solicitor. If there has been malpractice in the acquisition of business then the solicitor taking the business has breached the rules governing solicitors' conduct as well as the introducer breaching the Rules of Conduct under the Compensation Act. The Department has therefore sought to work closely with the SRA and will pass on to the SRA details of solicitors accepting cases from authorised businesses that have been found to be breaching the rules.
- At the end of every criminal injuries compensation claim is the Criminal Injuries Compensation Authority. The Department has worked with the Authority which has agreed to refuse to deal with unauthorised businesses and to report unauthorised businesses and businesses engaged in malpractice to the Department
- The banks and the insurance companies have been asked to refuse to deal with unauthorised businesses and to report malpractice to the Department.
- The Department is engaging with a number of other stakeholders to attempt to deal with the problem of contrived accidents.

### **Rules of conduct**

3.7 The Rules of Conduct are very brief but deal specifically with malpractice. There has been no attempt to "throw in the kitchen sink" or to force "best practice". The Rules target identified malpractice, for example specifically covering cold calling in person and unauthorised marketing in hospitals.

### **Enforcement**

3.8 It is essential that rules are enforced. If they are not the credibility of regulation will be undermined. The strategy from the beginning has been to enforce rigorously the Rules of Conduct and to demonstrate this. However, resource constraints have to be accepted. Enforcement activity has concentrated on the major issues with the expectation that the 'demonstration' effect would impact to some extent throughout the market.

### **Partnership working**

3.9 The Claims Management Regulator is small, with limited resources, and is operating in markets where there are other better resourced regulators including the SRA, the FSA and the Police. The approach has been to work with other regulators, recognising that unless this is done, the regulator cannot hope to be successful.

### **Baseline Study**

3.10 Impact can be measured only if there is an assessment of malpractice prior to regulation. Such a baseline study was duly completed and published on the website in April 2007. The Executive Summary of that study is reproduced as the Appendix.

## **4. The Authorisation Process**

### **Introduction**

4.1. The authorisation process has always been seen as a key part of the overall regulatory regime. It is, in itself, able to help ensure compliance with the various rules. A separate review of the Authorisation process (dated 24 May 2007) has been prepared. The Executive Summary is reproduced below.

### **Objectives of the authorisation process**

4.2 There were three principal objectives of the authorisation process –

- To set the tone for the whole regulatory regime so that the industry would know that this was a serious and professional regulator.
- To provide the platform on which monitoring and compliance work could be effective, in particular by obtaining the necessary information about authorised businesses.
- To provide aggregate data on the various markets subject to regulation.

### **Risk Framework**

4.3 A risk framework was prepared, identifying the factors associated with malpractice; this was used to influence the design of the application form and to shape the authorisation process.

### **The application form**

4.4 The application form was regarded as a vital part of the authorisation process. The FSA form was used as the starting point and there was both formal and informal consultation on the form.

4.5 Potential applicants had to provide contact details in order to obtain a copy of the form. A web-based form was used. Key features were –

- Where the form is completed online, all the necessary questions must be completed as the form is self-checking to some extent.
- Details are required of the business including principal place of business; registered address, if a company; and all website addresses.
- Details are required of the directors or partners and any other people able to have significant influence over the policy or management of the business.
- A requirement to state the sectors in which the business intended to operate and the turnover of the business.
- A detailed self-certification statement - businesses being required to confirm that they complied with or would comply with each of 26 provisions in the rules.
- A signed declaration that the information provided was correct.

### **The authorisation process**

4.6 The information provided on the application form was exhaustively checked, including Companies House checks and Google checks on the business and the people associated with it. Websites were checked for consistency with the information on the application form, the Rules of Conduct and the Electronic Commerce Regulations. In about 90% of applications it was necessary to go back to the business to request further information or to seek changes to websites or contracts.

### **Number and timing of applications**

4.7 Applications were invited from 30 November 2006; a deadline of 16 February was set for applications to be received to enable processing of applications to be completed in April. 1,007 applications were received by the deadline, 80% in the final two weeks. The prohibition under the Act was commenced on 23 April. A steady number of applications continued to arrive after the full commencement of the Act.

## **Assessment of the process**

4.8 The initial assessment of the process is -

- Generally, the strategy to get the message over about the need to be authorised was successful.
- The informal deadline for applications worked well and maintaining deadlines generally was effective.
- The quality of applications was very poor, greatly increasing the work required in the application process.
- The application process had a desirable effect on businesses and generally businesses seemed content with the process.
- Using a web-based system had huge advantages as did the requirement on businesses to provide contact details when requesting a form.
- Website checks, and to a lesser extent contract checks, resulted in a significant increase in compliance with the Rules of Conduct and general legal requirements.
- Some businesses engaged in malpractice were probably deterred from seeking authorisation.
- The data provided on the application form enabled the market to be mapped for the first time.
- Those businesses that requested an application form but did not apply, or which started the application process but did not finish it, have been identified; some may seek to engage in unauthorised activity.
- How businesses handled the application process has been used in the risk assessment process.
- The authorisation process was less effective in scrutinising businesses that were not companies and businesses without websites.

## **Risks and issues**

4.9 The IT system was fairly standard but nevertheless required design and testing. The time frame meant that there was little margin for error or for full testing. Had there been any errors or system failures this may have delayed the authorisation process. However, the work was completed in time and everything worked well.

4.10 The high number of applications necessitated increasing the number of staff and opening of a second office. This increased the risk of inconsistencies in dealing with applications. A clear procedure manual combined with quality controls minimised this risk.

4.11 The deadlines worked well. However, the number of applications was much higher than expected and 80% were received in the final two weeks. It was not possible to authorise late applicants and those that had applied before the deadline but that had failed to respond adequately to queries before 23 April. It had been assumed that there would be few applications after the deadline. In the event there have been more than 400. Resources had to be increased to handle the additional work and tactical decisions had to be taken on priorities.

## **Conclusion**

4.12 The preliminary assessment of the authorisation process is that it has been very successful.

4.13 The application form and authorisation process both worked well. There were no significant problems with the form or the technology. Feedback from applicants indicated broad satisfaction with the arrangements by businesses.

4.14 The process has made a significant contribution to meeting the objectives of the legislation –

- Claims management businesses realise that this is a serious regulatory regime that is likely to be enforced.
- Major deficiencies in websites and contracts have largely been addressed. In itself this means that much of the malpractice in respect of endowment mis-selling has been addressed.

- A significant amount of information has been gathered on businesses that might seek to trade without authorisation.
- Authorised businesses that pose some risk have been identified.

4.15 The process has given the necessary platform on which monitoring and compliance work can be effective.

4.16 Key success factors are considered to have been –

- The requirement to provide contact details in order to obtain an application form.
- Using a web-based application form.
- The self-certification compliance statement.
- The thorough checking of everything on the application form and websites.
- The short time frame, which concentrated minds and maintained momentum.
- The relatively small sector.
- The built-in enforcement right through the distribution chain.

4.17 Some things could have been improved –

- Ideally the website and application form should have been ready a week or two earlier for full testing. However, the timescale was short and the system did work well.
- Although additional resources were provided to deal with the higher than expected workload ideally these could have been increased even more around 23 April when volumes were at their absolute peak.
- Many applications were of a poor quality. Perhaps this could have been anticipated given that the businesses to which regulation was being applied had little or no previous experience of regulation. In retrospect the application form could have done more to require a better quality of application through forcing applicants to read the Rules of Conduct, providing more explanation on the form itself rather than in a guidance note and perhaps some reordering of questions so that mistakes would be more difficult to make.
- The combination of application volumes greatly exceeding all government or industry estimates; the low standard of many applications received, which meant they took longer to process; and many applications being received after the deadline, could not have been foreseen at the outset. Given a longer implementation timescale, it may have been possible to identify the trends a little earlier but the advantages of quick implementation are clear.

## 5. Personal injury

5.1 Personal injury was by far the largest sector being regulated. 1,306 businesses said that they intended to operate in this sector and the estimated annual size of the market was £190 million. The baseline study identified five main types of malpractice in respect of personal injury cases –

- Misleading advertising, in particular suggestions that making a claim is easy and that large amounts of compensation can be obtained quickly. The Conduct Rules deem websites to be advertising, and websites are also subject to the Electronic Commerce Regulations. The expression “no win no fee” has been used without the necessary qualifications rather too often. More generally, many websites of claims management businesses fail to comply with legal requirements governing electronic commerce generally.
- Improper acquisition of business through aggressive marketing techniques and misuse of personal information. At its worst this includes cold calling on the high street, on the doorstep and in hospitals. However, it can also include an insurance broker, a garage or an accident management company pressurizing a client to make a claim.
- Opaque contracts that conceal the nature of the arrangement between a client and claims management business and possibly also conceal costs that have to be paid. Contractual relationships may include an ATE policy and a loan taken out to finance the purchase of the policy (although this is now unusual), the business making its money through selling cases to solicitors and other fees. The contractual terms may well not be transparent.
- Cases being run for the benefit of intermediaries not the client. “No win no fee” is often not adequately qualified. Also significant is the “win but little compensation” scenario in which a claimant wins compensation but most of it is taken away in costs leaving the claimant with a small amount that does not make running the claim worthwhile.
- Outright fraud, particularly as a result of contrived accidents.

### Misleading advertising

5.2 The problem of misleading advertising has largely been dealt with in the authorisation process. In practice there has been little misleading national media advertising as such advertising is well controlled by the Advertising Standards Authority (ASA). Problems are more apparent at a very local level, in particular leaflets, and also on websites. All websites are scrutinised as part of the application process. No business was authorised unless its website –

- Complied with the ASA Help Note on use of the expression “no win no fee”.
- Complied with the Electronic Commerce Regulations by including a physical address.
- Did not otherwise include misleading information.

5.3 Businesses must comply with the new Companies Act 2006 requirements, by including details of their company registration, and must state that they are regulated by the Ministry of Justice in respect of regulated claims management activities.

### Cold calling in person

5.4 A small number of businesses have engaged in cold calling in high streets and shopping centres. While there is significant evidence of cold calling, the difficulty is identifying who is doing it. Dealing with this problem is, for this reason, labour intensive as hard evidence is needed. This is best obtained by test purchasers, which requires the regulator to have people in places where those cold calling operate.

5.5 The approach has been –

- Make the requirement clear and unambiguous, emphasising that the approaches of the SRA and the Department are identical.
- Deal vigorously with queries that seek to soften the definition of cold calling. Following a number of such challenges the Guidance Note on *Marketing and Advertising Claims Management Services* was amended to include the following -  
“Client specific rule 4 states that “cold calling in person is prohibited”. There have been a number of questions on what is meant by cold calling in person. The term should need little explanation. Any face to face contact initiated by the claims management

businesses is cold calling in person. This includes knocking on doors and approaching people in the street or shopping centres, including what is known as “clipboarding”. It is permissible to have a booth or stand in a shopping centre or exhibition as long as the people manning it do not attempt to make the first contact.”

- Seek evidence from other claims management businesses and solicitors, and also local authorities and town centre managers. Such evidence has frequently been volunteered.
- Pass on details of solicitors, who take cases from those engaged in cold calling, to the SRA with a request that the appropriate action be taken against the solicitor.

5.6 Almost all the larger businesses engaged in cold calling have ceased this activity as a result of enforcement activity. However, the problem has not been eliminated. It will continue as long as solicitors are prepared to pay upwards of £500 for cases procured in this way. The effect of regulation will be to fragment this procurement method such that it will be undertaken by individuals rather than businesses and then laundered through claims management companies. Although this is on a smaller scale than the organised businesses, it is more difficult to deal with. There is therefore an ongoing need to take enforcement action and also to work with the SRA to deal with those solicitors prepared to take cases acquired in this way.

### **Unauthorised marketing in hospitals**

5.7 This was identified as a specific problem in the Baseline Study. It has included placing thousands of leaflets, some containing the NHS logo, in hospitals without authority, and sometimes face to face marketing as well. The activity has been a significant nuisance to hospitals.

5.8 The rules of conduct specifically prohibited cold marketing in medical establishments without the approval of the establishment concerned. The MCU has sought evidence by, among other things -

- Requesting hospitals to send copies of unauthorised leaflets and details of when they were left.
- Collecting such evidence itself.
- Collecting information from other businesses.
- Collecting information from solicitors that have been approached to deal with the company.
- Requesting information from the businesses thought to be involved in such activity.

5.9 Enforcement action has been taken against businesses found to have been engaged in such activity.

5.10 The MCU's analysis of the situation, supported by the views of a company that has contracts to advertise in hospitals, is that unauthorised marketing in hospitals has been reduced by about 90%. However, as with cold calling, the economic incentive for such business remains and continued monitoring and, if necessary, enforcement action will be necessary as will obtaining details of the solicitors who take the cases and passing this information to the SRA.

### **Clients being pressurised to make a claim**

5.11 This malpractice is very difficult to identify; it is likely to come to light only through complaints. The scale of malpractice is not known but is probably modest.

### **Future work**

5.12 There are two related areas on which future work needs to be concentrated –

- Ensuring that the rules governing solicitors conduct and the Rules of Conduct are applied throughout the whole supply chain to solicitors.
- Removing any scope for abuse of the “exempt introducer” concept, particularly by claims farmers claiming to be exempt and “refer a friend” schemes.

## 6. Contrived accidents

6.1 While combating insurance fraud generally was one of reasons for the legislation, the issue of contrived accidents was not apparent until after Royal Assent. It is understood that contrived accidents result in fraud of over £200 million a year and that they are connected with other criminal activity. "Accident management companies" generally manage such frauds, of which multiple personal injury claims are a significant part.

6.2 Early analyses of applications for authorisation showed a significant number of applications for authorisation from accident management companies, with a heavy concentration in some geographical areas. Most were either sole traders or recently formed companies with one director. As soon as the Department realised the significance of the contrived accident issue it was elevated in importance and now is a high priority. A short term strategy was agreed -

- Seeking information sharing agreements with the Insurance Fraud Bureau (IFB), Insurance Fraud Investigators Group (IFIG), the SRA and City of London Police.
- Analysing claims management businesses, seeking to identify areas with an excessive concentration of businesses and evidence of informal franchise arrangements.
- Surveys of businesses in selected areas followed up by visits to businesses about which there are concerns.
- Using specialists from the insurance industry to participate in specific investigations.
- Working with the SRA, the police and other enforcement agencies on specific cases.

6.3 This strategy is being implemented. A number of authorised businesses are currently being investigated and the Department is co-ordinating activity between enforcement agencies and the insurance industry.

## **7. Criminal Injuries Compensation**

7.1 This is a small scale business. 160 applicants for authorisation reported turnover in criminal injuries and 413 indicated that they intended to operate in this market. Total turnover was £1.2 million. No individual business had turnover in excess of £100,000. The three largest companies were specialists, the remainder were predominantly personal injury businesses.

7.2 The Baseline Study identified that the main concern was “websites run by businesses that imply that they are part of CICA or have a connection with it.”

7.3 The strategy for dealing with the sector, as set out in the Baseline Study, is –

- Scrutinise the websites of companies in the sector to ensure that they comply with the Rules of Conduct and advertising rules.
- Scrutinise the contracts used by companies in the sector to ensure that they are transparent and that there are no hidden costs.
- Use the client account rules to make it more difficult for businesses to conceal their costs.
- Ask the CICA to refer to the Department examples of businesses not complying with the rules. After it becomes an offence to operate without authorisation, the CICA can legitimately refuse to deal with unauthorised businesses.

7.4 This strategy has been implemented. Four companies were identified that were engaged in significant malpractice. Two of these have stopped trading and the conduct of the other businesses has improved.

7.5 The Regulator has worked closely with the CICA, which has duly refused to deal with unauthorised businesses and passed on useful information about businesses in the market.

7.6 Malpractice in this sector has been largely eliminated. This was comparatively easy because every case is considered by the CICA, which can both monitor that businesses are authorised and that the Rules of conduct are being complied with. Significantly, the CICA is also advising businesses that only operate in Scotland that it would like them voluntarily to apply for authorisation under the Compensation Act.

## **8. Industrial Injuries Disablement Benefit**

8.1 This sector is similar in some respects to criminal injuries. Again, there is a single recipient of claims, this time the Department for Work and Pensions. The business is small scale. 60 applicants for authorisation reported turnover in the year to 30 September 2006, with 216 saying they intended to operate. Total turnover was £1.4 million. Five businesses reported turnover in excess of £100,000.

8.2 The strategy is very similar to that for criminal injuries compensation –

- Scrutinise the marketing material to ensure that it is not misleading.
- Scrutinise the contracts to ensure that they are transparent and that there are no hidden costs.
- The client account rules will make it more difficult for businesses to conceal their charging practices and will require more professional administration.
- The DWP has been asked to refer to the Department examples of businesses not complying with the rules. Now that it is an offence to operate without authorisation, the DWP can legitimately refuse to deal with unauthorised businesses.

8.3 Action to deal with malpractice in respect of personal injury claims should have a knock on effect in this sector; in due course this should be reviewed with DWP and followed up by specific action if necessary.

## **9. Employment claims**

9.1 Again this is a very small sector. 87 applicants for authorisation reported turnover in this sector, with 195 stating that they intended to operate. Turnover was £4.0 million. 13 businesses had turnover of over £100,000 but 30 were very small with turnover of under £5,000. Almost all the businesses are specialist and do not operate in the other sectors.

9.2 There were some initial difficulties contacting businesses in this sector while the regulatory regime was being put in place. There was no trade body to speak for the sector and many of the businesses were not known about. The concerns in the sector were more to do with poor quality of service.

9.3 The contact difficulties with businesses in the sector meant that many did not know that they had to seek authorisation. Some Tribunals have taken the view that an unauthorised business could not represent a client. For these two reasons the decision was taken to fast-track applicants in this sector. A second issue then emerged. Many employment advice businesses largely serve defendants, and may perhaps do a handful of cases a year for claimants. Only a small proportion of their turnover derives from regulated activities. A business turning over say £3,000 a year from representing claimants is unlikely to be willing to pay a £400 application fee, a £400 annual fee and perhaps a PI premium of £1,000 a year. A number of such businesses have indicated that they will stop serving claimants to avoid the need to be authorised.

9.4 It is as yet too early to assess any impact on the sector. Understanding of the sector has increased as a result of the authorisation process; it may be appropriate to develop a specific programme for the sector.

## **10. Housing disrepair**

10.1 The market seems small and local in nature. Just 21 businesses reported activity in the housing disrepair sector although 83 said that they intended to operate. Two companies accounted for most of the turnover of £0.5 million. There is some activity by claims farmers who sell cases on to solicitors. Malpractice will be addressed in the same way as for personal injury business.

10.2 Proactive compliance activity will be possible only with the co-operation of one or more large social landlords to facilitate the process. The offer of such co-operation has been made to social landlords.

## 11. Endowment claims

11.1 Handling endowment claims is the second largest market regulated under the Compensation Act. 145 applicants for authorisation reported turnover in financial services and products with 376 saying that they intended to operate. Total turnover was £74.5 million. However, this gives a misleading impression. Most endowment mis-selling cases have been dealt with and time barring is having an effect. The business has probably fallen by over 50% and is likely to fall further.

11.2 The Financial Services Consumer Panel published some research in November 2006 on consumers' experience with the endowment compensation companies. This showed a high level of consumer satisfaction. There seemed few complaints about the level or transparency of charges. Two thirds of consumers were satisfied with the value for money they had obtained. 63% of consumers rated the service as good or extremely good, 17% as average and 16% as poor.

11.3 The only significant negative comment was that 37% were concerned about an apparent lack of contact when the company had decided not to pursue a case. This is reflected in comments by insurance companies that many of the claims management companies do 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.

11.4 There are two more specific concerns –

- Turning down guarantees which may be valuable for the customer but are of no value to the claims management company.
- Where a company has in effect dropped a claim then seeking a proportion of the compensation when the claimant has subsequently pursued the case directly.

11.5 A scrutiny of websites during preparation of the Baseline Study also indicated issues that needed to be addressed –

- Scare tactics, implying that it is difficult to make a claim directly.
- Failure to comply with the Electronic Commerce Regulations, in particular by not including a physical address.
- Misrepresentation of the chances of success if claiming directly. This is probably the biggest problem. The ABI has reported that in 2006 71% of complaints made directly were upheld compared with 51% received through claims management companies. Most of the websites claimed a very different position, typically arguing that fewer than 40% of those who claim directly succeed.

11.6 There have also been allegations of cold calling by telephone contrary to the DSA code against a few companies.

11.7 The strategy for this sector, set out in the Baseline Study, is –

- Scrutinising websites when applications for authorisation are made, in particular to remove scare stories about the difficulty of claiming directly and misleading comparisons.
- Requiring compensation to be held in client accounts.
- Reviewing contracts to ensure that they are transparent and to remove unfair terms.
- Using the complaints mechanism to limit the scope for companies to claim a share of the compensation when they have provided little service and the claimant has pursued the case himself.
- Working with the Association of British Insurers to encourage insurers to refuse to deal with unauthorised businesses, but protecting consumers through an assurance that the insurers would deal directly with claimants in such circumstances. Insurers have also been asked to report malpractice to the Department.

11.8 The Department has also worked closely with the Financial Ombudsman Service, which has been a useful source of intelligence about the development of the market and the nature of any malpractice.

11.9 This strategy has been fully implemented and is considered to have eliminated a great deal of the malpractice –

- Client Account rules were made in January 2007, coming into operation in April 2007. In practice insurance companies now generally insist in paying compensation directly to the client so the Rules are of relatively minor importance.
- During the authorisation process the websites of all, and the contracts of most, companies in this market were scrutinised. Significant changes were required, particularly to remove misleading claims about the benefits of using a claim handling company. A small number of companies had onerous clauses in their contracts, particularly where a fee was being paid up-front. These have been removed.
- The number of businesses in the market seems to be declining. Marginal participants may well have decided that a combination of falling business and the advent of regulation was too much for them to cope with.

11.10 It was anticipated that the complaints mechanism would deal with companies that tried to claim a fee when they had done little work. The first two formal complaints were duly along these lines. In both cases the complaints were rejected. The companies had a proper complaints mechanism in place and there was no evidence that the companies had acted improperly in handling the respective cases. It is in fact encouraging that the two companies had put in place effective complaints handling procedures, a welcome consequence of the introduction of regulation.

11.11 The general conclusion is that what malpractice there was has largely been eliminated. Regular scrutiny of websites and dealing with complaints should maintain this position.

## 12. Other financial products

### Bank accounts

12.1 Recovering bank charges became a significant issue in the second half of 2006 as the regulatory regime was being put in place. This usefully illustrates the flexibility of the legislation. While the Compensation Bill was going through Parliament the issue was endowment claims, and the intention was to cover mis-selling of insurance products in the Scope Order. This would not have covered bank accounts as there is no mis-selling. Accordingly, the scope was widened to cover "financial products and services", which brought in bank charges.

12.2 From about September 2006 a significant number of businesses, perhaps 100 in total, have begun to offer a service in respect of bank charges. Some of these were companies that previously dealt with endowment claims. The business is fairly similar and the endowment claims companies were already aware of the Act. Surprisingly, a number were also in the personal injury market, where there is little synergy with financial products, but again at least they were aware of the Act. However, the majority have been newly established businesses seeing a market opportunity.

12.3 The strategy for dealing with these companies was similar to that for the endowment claims companies. Websites and contracts were scrutinised and the British Bankers Association agreed to inform its members that they should not deal with unauthorised businesses, that they should deal direct with customers in such cases and that malpractice should be reported to the Department.

12.4 The first priority was therefore to ensure that such businesses went through the authorisation process. A website survey revealed some businesses and others came forward as a result of banks refusing to deal with them. This coincided with the peak period for processing applications. This put such companies in a difficult position as after 23 April banks began to refuse to deal with them.

12.5 There was a specific concern that some businesses might obtain details of customers' accounts ostensibly to pursue a claim against the bank, and then use the details to defraud the customer. A warning notice was published on the Regulator's website and achieved some useful publicity. The Department has also worked closely with Which? on this issue, including putting a link to Which?'s website on the Claims Management Regulation website.

12.6 The strategy is considered to have been successful in stopping malpractice developing. As with endowment mis-selling, changes have been required to websites and contracts as a condition of authorisation. As any compensation is paid directly into bank accounts there is no chance of claims handlers hanging on to compensation. However, there has been a concern about some companies asking for payments up-front.

12.7 This market is capable of rapid change. This has been very clearly illustrated by the announcement by the OFT on 26 July that they had agreed with most of the banks to take a test case to the High Court and the FSA deciding to issue a waiver in respect of banks obligations to deal with complaints pending the outcome of the test case. If this leads to all claims being put on hold then the impact on those companies that rely on handling bank charge complaints could be significant. The market will need to continue to be closely monitored.

### Other financial products

12.8 As yet no significant market has emerged for other financial products. There is a very limited market in pensions opt out and an even more limited market in payment protection. The companies in these markets are already in the endowment claims market so are already regulated. These markets, and other markets where compensation claims may arise are closely monitored, including through liaison with the Financial Ombudsman Service. There is always a risk that a market will develop suddenly with the capability of consumers suffering detriment because the Department is not up to speed. There are arrangements in place to prevent this happening.

## 13. Conclusions and future work

13.1 The regulatory regime for claims management activities is considered to have had a significant effect in removing malpractice one year after the Compensation Act 2006 received Royal Assent. Specifically –

- Cold calling in person has been significantly reduced.
- Unauthorised marketing in hospitals has been reduced by about 90%.
- A joint approach is in place with the SRA to reduce other malpractice in the acquisition of personal injury claims.
- An effective strategy has been developed for dealing with contrived accidents, with the Department also taking a co-ordinating role for the various enforcement agencies and the insurance industry.
- Malpractice by companies handling claims against the Criminal Injuries Compensation Authority has been significantly reduced, including through some companies voluntarily leaving the market.
- Misleading use of the expression “no win no win” has largely been eliminated.
- Misleading claims on websites have been almost entirely removed and rules requiring websites to give a physical address are being complied with.
- What little malpractice there was in respect of handling endowment claims has largely been removed.
- The growth of claims handlers dealing with bank charges has been controlled, preventing malpractice from developing.

13.2 The overall success can be attributed to a number of factors –

- The small size of the sector being regulated.
- The speed with which the regulatory regime was implemented; normally those engaged in malpractice have several years to rearrange their businesses before legislation is implemented.
- The interest that those receiving claims have in curbing malpractice and their willingness to refuse to deal with businesses that have not been authorised.
- The decline in the market as a result of the downturn in endowment business and, looking forward, the impact of the reforms to the claims process.

13.3 There remains much work to be done, in particular –

- Regular surveillance of websites to ensure that bad practices do not return.
- Eliminating all cold calling in person.
- Implementing the strategy on contrived accidents.
- Reducing the scope for abuse of the “exempt introducer” concept and beginning to deal with the unseen malpractice in the acquisition of personal injury claims, including ensuring full compliance with the SRA rules throughout the supply chain to solicitors.
- Seeking to ameliorate the regulatory burden on small businesses particularly where claims management is a small part of their total business.
- Ensuring that the regular closing down and creation of businesses is not used as a means of prolonging malpractice.

## **Appendix: Summary of Baseline Study – April 2007**

### **Personal injury**

Personal injury claims cost around £6 billion a year, motor accounting for nearly 70%, employer's liability for 20% and general liability for 10%. The way claims are handled is complex. Almost all ultimately are handled by solicitors. Some solicitors attract business through their own marketing or by using joint marketing companies. However, much business is referred by intermediaries. Solicitors will pay around £600 for a good personal injury case. There are about 1,000 intermediaries in this market, mainly specialists in claims management but including over 200 accident management companies. Their annual turnover is around £190 million.

There is substantial scope for malpractice. There are two principal problems - selling practices, in particular cold calling, and misleading contracts. There are also two specific problems – marketing in hospitals and contrived accidents leading to fraudulent claims.

Mystery shopping, surveys, inspections of businesses and intelligence information will be used to help enforce the rules. However, success is dependent on the solicitors' Practice Rules being more effectively enforced and the exempt introducer concept working satisfactorily. The Regulator will be working closely with the Solicitors Regulation Authority to ensure that the work of the two regulators is complementary.

Regulation is likely to have significant effects on the nature of the market, including on solicitors that specialise in handling personal injury claims. The market is also likely to be affected by the Government's proposed reforms to the claims process, published on 20 April.

### **Criminal injuries compensation**

The Criminal Injuries Compensation Authority (CICA) pays out about £200 million a year. Regulated intermediaries play only a small role in the market; their turnover is under £1 million a year. Most are also in the personal injury market. Intermediaries can add little value to the process. Some intermediaries have sought to give the impression that they are part of the official process. In co-operation with the CICA, it should be comparatively easy to deal with malpractice.

### **Industrial Injuries Disablement Benefit**

The Department for Work and Pensions (DWP) pays out around £800 million in Industrial Injuries Disablement Benefit a year. Regulated intermediaries play only a small role in the market; their turnover is under £1 million a year. Most are also in the personal injury market. Intermediaries can add little value to the process. There is scope for malpractice through misleading contracts, which the authorisation process and subsequent monitoring should be able to address.

### **Employment issues**

Employment tribunals award around £500 million a year, and many other cases are settled before going to a tribunal. Claims management companies have a very small role in this market; it should be possible to deal with any malpractice.

### **Endowment policies**

Compensation payments in respect of mis-sold endowment policies exceed £1 billion a year. Intermediaries can earn an average of £800 a case. Their turnover is estimated at £75 million a year. The main problem areas are misleading information on websites, in particular the use of scare tactics, and contracts that are weighted against the consumer. These issues are being dealt with at the application stage. This, combined with scrutiny of contracts and the client account rules, should remove much of the scope for malpractice.

## Other financial products

There is limited activity in respect of payment protection insurance, bank charges and opting out of SERPS. However, the scope does not currently exist for a market anything like the size of the endowment compensation market. Recent activity in respect of bank charges means that this is likely to become the most significant new financial services market. The issues will be dealt with in the same way as for endowment mis-selling.

## Housing disrepair

The market seems very small and local in nature. There is some activity by claims farmers who sell cases on to solicitors. Malpractice will be addressed in the same way as for personal injury business; the co-operation of one or more large social landlords will facilitate the process.

## Summary

The following table summarises the analysis and makes a preliminary assessment of the chances of success. Unreasonable selling tactics is the one common theme. The most difficult sector to tackle will be personal injury, because it offers most scope for businesses to seek to circumvent the rules and because, unlike in the other sectors, the malpractice is generally paid for by the defendant and his insurers rather than by the client.

The following points should be noted –

- The first column shows the number of businesses that applied for authorisation, by 19 February 2007, indicating that they intended to operate in this market. The number adds up to over 2,000, many businesses saying that they intended to operate in more than one sector. In practice almost all the businesses in the criminal injuries, industrial injuries and housing disrepair sector (570) were also in the personal injuries sector.
- Not all the businesses that said they intended to operate in a particular market have operated in the market. For example, of the 130 saying that they intended to operate in the employment sector only 43 reported turnover in the previous year.
- 604 businesses, nearly half the total, said that they had not been trading for the full year to 30 September 2006. This indicates both a rapidly changing sector, and probably also some re-organisation to take account of the introduction of regulation.
- The turnover figures are estimates for the size of the markets, in the year to 30 September 2006, for business subject to regulation under the Act.

<b>Market sector</b>	<b>No of Businesses</b>	<b>Estimated annual size of market</b>	<b>Malpractice</b>	<b>Prognosis</b>
Personal injury	1,128	£190m	Aggressive selling. Marketing in hospitals. Misleading contracts. Involvement in fraud.	Most difficult sector. Regulatory arbitrage and attempts to get round regulation are certain.
Criminal injuries compensation	340	£1m	Claimants deceived into thinking they are dealing with CICA.	Good
Industrial injuries disablement benefit	165	£1m	Claimants deceived into using intermediary.	Good
Employment matters	130	£2m	Claimants deceived into using an intermediary.	Difficulty will be identifying malpractice.
Endowment mi-selling	176	£75m	Scare selling tactics. Clients dropped if cases difficult.	Good, but a large sector to tackle.

Other financial products		£1m	Claimants deceived into dealing with an intermediary.	Should be able to prevent malpractice being developed on a significant scale.
Housing disrepair	65	£1m	Aggressive selling.	Local in nature, so problem will be to identify.
Total	1,256	£275m		