

Independent review of claims management regulation

March 2016

Independent review of claims management regulation

March 2016



© Crown copyright 2016

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at general.queries@justice.gsi.gov.uk

ISBN 978-1-910835-71-5
PU1918

Contents

	Page
Foreword	3
Executive summary	5
Chapter 1 Glossary	13
Chapter 2 Background	15
Chapter 3 Ideal regulatory objectives	25
Chapter 4 Regulatory architecture recommendations	27
Chapter 5 Authorisation recommendations	31
Chapter 6 Supervision recommendations	35
Chapter 7 Enforcement recommendations	39
Chapter 8 Funding recommendations	41
Chapter 9 Perimeter findings	43
Chapter 10 Analysis of future regulatory responsibility	45
Annex A Acknowledgements	57
Annex B Details of CMC charge cap	59
Annex C Insurance Fraud Taskforce recommendations for claims management	61
Annex D Stakeholder contributions	63

Foreword

The claims management industry has grown substantially since the Claims Management Regulation Unit was first established in 2007. The composition of the market has also changed, with financial services claims having overtaken personal injury as the greatest source of turnover for claims management companies; it is estimated that CMCs have taken over £3.5 billion in consumer charges¹ since 2011 for payment protection insurance mis-selling claims alone.

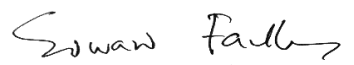
Government has already taken steps to ensure consumers get a fair deal, including strengthening the powers of the existing regulator and proposing a cap on the amount claims management companies can charge their customers. It will take some time before the full effect of these reforms will be apparent, but it is clear that the claims management industry requires change of a more fundamental nature given that reports persist of poor services, confusing fee structures and nuisance marketing such as cold calls and text messages.

The recommendations in this report complement government's existing reforms and build on the excellent work of the CMR. They provide the framework for a much tougher regulatory regime. This should ensure that in future consumers can access high quality complaint handling services, which do not have a disproportionate impact on society as a whole.

We are grateful to Carol Brady for her hard work in compiling this final report.



Harriett Baldwin MP
Economic Secretary to the Treasury



Lord Faulks QC
Minister of State for Civil Justice

¹ <http://www.fca.org.uk/news/annual-report-14-15>

Executive summary

The Claims Management Regulation Unit (CMRU) was established within the Ministry of Justice (MoJ) in April 2007. It is relatively unusual for a government department to directly regulate an industry and it was originally intended as an interim measure. The sector established itself quickly following civil justice reforms to allow 'no-win no-fee' arrangements and regulation was required to tackle unscrupulous marketing and trading practices in the personal injury sector, and in some cases fraudulent activity.

Despite incremental reforms and improvements to the regulator's powers and rules since its creation, there is a widely held perception among stakeholders and government that there is widespread misconduct among Claims Management Companies (CMCs). Government commissioned this review to examine the nature and extent of problems in the market and make recommendations to improve the regulatory regime.

In terms of process, this review first considered what objectives the regulator should ideally seek to achieve. It then considered what tools were necessary to deliver those objectives, before ultimately considering which organisation is best placed to supervise the market. This report follows that structure. In developing the recommendations, the review team met with a wide range of stakeholders and undertook a call for evidence. The emerging conclusions were also tested with a wide range of stakeholders. This final report presents the review's final conclusions.

It is important to note that CMCs provide access to justice for a wide range of consumers who may be unwilling or unable to bring a claim themselves. A well-functioning CMCs market can also act as a check and balance on the conduct and complaint handling processes of businesses, thereby benefitting the public interest. The overwhelming majority of stakeholders, including the banking and insurance industries which have been hardest hit by CMC misconduct, argued that there is a legitimate need for CMCs and that the Government should not seek to regulate them out of existence.

The majority of stakeholders feel the CMRU still lacks sufficient powers and resources to supervise the market properly. CMCs continue to fuel speculative claims for redress, particularly in financial sectors. Evidence also highlights that consumers struggle to understand precisely what services CMCs offer, and what the alternatives are, due to a lack of transparency in the manner in which CMCs promote themselves to consumers. Research conducted on behalf of the Financial Conduct Authority (FCA) in 2015¹ on PPI mis-selling claims found that 'while potential future complainants had occasionally heard or read about PPI in the media... CMCs advertising and direct contact (e.g. telephone calls) had led to widespread confusion and misconceptions about the Payment Protection Insurance (PPI) complaints process.' This is reinforced by complaints data from the Legal Ombudsman², where between 28 January and the end of April 2015 the 'biggest source of complaints about CMCs of all kinds was the lack of clear and transparent fees, followed by delays and the failure to provide regular updates.'³

The FCA's research also found that 'those who made their complaint via a CMC were often prompted to do so by heavy and persuasive marketing tactics; many engaged only after turning

¹ <http://www.fca.org.uk/your-fca/documents/consultation-papers/understanding-ppi-redress>

² The Legal Ombudsman took on the job of complaints handling for the sector in January 2015 from the CMRU.

³ <http://www.legalfutures.co.uk/latest-news/only-4-of-cmc-complaints-relate-to-personal-injury-work-leo-reveals>

away multiple companies.’ They also found that CMCs ‘*deterred*’ many potential future complainants from pursuing complaints... through their persistent phone calls and encouragement to complain’ (emphasis added).

Common conduct issues identified by this review include:

- poor value for money services offered by CMCs – caused by information asymmetries
- mis-representation of service offered to consumers – advertising focused on enhancements to value of compensation claims rather than 'convenience/time' benefits
- nuisance calls and text messages sent to consumers – caused by unenforced breaches of data regulations, and legitimate exploitation of consent provision by unwitting consumers
- progression of inappropriate (i.e. speculative and/or fraudulent) claims by CMCs – caused by different factors in different sectors

In light of the evidence seen by this review, it is clear that the existing regulatory regime requires strengthening in several areas.

Ideal organisational objectives for claims management regulation

Before making substantive policy recommendations, this review sought to establish what the regulator should aim to achieve. In doing so, it considered the objectives of other relevant organisations, such as the FCA and the existing CMRU. The objectives aim to balance the interests of consumers, CMCs, the businesses they complain against and the wider public interest. This review led to a proposed mission statement for the regulator and three operational objectives:

Mission statement: ‘To ensure claims management services function effectively, in the interests of consumers and relevant markets’.

Objective 1: *Maintain adequate and effective access to justice where a legitimate claim for redress exists*

Objective 2: *Empower consumers to choose a value for money service which is appropriate for their needs*

Objective 3: *Ensure the impact of claims management on consumers and business is proportionate, reasonable, and in the public interest*

In order to describe how these could be achieved, these were broken down into eight outcomes-focused operational objectives:

- 1 claims management companies adhere to regulatory requirements
- 2 fees charged by CMCs are in proportion to their costs and services, and are presented in a transparent manner
- 3 CMCs offer clear, fair and not misleading information about their services and the value they offer to consumers

- 4 minimal number of poor quality, fraudulent and unmeritorious claims submitted by CMCs
- 5 consumers can readily assess the relative value of using claims management services
- 6 regulatory rules and guidance are developed in accordance with changing market conditions
- 7 consumers understand the implications of providing consent for their personal data to be shared by firms involved in claims management
- 8 minimal prevalence of unauthorised claims management activity

Summary of recommendations

Existing powers and resources

Throughout the review, stakeholders were extremely keen to impress upon the review team their positive experiences of working with CMRU. This review has seen no evidence that the staff in either the MoJ policy unit or the contractual arrangement with Staffordshire County Council have been ineffective. On the contrary, several stakeholders said they did a very good job, considering their lack of resources and powers. The CMRU has built up an unrivalled level of knowledge and expertise about claims management, and therefore **every effort should be made to retain existing staff**. This is particularly important given the widespread changes that are occurring in the sector.

No Senior Civil Servants are employed within the CMRU, and the existing governance structure means that the head of the CMRU effectively acts as CEO and Chair. While the CEO should be the primary decision-maker for the organisation, the role of the Chair, in leading the Board, should include holding the CEO to account for setting organisational strategy and making executive decisions. The appointment of two non-executive board members has provided broader regulatory expertise to the CMRU's board, but the inclusion of further non-executive board members from relevant regulatory organisations such as the Solicitors Regulation Authority (SRA), Information Commissioner's Office (ICO), would help to join up the regulatory landscape as recommended by the Insurance Fraud Taskforce (IFT) report. The **CMRU should appoint an independent Chair, and broaden its range of non-executive board members** to include other regulators who operate within the market such as ICO, SRA and with wider regulatory experience such as the FCA.

The review did not encounter any evidence to suggest that the regulator's existing enforcement or rule-making capabilities are excessive or unnecessary, and therefore they should be retained.

The regulator has a range of roles and responsibilities as regards the publication of data. For consumers, its unique insight into the market means it is well-placed to provide access to the information they need to choose a service which is appropriate for them. For businesses, the regulator can provide information on how to deal with CMCs more efficiently and act as an independent, free source of information for consumers wishing to complain against them. And for CMCs, the regulator has two important roles: providing information for CMCs on how to comply with their rules; and publishing details of enforcement action, which acts as a deterrent for others. While the regulator does already have the power to publish this type of information, this review considers those powers could be used more effectively. The **CMRU's website should be optimised to help consumers choose a service appropriate for their needs and the CMRU**

should also be empowered to publish all appropriate information on enforcement activity, including against unauthorised firms.

Authorisation

Authorisation processes have benefits for both regulators and regulated businesses. For regulators, they are a way of preventing unscrupulous or incompetent businesses undertaking regulated activities and trading in the first place. In this way, having a robust authorisation process for CMCs diminish the need for enforcement activity, which in turn eases resource burdens for the regulator and helps to keep the regulatory levy to a minimum.

Evidence of non-compliance by CMCs is widespread. For example in 2014-15 alone, 296 warnings were issued to CMCs and 105 authorisations, representing 6% of total, were cancelled by the regulator. The Financial Ombudsman Service (FOS) also expressed concern over the amount of resource it dedicates to advising CMCs on compliance issues. Both of these factors suggest the authorisation process for CMCs should be made more robust, both in terms of acting as a barrier to unscrupulous firms, and ensuring firms understand the rules. The regulator should therefore undertake to **re-authorise all CMCs who wish to continue trading under a robust new process, tailored to the specific sector in which they operate.**

Stakeholders, including the CMRU, expressed concerns about the ability of the director of a liquidated firm to take over another authorised firm without requiring approval from the CMRU. Another concern is the frequency and ease with which CMCs re-emerge as a new firm following liquidation or insolvency with some or all of the directors remaining in place. This is known as “phoenixing” and was also highlighted as a problem in the final report of the IFT.

These problems show how authorisation alone is not sufficient to deter or prevent unscrupulous business or individuals operating in the CMC sector. At present, the regulator does not have sufficient powers to address this issue. This review therefore recommends that **persons wishing to perform controlled functions for a firm regulated by the CMRU should be required to pass a fit and proper persons test, and be held personally accountable for rule breaches for which they are responsible.**

Supervision

The regulator has not yet used its powers to introduce outcomes-based rules. Instead, it relies on a rulebook which codifies all the requirements with which CMCs must comply. This can mean that regulated firms can avoid enforcement by maintaining technical compliance with rules, but without due regard for consumer outcomes. The CMRU’s existing Conduct of Authorised Persons rulebook should therefore be enhanced with the addition of outcomes-based conduct rules to the existing rulebook.

While existing rules require CMCs to disclose key product information such as their fee structure, they are not compelled to disclose it in a consistent manner, often opting to present relevant product data deep in the contract’s terms and conditions. **A standardised disclosure document for each claims management sector could combine the smarter communications tools identified by the FCA to help consumers to be better informed when signing a contract with a CMC.** In turn, this would be expected to improve competition between CMCs, improving standards and lowering prices, and help consumers to choose services which are appropriate for their needs.

Citizen's Advice research (2014)⁴ found that 39% of people who had used a CMC to make a claim didn't know that they could have made the claim themselves, and almost half said that they if they had been aware of the free alternatives, then they would not have used a CMC, indicating that current rules are not sufficient to ensure consumers are properly informed of the options available to them. **Better signposting to alternative claim resolution channels would help to enhance consumer awareness and help them make fully informed decisions.**

Requiring firms to disclose referral sources would make it easier for the regulator to identify those from 'claims farmers' and other questionable sources.

The lack of requirement for CMCs to record calls with clients unless directed to do so as part of an enforcement measure creates scope for CMCs to mis-represent their services or use aggressive sales tactics. **CMCs should therefore be mandated to record all calls with clients, and retain them for a minimum of 12 months following the conclusion of a contract with that client.**

CMRU currently gives prior notice of on-site audits, which gives CMCs the opportunity to 'sanitise' premises before the enforcement staff arrive. CMRU auditors often recognise signs that a premises has been 'sanitised', offering little resemblance to intelligence obtained from consumer complaints and provided by whistle-blowers. The **CMRU should seek to make wider use of warrants and seizure powers**, and support to encourage compliance rather than enforcement through greater use of regulatory roadshows, workshops, and training support.

Enforcement

So far, the regulator has only used its powers to impose fines for major conduct breaches. Despite having the necessary powers the regulator has not yet fined any firms for minor regulatory breaches. There are therefore questions over whether or not firms perceive these powers to be a credible deterrent for making minor breaches. **The regulator should consider whether smaller fines or mandatory training may have a complementary effect as a credible deterrent** by showing that the regulator will not tolerate persistent or deliberate rule breaches.

Establishing a stronger regulatory regime will increase incentives to avoid regulation entirely. It is therefore possible that there is an increase in unauthorised activity. It is imperative that the regulator is alive to this risk and should **take tough enforcement against unauthorised activity, and publish on its website as a deterrent.**

Funding

The CMRU operates on a self-funding basis with all operating costs recovered through regulatory fees paid by CMCs. The new regulatory framework proposed in this review will mean the CMRU needs additional funding, both in the short term to pay for the policy work to develop and implement the policies, and probably also in the medium term to sustain a more intrusive supervisory approach. Given the scale of work required in the near term to implement the recommendations, it might not be possible to fully fund the transition costs from a single year's regulatory levy. When implementing the findings of this review, government should consider whether the implementation costs should be spread over several years through a supplementary levy.

A proportion of receipts from enforcement activity (i.e. fines) should be used to subsidise enforcement activities. A resourcing structure of this nature would mitigate the risk of

⁴ <https://www.citizensadvice.org.uk/cymraeg/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/the-cost-of-redress/>

unsustainable increases in the regulatory levy resulting from a further drop in the number of regulated CMCs.

Regulatory responsibility

In principle, the most suitable option would appear to be a new, a stand-alone, independent regulator focused solely on CMC regulation. It could pursue its objectives without risk of the interference or competition from other organisational priorities. In practice, such a recommendation is unlikely to be accepted by Government, given its drive to reduce the number of public and arms-length bodies, and the fact that establishing an entirely new organisation is likely to be more expensive than other options.

Of the remaining options, strengthening the existing MoJ based regulator and passing responsibility to the FCA are the most credible, and the decision between them is finely balanced; each has strengths and weaknesses.

The claims management industry is undergoing a period of uncertainty and it is difficult to predict the extent to which existing reforms will change the claims management landscape. In particular, the proposal to increase the small claims track means that claims currently handled by solicitors may in future be handled by CMCs. While the proposed fee cap for financial service claims will reduce incentives for CMCs, it is anticipated that there will be a spike in PPI activity ahead of the FCA's deadline by which consumers would need to make a PPI complaint.

The changes to the regulatory regime recommended in this review are likely to cause further disruption to the industry and will also create a risk that the regulator takes its "eye off the ball".

Strengthening the existing MoJ regime is likely to be less disruptive than other options. In particular, the regulator is more likely to be capable of retaining the skills, knowledge and experience of its existing staff. Keeping the CMRU within MoJ may also reduce the risk of the regulator being distracted from its existing functions while the new regime is being implemented. The early indications from the CMRU's use of new fining powers are positive and demonstrate the CMRU's ability to implement new rules in an effective and capable manner. As such, retaining the CMRU within MoJ provides a low risk with a high degree of certainty that conduct standards will not slip during transition to the new regime.

At the same time, the existing regulator's location within MoJ does give rise to practical constraints, particularly as regards staffing and costs. What follows this review will be the most radical overhaul of regulation in the sector since the CMRU was first established. Designing and implementing the reauthorisation process and senior managers regime will be resource intensive and will require the regulator to expand its policymaking and operational capacity. The existing CMRU may struggle to deliver this work programme unaided, so the viability of this option is contingent on substantial support from the FCA, given their relevant experience. In practice, such support may be limited given their need to prioritise functions relating to their existing responsibilities. Similarly, and despite the self-funding nature of CMRU, MoJ may not be able to commit necessary resources both in the short and medium term given the substantial and well publicised pressure on all government departments to reduce overall levels of expenditure and headcount.

Meanwhile, the FCA already has well developed and relevant expertise that could be applied since more than 99% of CMC turnover is directly or indirectly related to financial services, such as PPI and packaged bank accounts (60%) or the insurance aspect of personal injury claims (40%). Furthermore, it may afford FCA a broader perspective on any future financial services mis-selling scandals and a wider range of powers. As an example, the FCA's proposed

advertising campaign ahead of the PPI deadline will aim to encourage consumers to complain to providers directly, without using a CMC.

While the FCA does not have the same detailed knowledge of the sector as the existing CMRU, it has expertise as a conduct regulator across a wide range of sectors and recently implemented policies similar to those outlined in this review during the transition of consumer credit regulation.

The overall decision depends on the weight attached to each of the factors outlined above. Taken together, these factors mean that the MoJ option is likely to provide a “safe pair of hands” in the short term, but practical constraints on resources could mean it may struggle to deliver a real step-change. Comparatively, there may be more disruption in the short term if regulation is transferred to the FCA due to the complexities of transferring responsibilities between organisations at the same time as bolstering the regime, but the FCA is likely to be able to deliver a more ambitious reform package overall.

On balance, given the wide range of reforms already underway in this area, and the expected turbulence and contraction in the market, **the least disruptive option would be for responsibility to remain with MoJ. If, however, the Government wants a step change in the regulation of the sector, then the balance would shift in favour of the FCA.**

1 Glossary

ASA – Advertising Standards Authority
ABS – Alternative Business Structure
ABI – Association of British Insurers
BBA – British Banking Association
CMA – Competition and Markets Authority
CMC – Claims Management Company
CMRU – Claims Management Regulation Unit
CHO – Credit Hire Organisation
FCA – Financial Conduct Authority
FOS – Financial Ombudsman
FSCS – Financial Services Compensation Scheme
ICO – Information Commissioner’s Office
IFB – Insurance Fraud Bureau
IFT – Insurance Fraud Taskforce
LeO – Legal Ombudsman
LSB – Legal Services Board
MoJ – Ministry of Justice
MSE – Money Saving Expert
NDPB – Non-Departmental Public Body
PECR – Privacy and Electronic Communication Regulations
SRA – Solicitors Regulation Authority
TPS – Telephone Preference Service

2 Background

Purpose of the review

2.1 Claims Management Companies (CMCs) are regulated by the Claims Management Regulation Unit (CMRU) which is based in the Ministry of Justice (MoJ). The CMRU has recently received additional powers, but evidence suggests that CMC regulation regime should be put on a more robust footing to be in a position to address existing misconduct and meet future regulatory challenges.

2.2 Consumers and affected sectors, particularly financial services, remain concerned that CMCs continue to fuel speculative claims for redress, and in doing so create a significant social nuisance through the use of cold-calls and text messages and add waste into the redress systems.

2.3 As a result, HM Treasury and the MoJ jointly commissioned a review into how to implement a much more rigorous regulatory regime for CMCs, with particular reference to the high standards applied to other regulated industries such as financial services.

Carol Brady biography

2.4 This independent review is led by Carol Brady, a non-executive board member of the CMRU. Carol has over 30 years' experience working in the field of regulation and consumer protection and particularly in delivering consumer services. She runs her own consultancy business, and is the Chair of the Board of the Chartered Trading Standards Institute.

2.5 She began her career within the Trading Standards Service and has since worked at a senior level in the Department for Business Innovation and Skills as National Operations Manager developing a major project to set up the Consumer Direct helpline across the UK.

2.6 She was a Senior Ombudsman for the Office for Legal Complaints, making final decisions on complaints which had not been resolved within a lawyers' first tier complaints procedure.

2.7 She worked for a number of years in the Local Better Regulation Office as Service Improvement Director to improve the performance of regulation and the relationship between regulators and business, before transferring to the Office of Fair Trading (OFT) as Director of Operations for Consumer Direct to oversee its transition.

Terms of reference and scope of the review

2.8 The objective and focus of this review is to make recommendations to HM Treasury and the Ministry of Justice on reforms to the regulatory architecture for CMCs which will lead to consistently improved outcomes in the way that CMCs conduct business. In doing so, the review should consider how to improve consumer protection and mitigate the wasteful impact of poor conduct and service on those businesses which are subject to claims from CMCs.

2.9 Specifically, it should consider the resources and powers required for a strengthened regulatory regime – including the power to implement the cap on charges that CMCs can apply to their customers – and what architecture might be most appropriate to deliver this, including its governance and scope.

2.10 The review may consider, but is not limited to recommendations on:

- further reform of the existing regime, with new powers and resources provided to the CMRU
- dual regulation between the CMRU and the FCA
- creation of a new independent regulator; or
- transfer of responsibility for regulation of CMCs to the FCA

Issues not considered during the review

2.11 The review has not been able to assess/investigate the following areas;

- full impact of the new fining powers which were introduced in December 2014 by The Financial Services (Banking Reform) Act
- the effectiveness of the Legal Ombudsman's ability to handle claims management complaints, which was introduced from January 2015 by The Financial Services (Banking Reform) Act
- the arrangement by which enforcement duties are contracted to Staffordshire County Council
- the definition of regulated claims management activity – stakeholders made cases for various types of claims management activity to become regulated, including claims brought under section 75 of the Consumer Credit Act; claims brought by ABSs; Medical Reporting Organisations (MROs) and Credit Hire Organisations (CHOs)
- the potential benefit of de-regulating some sectors of CMC activity in which there is no evidence that detriment is occurring, or is likely to occur (e.g. housing disrepair and criminal injuries compensation)
- regulatory impact assessment for the review's recommendations
- the CMRU's jurisdiction being confined to England and Wales, but not Scotland and Northern Ireland

The origins of claims management regulation

2.12 The current regulatory regime for claims management was established in April 2007 principally in response to the concerns at the time that a growing number of CMCs were engaged in malpractice to the clear detriment of consumers and the public interest. This followed a number of reforms to rules in respect of civil compensation claims, in particular Conditional Fee Agreements allowing people to make claims for damages, for example in personal injury cases, on a "no-win no-fee" basis. These reforms enabled new business models to emerge, allowing CMCs to introduce clients to solicitors in return for referral fees for marketing and preparatory work in the case. Reports of unscrupulous marketing and trading practices in the personal injury sector grew, and in some cases fraudulent activity. This included practices such as:

- aggressive marketing techniques, including unsolicited phone calls and text messages

- encouraging frivolous claims resulting in what some perceive to be a “compensation culture”
- misleading consumers about the cost of handling claims
- providing poor quality advice and claims handling services
- dropping claims where they were not financially lucrative
- soliciting claims in hospital premises

2.13 Mis-sold mortgage endowment policies emerged as a substantive market for compensation claims. There was also some concern about the practices of non-legal practitioners in employment claims, and CMCs encouraging consumers to submit claims for housing disrepair but with little intention of the necessary repair work being undertaken. Further evidence emerged of detrimental practice in claims made to the Criminal Injuries Compensation Authority and for Industrial Injury Disablement Benefit.

2.14 These practices led to calls for the regulation of CMCs. In order that a regulatory regime could be established quickly, under the Compensation Act 2006 the Secretary of State for Constitutional Affairs exercised the regulatory functions in the absence of another regulator. Although other regulatory bodies, including the former Office of Fair Trading and Financial Services Authority, were approached about taking on the function, they were reluctant to do so. Therefore, it was considered that establishing the regulatory regime ‘in-house’ was the best way for the Department to meet the policy requirement quickly, and without the greater costs and upheaval associated with either setting up an arms-length body or negotiating the adoption of the function by an existing office.

2.15 Claims management regulation was fully implemented by April 2007 under the provisions of the Compensation Act 2006. The Act defines claims management services as “advice or other services in relation to the making of a claim”. Almost any claims activity from referring claims through to representing clients is covered. The objective of regulation was to provide better safeguards to consumers of claims management services and to promote access to justice. The types of claims management activities regulated include:

- advertising for, or seeking out (for example by canvassing or direct marketing), persons who may have a cause of action;
- advising a claimant or potential claimant in relation to his claim or cause of action;
- referring details for a fee of a claim or claimant, or cause of action or potential claimant, to another person, including a person having a right to conduct litigation;
- investigating or commissioning the investigation of the circumstances, merits or origins of a claim with a view to using the results in pursuing the claim;
- representing a claimant

Current framework

2.16 The MoJ is responsible for directly regulating the activities of businesses providing claims management services. Regulation covers six claims sectors:

- personal injury
- financial products and services

- employment
- criminal injuries
- housing disrepair
- industrial injuries Disablement Benefit

2.17 Regulation is carried out by the MoJ's CMRU and led by the Head of Regulation who is a civil servant. At present, he takes statutory regulatory decisions on behalf of the Secretary of State under the Compensation Act 2006 and the Regulations and Rules made under that Act, notably the Conduct of Authorised Persons Rules. Such decisions include imposing a financial penalty and the variation, suspension and cancellation of the authorisation of a CMC to provide claims management services. The CMRU comprises of a small team of London based MoJ officials and a Compliance Office located in Burton-on-Trent provided by Staffordshire County Council under contract to the MoJ.

2.18 The London team of 10 civil servants manage policy, funding, communications, and stakeholder relations, while the Compliance Office leads on the processing of applications, gathering intelligence, monitoring compliance, investigating malpractice and taking enforcement action. The Compliance Office consists of a team of approximately 120 staff with a range of trading standards, police, legal, consumer advice, intelligence gathering and fraud investigation experience and skills. The compliance office function has been contracted out to Staffordshire County Council since the start of the regime. The CMRU operates on a self-funding basis with all operating costs recovered through regulation fees paid by CMCs.

2.19 The gross cost of regulation in 2014-15 of around £6m was financed by new licence applications and annual regulation fees charged to businesses. The Head of CMRU oversees the budget and is responsible for raising enough fee income from the claims management industry to cover the running costs of the regulatory operation.

2.20 CMCs are required to apply for authorisation (a licence) to provide services. Trading without a licence or exemption is an offence. Persons providing assistance for making a claim on a voluntary basis are exempted from the need to be authorised in the 2006 Act. Any person who is already regulated including legal practitioners and not for profit organisations such as Citizens Advice are exempted and do not need to be authorised.

2.21 CMCs are required to adhere to the Conduct of Authorised Person Rules¹, which, among other rules, requires CMCs to;

- give consumers clear information about the options available for pursuing their claim (including self-help and the relevant ombudsman) and the costs of doing so
- not use high-pressure selling tactics, not make cold-calls for claims that are going to be referred to a solicitor, not make hidden charges, and not use misleading marketing
- have a complaints handling procedure, and if a consumer is not satisfied with a CMC's response they can follow this up with the Legal Ombudsman which has responsibility for dealing with consumer complaints about poor service from a CMC

¹ <https://www.gov.uk/government/publications/claims-management-regulation-conduct-of-authorised-person-rules-2014>

2.22 Any changes to the Conduct of Authorised Person Rules and to the Compensation (Claims Management Services) Regulations could be made by the Secretary of State, although the latter would be subject to parliamentary approval.

Recent reforms

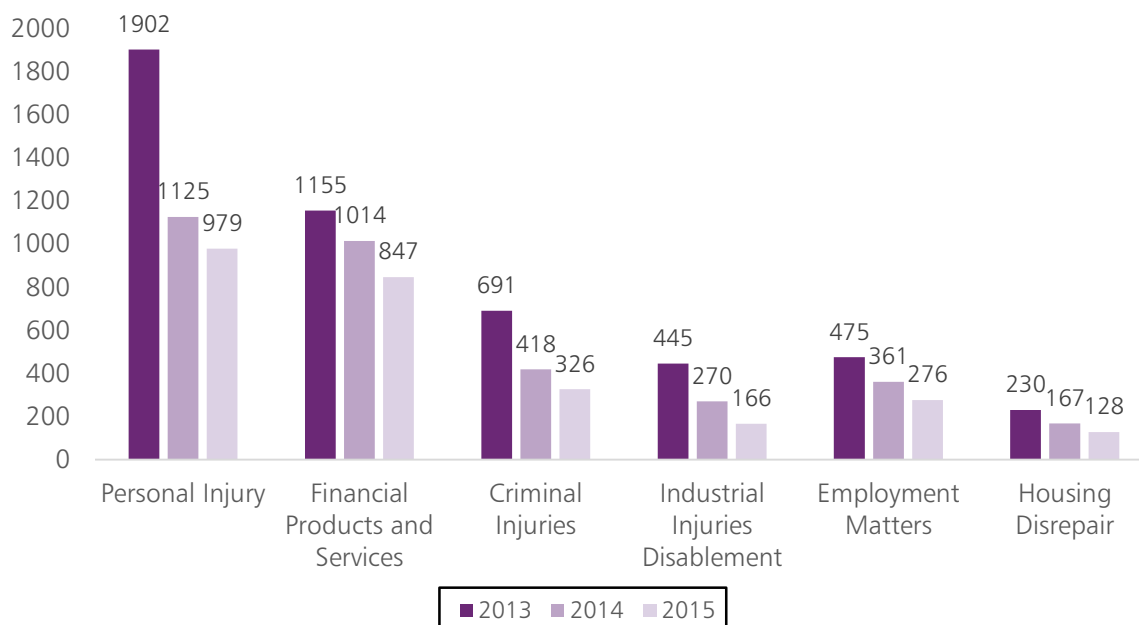
2.23 The Regulator has overseen an extensive package of reforms to the regulatory regime in the past 3 years;

- **April 2013:** CMCs banned from offering financial rewards or similar benefits to potential claimants as an inducement to make a claim
- **April 2013:** Payment or receipt of referral fees banned between CMCs, lawyers, insurers and others for profitable personal injury claims
- **June 2013:** CMCs under investigation and subject to enforcement action named, as part of ongoing work to raise industry standards and ensure consumers and businesses are better informed
- **July 2013:** Conduct Rules for CMCs tightened to better protect consumers, including banning verbal contracts and requiring CMCs to obtain signed contracts before taking a fee
- **May 2014:** First two non-executive board members appointed to the executive-led Claims Management Regulation Board to provide a greater element of external challenge and scrutiny and help ensure continuous improvement
- **October 2014:** Conduct Rules for CMCs strengthened further to help tackle abuses in the financial claims sector. Key changes were made around ensuring claims are properly substantiated before being pursued and any data received through telemarketing is legally obtained
- **December 2014:** Power to fine CMCs for rule breaches introduced
- **January 2015:** Consumers empowered to bring service complaints against CMCs to the Legal Ombudsman (LeO)
- **April 2015:** Threshold for Information Commissioner's Office (ICO) to issue fines to businesses that send spam text messages or make nuisance calls reduced²

² Previously, The ICO had to prove that the calls or texts caused "substantial damage or substantial distress" before it could fine companies up to £500,000 for breaches of the Privacy and Electronic Communication Regulations (PECR). Since 6 April 2015, it need only prove that the company was committing a serious breach of the law, and has worked with the CMRU to begin issuing large fines using the new, lower threshold, which would not previously have been feasible.

Claims management sectors

Chart 2.A: Total authorised CMCs by sector



Source: CMRU Annual Report 2014-15

Table 2.A: Total claims management turnover by sector

	2013	2014	2015
Financial products & services	£653.1m	£453.0m	£458.2m
Personal injury	£354.1m	£238.2m	£309.7m
Employment	£4.0m	£3.8m	£2.7m
Criminal injuries	£0.5m	£0.5m	£0.5m
Housing disrepair	£0.1m	£0.1m	£0.2m
Industrial injuries	£2.1m	£2.2m	£0.3m
Total	£1,007.3m	£697.9m	£771.7m

Source: CMRU Annual Report 2014-15

Financial Products & Services

2.24 Financial products and services dominate claims management, representing 59% (£458.2m) of total CMC turnover in 2014-15. It is the second largest sector in terms of authorised CMCs with 847 authorised firms. PPI mis-selling complaints make up a large proportion of CMC claims in financial services. There has also been increased activity in other financial claims areas during 2014-15 – most notably around claims for mis-sold packaged bank accounts (PBA). The larger CMCs with a background in PPI claims have been most active in this area, as well as some newer and smaller CMCs.

Personal Injury

2.25 A further 40% (£309.7m) of total CMC turnover relates to personal injury claims. During 2014-15, the personal injury CMC sector grew again after adjusting to the effects of major civil justice reforms, in particular the ban on referral fees, introduced in 2013. In terms of authorised CMCs, personal injury is the largest sector with around 900 CMCs in operation at the end of December 2015. The number of CMCs operating in the sector has fallen, albeit at a slower rate than anticipated, making the sector the smallest it has ever been since regulation began in 2007.

Employment

2.26 The most active area among these smaller sectors is employment matters, with a turnover of £2.7m in 2014-15. The number of CMCs operating in this sector has been falling year upon year and those reporting turnover in this sector are far fewer than the 280 authorised CMCs. The Regulator receives information about CMCs operating in the employment sector from a number of different sources including CMCs, consumers, solicitors and other representatives, and the employment tribunals. The concerns reported can range from unauthorised trading to the quality of representation.

Criminal Injuries

2.27 CMCs have a small part of the criminal injuries compensation market, with just under 300 CMCs authorised to operate and are predominantly personal injury businesses. Total turnover was £0.5m in 2014-15. Malpractice in this sector has been largely eliminated, as every case is considered by the Criminal Injuries Compensation Authority, which can both monitor that businesses are authorised and that the Conduct Rules are being complied with.

Industrial Injuries

2.28 Claims for industrial injuries disablement benefit are in some respects similar to criminal injuries. There is a single recipient of claims – the Department for Work and Pensions. Around 150 CMCs are authorised to operate in this sector and business is small scale, with turnover at £0.3m. Most, if not all, of the CMCs in this sector also handle personal injury claims and therefore have been subject to the strategy for that sector. In addition, the DWP share intelligence with the Regulator on CMCs, as necessary.

Housing Disrepair

2.29 The housing disrepair sector is small and local in nature, with around 100 CMCs authorised and very few that are active in this area. Reported turnover for 2014-15 was £0.2m. As with industrial injuries disablement benefit, malpractice has been addressed by employing the same strategy used for the personal injury sector, and has been largely dealt with by preventing cold-calling in person and local authorities rigorously scrutinising claims so that they are not seen as a “soft touch.”

The need for a new regulatory framework

2.30 CMCs provide access to justice for a wide range of consumers who may be unwilling or unable to bring a claim themselves. CMCs also act as a check and balance on the conduct and complaint handling processes of businesses, thereby benefitting the public interest. The overwhelming majority of stakeholders (most notably the banking and insurance industry) argued that there is a legitimate need for CMCs, and therefore the Government should not seek

to regulate them out of existence: for example, one major bank said in their evidence submission that 'CMCs have an important role to play in enabling consumers to seek redress across a range of sectors'.

2.31 The leading banking trade body, the British Banking Association (BBA), stated that; 'The financial services industry has long acknowledged that third parties should be able to raise complaints on customers' behalf... the BBA acknowledges that third party complaints handlers, including CMCs, can provide a useful function particularly for more complex cases, by helping customers to better structure their complaints. Banks have been happy to consider complaints by CMCs under this requirement and have been equally comfortable that CMCs are not legal representatives of their customers.'

2.32 Banks have certainly played a role in facilitating an environment for CMCs to flourish. Aside from the original mis-selling of PPI or PBAs, their complaint-handling processes have been demonstrably poor, leading to several fines being issued by the FCA where banks were found to have failed to handle PPI complaints fairly. In 2015, Clydesdale bank were fined £21m³, and Lloyds were fined £117m⁴ later the same year for failing to treat customers fairly when handling PPI complaints. The FCA stated;

2.33 'Examples of how customers lost out as a result of Lloyds' failings included that:

- complaint handlers justified the decision to reject customers' complaints on the basis that the sales process used by Lloyds was robust, when Lloyds knew there were significant sales process failures and mis-selling.
- some customers whose complaints were rejected were told that their complaint had been 'fully investigated' with 'appropriate weight and balanced consideration [given] to all available evidence', when this was not the case.
- when assessing a customer complaint, the customer's account of what had actually happened at the time of the sale was not always considered in a balanced way.
- due to poor customer contact processes, some customers may not have had an opportunity to provide further evidence needed for complaint handlers to reach a fair outcome for their complaint.'

2.34 Indeed, one CMC highlighted in their evidence that they remarketed to previous customers who had already had a successful claim, and sought authority to require banks to re-visit their claims. The CMC stated they had recovered £35m of redress in excess of what had originally been paid out by banks to over 11,000.

2.35 However, widespread evidence of detriment caused by CMCs exists. The LeO report that '94% of complaints received by the Legal Ombudsman in its first six months of operating its CMC service were about CMCs dealing with financial product claims. These include mis-sold mortgages, investments and interest rate swaps; but the majority (88%) were about mis-sold PPI.' LeO also stated that the 'biggest source of complaints about CMCs of all kinds was the lack of clear and transparent fees, followed by delays and the failure to provide regular updates.'⁵

³ <https://www.fca.org.uk/news/clydesdale-bank-fined-for-serious-failings-in-ppi-complaint-handling>

⁴ <http://www.fca.org.uk/news/lloyds-banking-group-fined-for-failing-to-handle-ppi-complaints-fairly>

⁵ <http://www.legalfutures.co.uk/latest-news/only-4-of-cmc-complaints-relate-to-personal-injury-work-leo-reveals>

2.36 The ABI noted ‘the fact that in 2014, 22% of regulated CMCs either lost their accreditation or received a formal warning demonstrates the need for a much more robust regulatory regime.’ A survey commissioned by the ABI in 2015⁶ found that 83% of people have been contacted by a claims management company encouraging them to claim for compensation, including for personal injury following a road traffic accident and PPI. 49% had been contacted within the last week. 92% of those who were contacted said that the contact had no relevance to any event or product that they held. 83% felt it is unacceptable to be contacted by CMCs without their consent.

2.37 There were a total of 5,638 concerns about live calls reported to the ICO during October 2015. Accident claims remained by far the top reported topic of live calls. A total of 1,625 concerns were reported to the ICO in October 2015; an increase of 41% compared to September 2015. The third highest subject of concerns submitted was PPI claims, with 564 complaints submitted in October 2015. Only Energy Saving and Home Improvement, with 745 reported concerns, prevented CMCs from being solely responsible for the top two categories. The ICO recently issued its largest ever fine of £350,000⁷ to a company called Prodiat Ltd, a lead generation firm responsible for over 46 million automated nuisance calls relating to PPI claims.

2.38 Qualitative research conducted for the FCA by Rowe et. al (2015)⁸ on PPI mis-selling claims found that ‘while potential future complainants had occasionally heard or read about PPI in the media... CMCs advertising and direct contact (e.g. telephone calls) had led to widespread confusion and misconceptions about the PPI complaints process.’

2.39 In addition, the FCA’s research found ‘those who made their complaint via a CMC were often prompted to do so by heavy and persuasive marketing tactics; many engaged only after turning away multiple companies.’ They also found that CMCs ‘*deterred* many potential future complainants from pursuing complaints... through their persistent phone calls and encouragement to complain’ (emphasis added). So while CMC advertising encourages some consumers to use CMCs, it simultaneously discourages others. Some common conduct issues identified by this review include:

- Poor value for money services offered by CMCs – caused by information asymmetries
- Mis-representation of service offered to consumers – advertising focused on enhancements to value of compensation claims rather than ‘convenience/time’ benefits
- Nuisance calls and texts made to consumers – caused by unenforced breaches of data regulations, and the legitimate utilisation of consent provision by unwitting consumers
- Progression of inappropriate (i.e. speculative and/or fraudulent) claims by CMCs – caused by different factors in different sectors

2.40 However, the FOS recognises ‘that some people prefer to pay someone to complain for them. So we continue to work with claims management companies to make sure they follow our approach and don’t refer cases to us unnecessarily.’

⁶ <https://www.abi.org.uk/News/News-releases/2015/09/ABI-clampdown-rogue-claims-management-companies-as-people-continue-bombarded-by-nuisance-calls-texts>

⁷ <https://ico.org.uk/about-the-ico/news-and-events/news-and-blogs/2016/02/record-fine-for-company-behind-staggering-46-million-nuisance-calls/>

⁸ <http://www.fca.org.uk/your-fca/documents/consultation-papers/understanding-ppi-redress>

3 Ideal regulatory objectives

3.1 Before making substantive policy recommendations, this review sought to establish what the regulator should aim to achieve. In doing so, it considered the objectives of relevant organisations including the existing CMRU, and the FCA. The current CMRU’s primary objectives are:

- Protecting and promoting the interests of consumers
- Protecting and promoting the public interest
- Improving standards of competence and conduct of authorised persons

3.2 The FCA’s operational objectives¹ are to;

- Secure an appropriate degree of protection for consumers
- Protect and enhance the integrity of the UK financial system
- Promote effective competition in the interests of consumers

3.3 This review has identified that the following mission statement, strategic and operational goals would constitute ideal regulatory objectives for a claims management regulator.

Mission statement

3.4 *‘To ensure claims management services function effectively, in the interests of consumers and relevant markets’*

Strategic objectives

Table 3.A: Proposed strategic objectives

Strategic objective	Primary benefit for consumers	Primary benefit for industry
Maintain adequate and effective access to justice where a legitimate claim for redress exists	Facilitates access to justice for consumers; provides check & balance on conduct of industry. Reduced volume of inappropriate and spurious claims enhances the efficiency of bringing a claim for compensation, reducing costs incurred by industry which are passed on to consumers and freeing up complaint handling capacity for genuine claims. Strengthens the integrity, legitimacy and value of the civil justice system. Encourages higher standards of conduct by CMCs and industry.	Fewer spurious and/or fraudulent claims reduces both the risk of paying out non-legitimate claims, and complaint-handling costs. Fewer complaints submitted to Ombudsman services brings reputational, administrative and financial benefits for industry.

¹ <http://www.fca.org.uk/static/documents/fca-approach-advancing-objectives.pdf>

Empower consumers to choose a value for money service which is appropriate for their needs	Consumers are equipped with the knowledge and tools to make informed choices about whether it is in their interests to use third party representation in bringing a claim for compensation, and the value for money offered by such services. The quality of services offered to consumers by CMCs will be higher. CMCs will be encouraged to be innovative, transparent and diligent in the services they provide. Faster complaint adjudication by Ombudsman services arising from lower administrative burdens as CMCs less likely to submit poor quality or unsubstantiated complaints.	CMCs will submit higher quality claims to firms, making it easier for firms to establish whether they have merit, reducing the cost of processing claims. Empowering consumers to make their own complaints means firms can own and strengthen the relationships with their consumers. Increased transparency in claims management services provides a level playing field, and favours CMCs who are innovative in the service they provide.
Ensure the impact of claims management on consumers and business is proportionate, reasonable, and in the public interest	Claims management acts as an effective check & balance on industry without being counterproductive to the wider public interest. Claims management marketing practices are reasonable and raise public awareness of their services without causing unnecessary social nuisance, for example through cold calls or texts. Consumers not subject to detriment from unauthorised activity	Ensures the regulator can take action where the impact of CMC activity on an industry is contrary to the wider public interest. Claims management sector provides an effective check and balance on the conduct of firms, leading to more efficient and innovative practices. Businesses benefit comes from not having to deal with unauthorised activity and operating on a level playing field

Operational objectives

- 1 Claims management companies adhere to regulatory requirements
- 2 Fees charged by CMCs are in proportion to their costs and services, and are presented in a transparent manner
- 3 CMCs offer clear, fair and not misleading information about their services and the value they offer to consumers
- 4 Minimal number of poor quality, fraudulent and unmeritorious claims submitted by CMCs
- 5 Consumers can readily assess the relative value of using claims management services
- 6 Regulatory rules and guidance are developed in accordance with changing market conditions
- 7 Consumers understand the implications of providing consent for their personal data to be shared by firms involved in claims management
- 8 Minimal prevalence of unauthorised claims management activity

Regulatory architecture

4 recommendations

Existing powers and resources

4.1 The CMRU received very little criticism during the stakeholder engagement phase or in the call for evidence – the general perception is that it is performing very well given the resources and powers it has.

4.2 Citizen’s Advice stated it has ‘had considerable experience of working with the [CMRU] from its inception. As it has developed its rules and gained new powers, we feel that it has become more effective at tackling poor and unacceptable conduct by claims management companies’.

4.3 The Trade Union Congress (TUC) said ‘The CMRU has been in place for 8 years growing in experience and authority’.

4.4 The ABI’s evidence stated ‘We acknowledge and welcome the improvements that have been made by the Government and the Claims Management Regulatory Unit (CMRU) in recent years... The ABI is supportive of work already undertaken... to tackle malpractice and drive up standards amongst CMCs.’

4.5 A financial service provider stated ‘we value the current relationship we have with CMRU and the MoJ in this area. And although progress has been slow, we have seen some real improvements in how CMCs are regulated.’

4.6 A firm of solicitors said in their submission that ‘Within its limited means the CMRU has done a good job of challenging bad behaviour’.

4.7 The criticism that was received focused on the CMRU lacking the regulatory toolkit required to minimise detriment and maximise compliance, and there was a common belief that significantly enhanced powers could empower the existing regulator to achieve the outcomes identified in chapter 3 above. For example, one submission from a financial service provider said ‘the current regime continues to evolve and the regulator is making steady progress to improve the industry but appears to be hampered by a lack of enforcement powers and resources.’ The ABI noted that ‘the current regulatory regime is only able to go part of the way to tackling the malpractice associated with certain CMCs operating in the market.’

Box 4.A: Recommendation 1

Given the considerable knowledge and expertise within the CMRU, every effort should be made to retain existing staff. This would ease the transition to the new regulatory regime

4.8 In 2014, the CMRU set up its own board as part of a review of its internal governance arrangements with the appointment of two independent non- executive board members to provide external challenge and scrutiny, and expert advice to enhance the delivery of continuous service improvement and effective regulation. However, the CMRU’s management structure is too shallow to provide the level of strategic oversight required to administer the new regulatory tools. No Senior Civil Servants are employed within the CMRU, and the existing governance

structure means that the head of the CMRU effectively acts as CEO and Chair. While the CEO should be the primary decision-maker for the organisation, the role of the Chair, in leading the Board, should include holding the CEO to account for setting organisational strategy and making executive decisions.

4.9 While the appointment of two non-executive board members has provided broader regulatory expertise to the CMRU's board, the inclusion of further non-executive board members from relevant regulatory organisations such as the SRA, ICO, would help to join up the regulatory landscape as recommended by the Insurance Fraud Taskforce (IFT) report.

Box 4.B: Recommendation 2

The CMRU should appoint an independent Chair, and broaden its range of non-executive board members to include other regulators who operate within the market such as ICO, SRA and with wider regulatory experience such as the FCA

Existing enforcement capabilities

4.10 A range of informal or formal statutory enforcement tools are available to the CMRU under the Compensation Act 2006, allowing for flexibility in its approach when dealing with both authorised and unauthorised CMCs. This action can range from written advice, warnings and undertakings – when the CMC has committed less serious breaches and is willing and able to comply – through to financial penalties, the variation, suspension or cancellation of authorisation where stronger action is required to address serious breaches. The Act also provides the statutory basis for the CMRU to prosecute any business providing claims management services without authorisation.

Box 4.C: Recommendation 3

The review has not encountered evidence to suggest that the regulator's existing enforcement capabilities are excessive or unnecessary, and therefore they should be retained

Rule-making powers

4.11 The CMC industry is innovative and dynamic and it is difficult to predict which industries it will evolve into next. This is partly because CMCs are reliant on misconduct or other grounds for complaint in other sectors, which is by its nature hard to predict. The media often reports on issues described as 'potentially the next PPI scandal'¹²³ and although a similar sized scandal is yet to materialise, this provides an indication of the variety of issues which could generate CMC future activity.

4.12 To respond to this dynamic market, it is essential that the regulator is able to design and implement new rules. The regulator already has rule-making powers, which will be used to

¹ <http://www.telegraph.co.uk/finance/property/advice/11411880/Could-the-cavity-wall-insulation-scandal-rival-PPI.html>

² <http://www.theguardian.com/money/2015/aug/29/packaged-bank-accounts-good-deal-ppi-scandal-misselling>

³ <http://citywire.co.uk/new-model-adviser/news/fca-annuity-probe-could-be-next-ppi-scandal-widows-warns/a843809>

implement the proposed cap on the fees CMCs charge⁴ and should therefore be retained in full. The CMRU has the necessary powers to implement the fee cap.

Box 4.D: Recommendation 4

The CMRU should retain its ability to design and implement new rules to reflect changing market conditions

Publication policy

4.13 The regulator has a range of roles and responsibilities as regards the publication of data. For consumers, its unique insight into the market means it is well-placed to provide access to the information they need to choose a service which is appropriate for them. For businesses, the regulator can provide information on how to deal with CMCs more efficiently and act as an independent, free source of information for consumers wishing to complain against them. And for CMCs, the regulator has two important roles: providing information for CMCs on how to comply with their rules; and publishing details of enforcement action, which acts as a deterrent for others. While the regulator does already have the power to publish this type of information, this review has heard representations from stakeholders suggesting that the powers could be used more effectively.

4.14 Educated and empowered consumers are core to achieving the strategic objectives of the CMRU and the review considers it would be appropriate for the regulator to expand its existing education remit. In particular, the CMRU is well-placed to provide the impartial information about CMCs and the services they provide which consumers need to make informed decisions. The CMRU's website⁵ already has a range of information on how to progress claims directly and different types of alternative dispute resolution bodies, including the financial and legal ombudsmen. This information should be comprehensively reviewed, to ensure it is fit for purpose and also be expanded, for example with an indication of how to establish when a legitimate entitlement to redress exists.

4.15 This information will also be of use to defendant businesses, who can point dissatisfied consumers towards the CMRU as a source of free and impartial information on complaints handling.

4.16 As an example of the importance of adequate information, research undertaken by the FCA⁶ indicated that many consumers enter into contracts with CMCs without fully understanding the reasons for using a claims management company or whether they need to use one, despite extensive information being available for consumers on the CMRU and FOS websites.

4.17 In workshops held during the review, several stakeholders suggested the regulator should publish market intelligence. Some suggested that the regulator may wish to consider disclosure of firm-level data for claim success rates, to help consumers to compare the performance of CMCs, and drive competition, leading to higher standards for consumers, and potentially leading to fewer spurious claims. Publishing claims data in this way may however have adverse consequences, as it may lead to CMC's "cherry picking" only those cases with a high probability

⁴ <https://www.gov.uk/government/consultations/cutting-costs-for-consumers-in-financial-claims>

⁵ <https://www.gov.uk/guidance/claim-compensation-for-injury-or-financial-loss>

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

of success, which could hamper access to CMC services or provide a false metric for comparison. The regulator itself is best placed to determine which market intelligence should be disclosed in the public interest, and to recognise the risks associated with disclosure.

4.18 As such this review does not make any specific recommendations in terms of what information should be disclosed, recommending instead that the regulator should consider what information could be made available to consumers to help them to make better decisions (see recommendation 8 on a standard disclosure document).

4.19 The CMRU's website can also provide a useful source of information for CMCs. Providing clear and comprehensive information about how to comply with the regulatory regime is a way to reduce costs and ensure consistent interpretation and compliance among CMCs. The CMRU should therefore expand the information available on its website, to provide information to the sector about the toughened regulatory regime which follows this review.

4.20 The CMRU is permitted to publish regulatory decisions and enforcement action. Its publication policy⁷ ensures that all publications comply with the Data Protection Act and are in the public interest. Under its publication policy, the regulator publishes information on:

- Investigations: the names of CMCs being investigated after they have been informed that they are under investigation under Regulation 35
- Warnings and undertakings: the names of CMCs that have received warnings or agreed to undertakings and a summary of the reasons
- Formal enforcement action: an account of the decision to refuse, vary, suspend or cancel authorisation, or impose a financial penalty including details of any rules that have been breached and where appropriate a summary of the general nature of those breaches

4.21 As well as providing a powerful deterrent, publishing regulatory decisions aids transparency. It informs users of claims management services, promotes compliance among CMCs, and helps others to hold the regulator accountable by helping them to assess whether it has acted proportionately and consistently. These publishing powers should also be used to highlight enforcement action taken against unauthorised firms.

Box 4.E: Recommendation 5

The CMRU should:

- Publish all appropriate information on enforcement activity, including against unauthorised firms
- Review the information available on its website to ensure it is fit for purpose and helps consumers choose a service appropriate for their needs.

⁷ CMRU Publication Policy: <https://www.gov.uk/government/publications/claims-management-regulator-publication-policy>

Authorisation

5 recommendations

Authorisation process

5.1 Authorisation processes have benefits for both regulators and regulated businesses. For regulators, they are a way of preventing unscrupulous or incompetent businesses undertaking regulated activities and trading in the first place. In this way, having a robust authorisation process for CMCs diminishes the need for enforcement activity, which in turn eases resource burdens for the regulator and helps to keep the regulatory levy to a minimum.

5.2 For firms, the process can provide a mechanism to ensure they understand the regulatory requirements before they start trading. This can help them run their business in a compliant way which minimises the risk of detriment to consumers.

5.3 Evidence of non-compliance by CMCs is widespread. For example in 2014-15 alone, 296 warnings were issued to CMCs and 105 authorisations, representing 6% of the total, were cancelled by the regulator. This provides an indication of the extent of compliance challenges, given that cancelling licenses is a last resort. The CMRU's annual report for 2014-15 reflected on the CMRU's approach, saying that 'in the first instance the task is to bring claims management companies (CMCs) to compliance'. Furthermore, the FOS has also expressed concern over the amount of resource it dedicates to advising CMCs on compliance issues, commenting in their 2014-15 annual review¹ that 'some people only realised that they might have a problem with PPI after being contacted by a claims manager – and so follow (sic) that route to us. Unfortunately – even after many years of handling PPI complaints – some claims managers still send us “generic” information that isn't specific to each individual customer. We continue to explain the difficulties this can cause us in deciding a fair answer in the customer's particular circumstances.'

5.4 Both of these factors suggest the authorisation process for CMCs should be made more robust, both in terms of acting as a barrier to unscrupulous firms, and ensuring firms understand the rules.

5.5 This review has recommended a range of new rules, such as a new disclosure document, new conduct rules tailored to each sector and a requirement to disclosure of referral source. It is imperative that the regulator can satisfy itself, at an early stage that CMCs are willing and able to comply with the new regime. Allowing CMCs to trade who do not understand or are unwilling to comply with the new rules will mean the regulator must expend resources on enforcement and sanctioning activities, diverting its focus from day to supervision and increasing funding pressures.

5.6 The regulator should therefore undertake to re-authorise all CMCs who wish to continue trading. This process would be similar to that currently being undertaken by the FCA in respect of consumer credit firms, for which it has recently taken responsibility from the OFT. This review has engaged with the FCA, who have indicated that, should the regulator remain within the MoJ, they would be willing to lend policy support to help design this process, given their recent and highly relevant experience and the fact that the process is likely to be resource intensive.

¹ <http://www.financial-ombudsman.org.uk/publications/ar15/about.html>

5.7 CMCs operate in a wide variety of sectors, and perform different roles in each. The nature of misconduct in each sector is also substantially different, as shown by the distribution of complaints submitted about CMCs to LeO by consumers. As such, authorisation requirements should be tailored to the nature of each sector. Under current regulations, CMCs are merely required to notify the regulator if they wish to operate in a different sector: they are not subjected to a new authorisation process. However, given that this review recommends that there be rules tailored to the specific sectors in which CMCs operate services they provide, this should be reflected in the new, stricter authorisation process. CMCs should therefore seek authorisation for each of the services they offer and sectors in which they operate, and should seek new permissions if they wish to change their line of business or customer offering. This would ensure the regulator retains sight of which CMCs are performing which activities, and ensure the regulator knows they are complying with appropriate rules with the required level of competence.

5.8 The majority of stakeholders supported these recommendations. Some stakeholders, predominantly CMCs, expressed concern that a more robust authorisation process would create additional regulatory burdens for firms, and additional resourcing requirements for the regulator with consequences for the levy. Although costs may rise in the short term, in the medium term, the resulting higher levels of compliance overall should actually ease pressure on the regulator, which in turn should also ease pressure on the levy.

Box 5.A: Recommendation 6

All firms should be re-authorised under a robust new process, and seek permissions for each of the activities they carry out.

Personal accountability for directors

5.9 Stakeholders, including the CMRU, expressed concerns about the ability of the director of a liquidated firm to take over another authorised firm without requiring approval from the CMRU.

5.10 There are two ways in which this is possible. The first way is by acquiring multiple authorisations simultaneously, with the extra companies to be used at a later stage where the first business experiences financial difficulties or once the CMRU begins enforcement action. The second method – which the CMRU reports is increasingly common – is to acquire an existing legitimate CMC, as a change in company director does not require authorisation from the regulator.

5.11 Another concern is the frequency and ease with which CMCs re-emerge as a new firm following liquidation or insolvency, with some or all of the directors remaining in place. CMRU has already taken some steps to tackle this issue, by refusing or otherwise deterring authorisations for ‘phoenix’ companies.

5.12 These examples demonstrate how authorisation alone is not sufficient to deter or prevent unscrupulous business or individuals operating in the CMC sector and suggests that the current regime is not robust enough to ensure that individuals suffer the consequences of their actions.

5.13 Under the CMRU’s Conduct of Authorised Persons Rules 2014², there is a requirement that CMCs ‘shall be directed by people with the necessary competence who must have a working

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380623/CMRU_Conduct_of_Authorised_Persons_Rules_Oct14a.pdf

knowledge of the legislation and rules relating to regulated claims management services'. However, the CMRU lacks a legislative mandate to enable these rules to hold individuals personally accountable for actions of the firms they control. The rules do not therefore create a sufficient deterrent to poor conduct.

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

5.15 A robust regime of personal accountability would have several benefits. First, unscrupulous directors would be prevented from utilising dormant pre-authorised companies, acquiring legitimate CMCs, or establishing 'phoenix' companies. Second, it would hold individuals personally accountable for the conduct of their firms, providing a proper framework to ensure that poor conduct does not go unpunished. Third, it would diminish the likelihood of a firm being controlled from behind the scenes, as individuals would be reluctant to be held accountable for regulatory breaches.

5.16 A majority of stakeholders (including the insurance industry, some in the banking industry, consumer bodies and many CMCs) supported a system of personal accountability. Many stakeholders explicitly referenced the FCA's Senior Managers regime as a model the CMRU should seek to mirror. The precise design of the regime would need to be subject to more detailed policy work and be tailored to the CMC sector, but is likely to include a test of fitness and propriety to practice and a requirement to disclose any associations with companies that have gone into liquidation.

5.17 Some CMCs felt that a senior managers-style regime would be disproportionate, deterring new entrants and harming competition, but a leading trade body and some of the largest individual CMCs believed this would be a positive step, enhancing professional standards and integrity.

Box 5.B: Recommendation 7

Persons wishing to perform controlled functions for a firm regulated by the CMRU should be required to:

- Pass a fit and proper persons test, which will consider honesty, integrity and reputation, but also competence and capability, and financial soundness
- Be personally accountable for rule breaches for which they are responsible

Supervision

6 recommendations

Conduct rules

6.1 Clear product disclosure is important to ensure that consumers choose products and services which are suitable for their needs. The FCA's thematic work and market studies have previously revealed¹ that 'the type of information consumers receive, when they receive it and the way it is delivered can drive both poor and positive consumer outcomes. It is essential that information empowers consumers to make informed decisions about products and services.' The FCA also found that 'clear and engaging information also helps to promote competition and deliver products and services that consumers want... Examples of smarter communications include... communications using plain language, short format, bullet points and clear graphics.'

6.2 Current disclosure practices by CMCs mean information is not presented clearly enough or in a way that allows consumers to compare services. While existing rules require CMCs to disclose key product information such as their fee structure, they are not compelled to disclose it in a consistent manner, often opting to present relevant product data deep in the contract's terms and conditions.

6.3 A standardised disclosure document for each claims management sector could combine the smarter communications tools identified by the FCA to help consumers to be better informed when signing a contract with a CMC. In turn, this would be expected to improve competition between CMCs, improving standards and lowering prices, and help consumers to choose services which are appropriate for their needs.

6.4 Where a CMC is making multiple claims on behalf of a consumer, it may be the case that each claim has very similar or identical features and fee structures. In such circumstances, 'smart disclosure' suggests separate disclosure documents would not be necessary. If, however, there are material differences between claims in the service provided by the CMC, then a different disclosure document should be signed for each claim to ensure that the consumer is fully aware of the terms of service they are agreeing to.

Box 6.A: Recommendation 8

The regulator should develop a concise standardised disclosure document to help consumers compare services and fee structures.

A separate disclosure document should be signed by the consumer for each claim where the key product features differ (such as commission structure)

6.5 Current rules state that, before seeking to enter into a contract with a client, CMCs 'must make reasonable enquiries as to whether the client has alternative mechanisms for pursuing a claim and must advise the client unambiguously of ombudsman schemes or other official means of redress.'

¹ www.fca.org.uk/news/smarter-effective-communications

6.6 Stakeholders from the CMC industry feel this is sufficient requirement for CMCs to inform consumers of alternatives. However, Citizen’s Advice research (2014)² found that 39% of people who had used a CMC to make a claim didn’t know that they could have made the claim themselves, and almost half said that they if they had been aware of the free alternatives, then they would not have used a CMC. Citizen’s Advice concluded that ‘while CMCs offer a legitimate service for consumers in some circumstances, too many people are paying for a CMC to make a claim on their behalf, even though they could make the claim directly for free.’³ Furthermore, FCA research⁴ found that some people who used CMCs for PPI mis-selling claims assumed CMC involvement was essential.

6.7 These studies indicate that the current rules are not sufficient to ensure consumers are properly informed of the options available to them. Broader requirements to signpost to alternative claim resolution channels would help to enhance consumer awareness and help them make fully informed decisions. Additional signposting may be useful at different points for those operating inbound rather than outbound services, and may be required in adverts, and/or in paper correspondence with consumers (such as settlement statements). The regulator should exercise its discretion in determining when and where additional signposting is appropriate and should consider whether or not this should form part of the mandatory disclosure document (recommendation 8).

Box 6.B: Recommendation 9

CMCs should signpost consumers to alternative claim resolution channels (e.g. direct to the firm/ombudsman) at the appropriate times when communicating with consumers

6.8 The regulator has not yet used its powers to introduce outcomes-based rules. Instead, it relies on a rulebook which codifies all the requirements with which CMCs must comply. A concern exists among stakeholders that some regulated firms can avoid enforcement by maintaining technical compliance with rules, but without due regard for consumer outcomes – i.e. they don’t comply with the ‘spirit’ of the rules. A combination of rule-based and outcome-based regulations would help to minimise this risk, and would ensure that firms must act in the interest of consumers as well as adhere to certain explicit rule requirements. Other regulators have used this type of approach with great success. For example, the FCA requires that firms’ communications with consumers must be ‘clear, fair and not misleading’. This holds firms to account for their actions, but allows them to use their judgement in determining how to design communications in a way which is suitable for the product and client base.

Box 6.C: Recommendation 10

Introduction of outcomes-based conduct rules to cover each area of core CMC activity (e.g. service provision, marketing etc.), to sit alongside enhanced existing rulebook.

6.9 There is no existing obligation for regulated firms to record the referral or recommendation source from which they received a claim. This makes it harder for consumers or the regulator to

² <https://www.citizensadvice.org.uk/cymraeg/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/the-cost-of-redress/>

³ <https://www.citizensadvice.org.uk/cymraeg/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/the-cost-of-redress/>

⁴ <http://www.fca.org.uk/your-fca/documents/consultation-papers/understanding-ppi-redress>

verify from where a CMC obtained personal details. Requiring firms to disclose referral sources would make it easier for the regulator to verify that referrals have come from a legitimate source, and identify those from 'claims farmers' and other questionable sources.

Box 6.D: Recommendation 11

Source origin to be recorded by relevant firms, for referrals and recommendations

6.10 At present, CMCs are not required to record calls with clients, unless directed to do so as part of an enforcement measure, where they can be required to retain call recordings for 6 months. This creates scope for CMCs to mis-represent their services or use aggressive sales tactics. CMCs should be mandated to record all calls with clients, and retain them for a minimum of 12 months following the conclusion of a contract with that client. This would allow the regulator to audit the firm's customer service levels, and for the Legal Ombudsman to recover records relevant to service complaints made by consumers against CMCs.

Box 6.E: Recommendation 12

Client communication records (including phone calls) to be retained for 12 months following contact with clients or settlement/conclusion of a claim – whichever comes later

Use of existing powers

6.11 The traditional approach of giving prior notice of audits affords CMCs the opportunity to 'sanitise' premises in preparation for the audit. CMRU auditors often recognise signs that a premises has been 'sanitised', offering little resemblance to intelligence obtained from consumer complaints and provided by whistle-blowers. While there would be advantages to strengthening the existing powers of seizure to enable the CMRU to take possession of evidence without notice, legislative obstacles⁵ prevent this from being viable.

6.12 However, powers of entry provide for the CMRU, under a court issued warrant, to enter and search premises to investigate whether an offence has been committed or assess compliance, and to take possession of written and electronic records. The CMRU abides by Better Regulation Principles and as such practices proportionality in enforcement methods. This power should be used more widely to ensure firms are held to account where there is sufficient indication that they have may have breached regulations.

Box 6.F: Recommendation 13

The CMRU should endeavour to make wider use of warrants and seizure powers

6.13 Engaging with regulated firms and offering them support encourages a culture of compliance rather than enforcement. With this in mind, the FCA hosts regular supervisory roadshows and workshops, and LeO also works closely with CMCs to improve their complaint-handling processes, offering training and workshops as appropriate. Both models are deemed to

⁵ For example, the Protection of Freedoms Act 2012 includes provisions that restrict strengthening existing powers of seizure

be very effective in raising the standards of the relevant firms. This review is encouraged to note that the CMRU, which used to employ such tools⁶, is looking to resume and expand such activities and that the CMC sector is likely to be receptive to such measures.

Box 6.G: Recommendation 14
Further use of regulatory roadshows, workshops, and training support to encourage compliance rather than enforcement

⁶ The CMRU led 4 workshops in 2007/8, and are planning more outreach work this year now that most CMCs are relatively mature, familiar with the regulatory regime and receptive to these types of events.

7 Enforcement recommendations

Range of enforcement measures

7.1 So far, the regulator has only used its powers to impose fines for major conduct breaches. Despite having the necessary powers the regulator has not yet fined any firms for minor regulatory breaches. There are therefore questions over whether or not firms perceive these powers to be a credible deterrent for making minor breaches.

7.2 Where a regulated firm has repeatedly or wilfully breached a regulation, even if it is considered to be relatively minor, the regulator could impose sanctions on the firm to ensure regulated firms are held fully to account.

7.3 However, in certain circumstances, some alternative enforcement measures may be more effective than fines alone in driving up conduct standards. For example, firms who breach regulations could be subject to a compulsory staff training programme, at the firm's own expense, as an alternative enforcement measure. In order for this to act as a credible deterrent, and ensure firms are incentivised to maintain compliance, this may be to a higher standard than required through the normal authorisation process. For example, CMCs who breach data regulations and/or disregard the Telephone Preference Service (TPS) could be obliged to register for TPS Assured – an annual audit and certification service operated by the TPS that assesses whether an organisation complies with Privacy and Electronic Communications Regulations (PECR), Ofcom Guidance, and TPS Assured's guidance on outbound telemarketing best practice.

Box 7.A: Recommendation 15

Use of a broader range of existing enforcement measures – such as smaller fines or mandatory training

Unauthorised activity

7.4 In 2014/15 the CMRU dealt with 523 enquires and conducted 33 investigations into unauthorised businesses. Unauthorised firms pose significant risks to consumers and to legitimate, authorised businesses. Not only are firms less likely to treat consumers fairly or abide by the rules of the CMRU, consumers have no recourse to the Legal Ombudsman to make a complaint about a CMC. Unauthorised firms are also more likely to source their clients from illegitimate sources, and so fuel demand for nuisance calls and texts.

7.5 The personal injury sector has seen more extensive unauthorised activity than other sectors, most notably after the referral fee ban came into effect in April 2013. This sector has also been most closely linked with fraud – criminal groups involved in “cash for crash” scams.

7.6 Meanwhile, some stakeholders believe that more could and should be done to combat existing unauthorised activity. And, while the recommendations outlined above are intended to raise standards of compliance among regulated firms, a potential unintended consequence is

that firms may be incentivised to surrender their authorisation but continue to operate as an unauthorised firm.

Box 7.B: Recommendation 16

Enforce against unauthorised activity in a more effective manner

8 Funding recommendations

8.1 The CMRU operates on a self-funding basis with all operating costs recovered through regulatory fees paid by CMCs. The levy, reviewed and consulted on by the MoJ each year, is currently determined by the turnover of the regulated firm. The aim is to achieve a sustainable balance between providing the regulator with adequate resource to achieve its objectives, and ensuring that CMCs contribute to a self-sustained model of regulation without the need to draw on public funds.

8.2 The new regulatory framework proposed in this review will mean the CMRU needs additional funding, both in the short term to pay for the policy work to develop and implement the policies, and probably also in the medium term to sustain a more intrusive supervisory approach. This may require a revised methodology for determining the regulatory levy imposed on each regulated firm in order to ensure the regulator is sufficiently resourced to supervise the claims management market. For example, the regulator should be free to consider whether claims volume should also be a factor in determining the levy, rather than according to revenue.

8.3 Given the scale of work required in the near term to implement the recommendations, it might not be possible to fully fund the transition costs from a single year's regulatory levy. When implementing the findings of this review, government should consider whether the implementation costs should be spread over several years through a supplementary levy, to avoid setting the levy at a level which would be unaffordable for many firms and risk causing the market to collapse. When deciding on the right approach, government should also consider that the impact of other reforms, such as the FCA's deadline for PPI complaints, the cap on fees for bulk financial claims, and the reforms to whiplash and the small claims track, which may contribute to a shrinking marketplace, which in turn may reduce levy receipts in future years and diminish industry's ability to pay a supplementary implementation levy.

8.4 Existing revenues collected by the regulator are transferred to HM Treasury's consolidated fund. In December 2014, penalties of up to £100,000 were introduced for rule breaches. If a CMC's turnover exceeds £500,000, a further 20% of turnover above this amount may be added to the fine.

8.5 A proportion of receipts from enforcement activity (i.e. fines) should be used to subsidise enforcement activities. While the CMRU is able to recover its costs from enforcement fines, a resourcing structure in which enforcement activities could be subsidised would mitigate the risk of unsustainable increases in the regulatory levy resulting from a further drop in the number of regulated CMCs. This would also enhance the independence of the regulator, as distinct and separate from government.

Box 8.A: Recommendation 17

A proportion of enforcement fees should be retained to pay for enforcement activities to help ensure the regulatory funding model remains sustainable

9 Perimeter findings

9.1 This review supports existing efforts to tackle nuisance calls. In March 2014, the government launched an Action Plan¹ on nuisance calls to tackle the problem. This resulted in the Which? Taskforce recommendations,² which the government are considering, including the ability of the ICO to hold to account board-level executives who fail to comply with rules and guidance on the use of consumers' personal data for marketing purposes.³ The government also announced in the March 2015 budget a £3.5m package to help stop nuisance calls and is exploring options to provide call blocking devices to people identified as being at higher risk of financial damage and personal distress as a result of nuisance calls. Furthermore, the government is due to consult on amendments to PECR requiring direct marketing callers to provide their Calling Line Identification (CLI) so consumers can identify who is calling them, making it easier for the consumer to report the call to the regulator.

9.2 It would be helpful for the CMRU if the ICO Direct Marketing Code was to become a statutory Code of Practice (i.e. enforceable) as existing guidance on duration of consent (6 months) can currently be breached without significant repercussion.

9.3 The existing environment for reporting complaints about direct marketing is confusing for consumers; different types of complaints currently need to be made to one or more of ICO, Ofcom, TPS, CMRU and/or the Advertising Standards Agency (ASA). The creation of a central reporting point for such complaints could help to reduce such confusion.

9.4 The TPS service is currently an opt-in service; only 3% of mobile telephones are registered, and 90% of consumers are unaware that mobiles can be registered to TPS. If TPS should become an opt-out service, this would help to stem increasing volumes of unsolicited nuisance calls.

9.5 The language used for the provision of 'indirect consent' (also known as 'third party consent') often leaves consumers unclear about what they are consenting to. It would be helpful for consumers if all third party organisations to whom the consumer's personal data will be passed to were explicitly named at the point of consent, and furthermore it should be made explicit that they are agreeing to being 'cold called'.

9.6 The SRA should make every effort to ensure the regulation of legal firms and Alternative Business Structures⁴ (ABS) who perform claims management activity is strong and effective. CMCs may seek to avoid regulation by the claims management regulator – and the senior managers regime in particular – by re-structuring their business as an ABS, which are subject to regulation by the SRA rather than the CMRU.

9.7 This review echoes the findings of the IFT⁵ which stated 'The SRA has raised concerns that its enforcement and fining powers are not consistent with those of other regulators such as the FCA, CMRU and ICO. For example the SRA can currently fine alternative business structures £250 million but can only fine a traditional solicitors' partnership £2,000. Higher fines or "striking off" require a prosecution before the independent Solicitors Disciplinary Tribunal (SDT). While the

¹ Accessed November 2015; https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/299140/Action_Plan.pdf

² Accessed November 2015; <http://www.which.co.uk/documents/pdf/nuisance-calls-task-force-recommendations-388317.pdf>

³ In addition to calling for a taskforce, as part of the Government's commitment in its Action Plan, the Department for Culture, Media and Sport published a consultation on nuisance calls on 25 October 2014, which can be found at: <https://www.gov.uk/government/consultations/nuisance-calls-consultation>

⁴ An ABS is a firm where a non-lawyer is a manager of the firm, or has an ownership-type interest in the firm.

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494105/PU1817_Insurance_Fraud_Taskforce.pdf

SDT has unlimited fining powers, it considers cases on the basis of the criminal standard of proof, meaning the case must be proven beyond all reasonable doubt. That makes it difficult to impose high financial penalties and more importantly means that those who are dishonest on the balance of probabilities (the civil standard of proof) can continue to practice. This undermines the strength of the regulator, and means its enforcement actions may not act as a credible deterrent.

Analysis of future regulatory responsibility

10

Introduction

10.1 Under the terms of reference, this review was also asked to consider:

- Further reform of the existing regime, with new powers and resources provided to the CMRU
- Dual regulation between the CMRU and the FCA
- Creation of a new independent regulator; or
- Transfer of responsibility for regulation of CMCs to the FCA

10.2 In addition, the review gave consideration to other options which arose during the course of the review including transferring of responsibility to the SRA.

10.3 None of the options were without substantial drawbacks. There is no perfect solution. As the review progressed, it transpired that there are just two options which would be both workable and effective in delivering the required outcomes. These are for the regulator to remain within the MoJ, or to transfer regulation to the FCA.

Option 1: Strengthen and restructure the existing regime

10.4 Throughout the review, stakeholders were extremely keen to impress upon the review team their positive experiences of working with CMRU. This review has seen no evidence that the staff in either the MoJ policy HQ or the contractual arrangement with Staffordshire County Council have been ineffective. On the contrary, several stakeholder said they did a very good job, considering their lack of resources and powers – though the latter of these has recently been bolstered. Citizen’s Advice stated it has ‘had considerable experience of working with the MoJ Claims Management Regulator from its inception. As it has developed its rules and gained new powers, we feel that it has become more effective at tackling poor and unacceptable conduct by claims management companies’.

10.5 The criticism that was received focused on the CMRU lacking the powers and resources to fully deliver on its objectives. One CMC noted that the CMRU ‘has been handicapped over the past few years because of the lack of enforcement capability’.

10.6 A major bank was among stakeholders who supported strengthening the existing regime in evidence submissions, stating their ‘preferred option is to support further reform of the CMRU... Based upon the CMRU being fully resourced to deliver a more intrusive regulatory approach where robust and swift enforcement action can be taken.’

10.7 Further support for strengthening the existing regime came from some CMCs, the TUC and Citizen’s Advice. The TUC commented that: ‘The CMRU has been in place for 8 years growing in experience and authority. With increasing powers (including fines and capping) and

hopefully further changes in the regulations as referred to above the CMRU has the armoury to effectively deal with CMCs. They are now broadly in line with similar regulatory bodies. They are a regulatory “best fit” for CMCs which cover such a range of different sectors, having matured as a regulator with a good understanding of their field’.

10.8 To the extent that it can remain cost-neutral, the MoJ are not opposed to the CMRU remaining within their remit.

Advantages

Unrivalled skills and expertise in claims management regulation

10.9 Since its inception, the CMRU has developed good working knowledge about the claims management sector. This unrivalled expertise gives it an obvious advantage over other candidate organisations. Keeping the CMRU as part of MoJ would maximise the chances of retaining key knowledge and relevant expertise.

10.10 The early indications are that the fining powers granted to the CMRU in December 2014 have proved to be a significant step in the right direction: the CMRU has imposed substantial fines on several CMCs. Public notification of fines has sent a strong message to the rest of the industry. A major bank stated ‘The CMRU has extensive expertise in dealing with CMC conduct issues and we judge that the recent use of its powers to fine is a good indicator of its intent to deal with issues in a more robust manner’.

10.11 The existing regulator – which is still relatively young when compared with other regulators – has delivered this expertise and capability with excellent value for money in a time in which it has quickly had to establish its functions and understanding of the market.

Minimal disruption

10.12 The CMC industry is undergoing a period of significant change. While a fee cap for financial service claims will act as a disincentive for CMC activity, it is anticipated that there will be a spike in PPI mis-selling claims ahead of the FCA’s deadline for making PPI mis-selling complaints coming into force. Meanwhile, an increase to the small claims track will mean many claims which are currently handled by solicitors may be dealt with by CMCs in future. All of these changes will create the risk of misconduct, particularly the deadline for PPI complaints, which may create the atmosphere of a “closing down sale” and, for those firms whose future is uncertain, possibly reduce the incentive to comply with the regulator’s rules.

10.13 During this uncertain time, the CMRU can be considered as a ‘safe pair of hands’, which would minimise disruption during the transition to the new regime, and while the full impact of concurrent reforms crystallises. The CMRU would be capable of continuing to deliver its existing functions while it develops new capability to deliver the new policy recommendations.

De facto independence

10.14 While the CMRU lacks the independence of many other regulators, in practice it operates largely without operational or strategic involvement from the MoJ, leaving it free to pursue priorities and objectives as it sees fit. Indeed, its position within the MoJ enables it to be close to Government policy and therefore one step ahead in adapting and responding to reforms that impact the industry.

Established stakeholder relationships

10.15 The CMRU has developed a positive working relationship with a broad range of stakeholders, which any new regulator would need to build up from scratch. For example, the UK Cards Association, which represents credit and debit card providers, 'greatly values the relationship it has built up with Kevin Rousell [the head of the CMRU] and his team at the CMRU. We have always found the CMRU most helpful and open to comments from our industry where it sees examples of consumer detriment and the speed with which these are investigated and addressed to the benefit of consumers. We trust that the outcome of this review will mean that this spirit of proactive cooperation on behalf of the consumer continues.'

10.16 Many stakeholders commended the regulator's existing approach to engagement. CMRU uses a range of communication channels and formal and informal exchange of intelligence with relevant bodies, such as the Regulatory Consultative Group (RCG)¹, which meets on a quarterly basis. Regular bi-lateral meetings are held with the FCA, FOS, SRA, OFCOM, ICO, LeO, Trading Standards and annual meetings are held with the ASA. The head of the CMRU regularly meets with trade bodies and major firms from the banking and insurance sectors. The CMRU also sits on the FCA's co-ordination committee (together with the FSCS, FOS, and CMA).

Disadvantages

Resource constraints

10.17 The regulator will need to significantly expand its policymaking and operational capacity in order to implement the recommendations in this review. Each of the recommendations will require detailed policy work to refine before they can be implemented and many, such as wider use of warrants, the Senior Managers Regime and more robust authorisation processes, will also require more operational resources. Given the need to continue to supervise the market, it seems unlikely that these additional resource needs could be met from the existing pool of resource.

10.18 Constraints on departmental spending and headcount, which are well publicised, create practical barriers. These pressures remain, despite the CMRU's self-funding status, and create a risk that the regulator is unable to scale its operations up in the short term to develop and implement the recommendations, in particular the reauthorisation process, which is likely to be resource-intensive. These challenges are made more difficult by the fact the existing set-up is somewhat unusual – MoJ does not supervise any other sectors – and that CMC regulation is relatively far-removed from the department's overall strategic priorities, such as reform to prisons, legal aid or civil justice reforms.

10.19 Indeed, it is perhaps instructive that the main criticism levied on the CMRU by stakeholders is that the regulator has not had enough resources. The BBA were among a number of stakeholders who commented on this issue, stating that they had 'a significant amount of respect for the CMRU Unit in the MoJ, who do a difficult job given the rapid growth in the market, but are perhaps under resourced for the role they undertake.'

¹ RCG membership includes: Advisory, Conciliation and Arbitration Service (ACAS), Advertising Standards Authority (ASA), Association of British Insurers (ABI), Association of Mortgage Intermediaries (AMI), Association of Personal Injury Lawyers (APIL), Association of Professional Financial Advisors (APFA), Association of Regulated Claims Management Companies, British Bankers Association (BBA), British Insurance Brokers Association (BIBA), Building Societies Association (BSA), Citizens Advice Bureau (CAB), Claims Standards Council (CSC), Council of Mortgage Lenders (CML), Direct Marketing Association Ltd (DMA), Employment Appeal Tribunal, Financial and Leasing Association (FLA), Financial Conduct Authority (FCA), Financial Ombudsman Service (FOS), Financial Services Compensation Scheme (FSCS), Law Society, Legal Ombudsman, Motor Accident Solicitors Society (MASS), Ofcom, Professional Financial Claims Association (PFCA), Solicitors Regulation Authority (SRA), UK Cards Association, Trade Union Congress (TUC), and Which?

10.20 While the CMRU has unrivalled experience and expertise in regulating the CMC industry, it lacks sufficient resource to undertake the scale of policy design, development and implementation that will be required to implement this review's recommendations. Given the FCA's recent experience in implementing two of the most substantial recommendations, through their reauthorisation of consumer credit firms and implementing a Senior Managers regime, the viability of this option would be contingent upon FCA support and oversight in the transition to the new regime.

10.21 The FCA have offered to provide resources to the CMRU if they were to remain within the MoJ, however the detail has not been defined sufficiently to understand whether the FCA's offer would empower the CMRU to successfully implement the new regime. This would therefore need further exploration.

Size of regulator

10.22 Scaling operations up or down in accordance with market shrinkage (reflecting tighter regulation) or expansion (for example, if a new mis-selling scandal emerges) would be possible to execute as a small, stand-alone regulator, but may be more difficult than for a larger regulatory organisation.

Lack of independence from Government

10.23 The Head of CMRU is answerable to the Secretary of State for Justice and is therefore not independent of the Executive, unlike other public regulators. The preference would be for the regulator to set its own agenda without the possibility for political interference. Although there are a few examples of regulators operating within a government department (such as the Forensic Science Regulator which operates within the Home Office), for the most part public regulators operate independently of the Executive and have arrangements which seek to preserve some distance between the Regulator and the Government. It is conventional for regulatory bodies to be separate from government in order to ensure autonomy, therefore the placement of the CMRU within the MoJ is viewed as a functional rather than optimal solution.

10.24 While in reality, the CMRU is largely autonomous and benefits from being close to Government policy decision-making, some stakeholders believed that full independence would improve the regulator's credibility and reputation.

10.25 The CMRU currently lacks the ability to publish its own information on its website without first having to get sign-off from the MoJ press department. In practice, this means press releases compete with other cross-Whitehall priorities, which can impede the CMRU's ability to publish information, such as recent enforcement action, in a timely way. This could have a negative impact on the regulator's ability to deliver this review's publication policy recommendation (recommendation no. 5).

10.26 While the CMRU is able to set its own priorities, CMC regulation has little in common with the MoJ's broader departmental objectives. This creates a theoretical risk that CMRU activity may be deprioritised.

Option 2: Transfer regulation of claims management to the FCA

10.27 Transferring regulatory responsibility to the FCA would receive widespread support from a range of stakeholders. It would remove a regulatory duty from government which was never intended to be a permanent solution.

10.28 A major bank backed a strengthened MoJ regime, and a second urged ‘caution in respect of assigning new responsibilities to the FCA given CMCs operate in sectors other than financial services’; however, most of the financial service providers² who provided evidence referencing the issue strongly supported the transfer of regulation to the FCA, notably including the BBA and ABI.

10.29 Meanwhile, some CMCs were open to the idea of FCA regulation – although they did express concern around a potential conflict of interest for the FCA in regulating both CMCs and an industry against which CMCs bring claims. As one CMC noted, ‘in principle we would not be opposed to the transfer of regulation to the FCA there would need to be a number of detailed controls that ensure the regulation of CMCs does not conflict with the same organisation regulating financial institutions.’ Another CMC stated there may be a ‘conflict in FCA’s (sic) trying to regulate, fairly, both the firms who sell things and the CMCs who hold them to account’. This review does not consider this perceived conflict to be a barrier to FCA regulation. The FCA is a well-established regulator, with responsibility for supervising a wide range of businesses with divergent and, at times, diametrically opposed interests. The FCA is therefore well placed to navigate any perceived conflict arising from regulating businesses and CMCs who facilitate complaints against them.

Advantages

Experience and reputation

10.30 The FCA has a reputation for being an effective conduct regulator that is not afraid to take strong regulatory action where necessary. Furthermore, it is a conduct regulator which has proved itself extremely capable of taking on additional regulation duties: responsibility for consumer credit was recently transferred to the FCA from the OFT, and powers to regulate competition³ in financial services (held concurrently with the Competition and Markets Authority (CMA)) were also granted.

10.31 The FCA has demonstrated itself capable of taking swift and effective action where widespread consumer detriment exists. This was particularly evident in the paradigm shift that occurred when the FCA took over the regulation of consumer credit from the OFT on 1 April 2014: the FCA’s regulation of high cost, short term credit, for example, led to greatly improved market conduct, and therefore better consumer outcomes. Similarly in the credit broking sector, where personal data issues and information asymmetries (also major causes of detriment in claims management) were identified by the FCA as widespread issues, the FCA took quick and effective action in response⁴. One bank stated that if regulation were to be transferred to the FCA, ‘we suggest it learn from the FCA’s experience of assuming the regulation of consumer credit from the Office of Fair Trading in April 2014 and in particular its ability to bring to bear its full regulatory toolkit in addressing problems in the market.’

10.32 The FCA has current experience of implementing the two key policy recommendations made by this review – the FCA is currently undertaking the reauthorisation of all consumer credit firms following the transfer of regulation from the OFT, and an Approved Persons regime

² Evidence submissions from financial service providers mostly came from the banking and insurance sectors, but also from consumer credit, credit reference agencies, and the mortgage industry

³ Specifically, the FCA was given: a) Competition Act 1998 (CA98) enforcement powers which can be used to address practices engaged in by companies operating in the UK that distort, restrict or prevent competition, and b) Power under the Enterprise Act 2002 to carry out market studies and make references to the Competition and Markets Authority (CMA).

⁴ The FCA’s new rules on credit broking came into effect on 2 January 2015. Further information available at www.fca.org.uk/news/ps14-18-credit-broking-and-fees

already exists for firms regulated by the FCA, soon to be replaced by the Senior Managers regime.

10.33 The FCA's large size and experience in conduct regulation brings further benefits. As one submission highlighted, 'A move into the FCA would provide the CMR with access to significantly wider resources'. The FCA has a large pool of expert conduct supervisors and flexible resources who can be readily deployed to claims management should they be required to help the CMRU scale up during the initial transition and, in the medium term, adjust resource in response to changing market conditions. Economies of scale would be created as the FCA has floating resource teams who are experts in matters such as behavioural economics, competition, or scenario modelling – all of which could be deployed to work on claims management on an ad hoc basis, rather than having to scale up the regulator's head count in the short term and then scale back down again once a study had been concluded (or outsource the functions, which would be costly and risky). As the ABI highlighted; 'The existing CMRU has only a limited capacity to assess how the CMC landscape is likely to develop – for example, how the falling number of PPI claims is likely to affect CMC activity in other sectors. The FCA's econometric modelling and ability to place the activities of one sector within a wider economic and societal context will allow a better understanding of how CMCs are likely to develop, in turn ensuring that the auditing and risk-assessing of firms is better targeted.'

10.34 The FCA has already developed some knowledge of CMCs given their responsibility for PPI – one of the largest drivers of CMC activity, and via its regulatory involvement relating to the referral fee ban and with insurance firms. The FCA will soon launch a consumer communications campaign specific to PPI mis-selling claims and in designing the campaign and their other regulatory interventions on PPI they will increase their expertise and knowledge of CMCs still further. For example, the FCA will establish a call centre as part of the campaign, for which staff will be trained about CMC activities and could be retained after the campaign to work in the FCA's existing firm contact centre, which regulated contact for support and advice on regulatory issues.

10.35 The FCA has detailed knowledge of financial services which makes up more than 60% of CMC turnover. This figure rises to over 99% once personal injury claims – relevant to the FCA because of their impact upon insurance – are factored in. While existing reforms are likely to shift the balance of CMCs' sector focus away from personal injury and PPI claims, the likelihood is that claims management will remain heavily weighted towards industries directly relevant to the FCA as other CMC sectors remain very small in terms of turnover.

Regulatory oversight and stakeholder engagement

10.36 The FCA would have oversight of the entire claims management process for claims related to financial services, from the original conduct of financial service providers, to the handling of complaints by those firms, and the submission of claims by CMCs and consumers. This overview may allow for more joined up and coherent regulatory interventions.

10.37 Evidence submitted to the review by Callcredit, a credit reference agency, stated 'we believe that the most appropriate way forward would be for regulation of the CMCs to be transferred to the FCA. This would result in a single regulator having oversight and control of processes. The FCA would then be in a position to ensure consumer needs and expectations are met in a joined-up and optimal manner, minimising detriment to any party.'

10.38 The FCA is able to quickly identify any emerging issues through an advanced horizon-scanning function which transcends sectors and products, and an effective method of bringing

stakeholders together and ensuring all perspectives are heard through their four statutory panels representing consumers, practitioners, smaller business practitioners and markets practitioners.⁵

10.39 The FCA has a very close existing working relationship with the FOS and would be ideally placed to collate and analyse intelligence about CMCs and share it with FOS. The FCA also has close links with consumer organisations via the UK consumer network and their own Consumer Panel. This means they have their ‘finger on the pulse’ of emerging consumer issues. They also conduct deep-dive investigations into specific consumer issues; for example, they authored a well-received paper on consumer vulnerability⁶. It is possible that lessons from these types of projects could be applied to consumers of claims handling services.

10.40 The FCA has strong working relationships with a wide range of organisations, including the ICO, SRA and FOS – all of whom have strong interest in claims management regulation. Given financial services has proven to be a key area of CMC activity and some consumer credit and other FCA regulated firms are now also acting as CMCs, the FCA could shape a more coherent approach to consumer redress and claims management regulation. This would support the IFT’s recommendation for government to ‘develop and deliver a coherent regulatory strategy to tackle nuisance calls that encourage fraudulent personal injury or other claims, in partnership with the CMR, IFB, ICO, ABI, Ofcom and SRA’.

Independence

10.41 The FCA is independent from Government, but accountable to Parliament. As an independent non-governmental body (and also a private company limited by guarantee) the FCA would provide greater independence than the existing model. The FCA would need to find a suitable way to integrate the CMC regulation into its existing operations in a way that ensured the objectives in this review could be delivered.

Organisational objectives

10.42 While the FCA's strategic objectives are not bespoke to claims management, they do align with CMRU, and the six retail outcomes set out in the FSA’s Treating Customers Fairly (TCF) initiative are consistent with the outcomes this review would like to see in claims management. The FCA; ‘aim to make sure that financial markets work well so that consumers get a fair deal. This means ensuring that: the financial industry is run with integrity; firms provide consumers with appropriate products and services; consumers can trust that firms have their best interests at heart’⁷.

Disadvantages

Relevance of CMC activity to core FCA functions

10.43 There are concerns that the FCA will be taking on the regulation of sectors (i.e. personal injury, employment matters, industrial injury disablement benefit, criminal injuries compensation and housing disrepair) that are outside its financial services remit. Citizen’s Advice stated; ‘As CMCs do not deal solely with financial services-related claims, we do not think transferring responsibility for them to the FCA is appropriate’.

⁵ <https://www.fca.org.uk/about/operate/who/statutory-panels>

⁶ <http://www.fca.org.uk/news/occasional-paper-no-8>

⁷ <http://www.fca.org.uk/about>

10.44 One bank stated in their submission that ‘we urge caution in respect of assigning new responsibilities to the FCA given CMCs operate in sectors other than financial services (including personal, criminal and industrial injuries, employment and housing disrepair).’

10.45 The FCA’s expertise is specific to financial services; any significant growth in claims management in non-financial sectors may stretch the FCA’s capabilities. The landscape has also changed since the review was commissioned. The FCA’s proposed introduction of a time bar for PPI claims will reduce the volume of CMC-submitted complaints which relate to the FCA’s areas of expertise, as will the proposed cap on the fees that CMCs can charge for bulk financial claims such as PPI and PBAs. Incoming reforms to the whiplash compensation process may further reduce this number. It is very difficult to predict with any certainty in which sector(s) the claims management sector will grow next, but current reforms suggest that future CMC activity may have less of a direct focus on financial services. That said, this is clearly a big unknown, and the FCA would probably be best placed to handle CMC activity in the event of future mis-selling scandals in the financial services sector. Moreover, the FCA’s regulatory experience – in authorisations, supervision and enforcement – does, to a certain extent, transcend sectors and would be highly advantageous for regulating claims management.

10.46 One of the review’s key recommendations is to retain CMRU’s existing expertise and this would be difficult to achieve in respect of CMRU’s Staffordshire based Compliance Office. Transfer to the FCA may see a loss of personnel and with that, knowledge and expertise.

10.47 At present, the FCA lacks intimate knowledge of non-financial CMC sectors. Given the depth of its regulatory experience it seems probable that FCA would be capable of building this knowledge over time. This was acknowledged by the ABI; ‘We also accept that some of the smaller sectors in which there is CMC activity do not directly relate to the FCA’s core expertise of financial services (for example, employment claims). However, the FCA already has well established working relationships with other regulators and public bodies, and will be able to use this to understand issues in this sector as they arise. The FCA’s remit is already broad and the clear advantages it offers to CMC regulation outweigh this small potential disadvantage’.

Ability to regulate effectively during transitional phase

10.48 Transferring regulatory responsibility creates a risk that the regulator may take its ‘eye off the ball’ during transitional phase, which could cause increased detriment/misconduct. There appears to be more potential for this to occur should the FCA take on regulation than if regulation remained with the MoJ, as the FCA would have to develop and implement the new policy recommendations while simultaneously taking on supervisory duties. This risk is amplified by the concurrent reforms currently taking place, which will mean transfer takes place during a particularly turbulent time.

10.49 Adding claims management regulation would further complicate an already very busy remit for the FCA. The FCA has relatively recently taken on additional regulatory responsibilities for consumer credit and competition, and is currently undergoing a period of organisational change following the departure of the previous CEO⁸ in September 2015. Existing resources are stretched and senior management may find it difficult to consider claims management regulation issues in sufficient depth, given competing organisational priorities.

⁸ <https://www.fca.org.uk/news/martin-wheatley-to-stand-down-as-fca-chief-executive>

The need to develop new cross-regulatory relationships

10.50 The FCA would need to expand and develop its limited existing relationships with ICO, LeO, SRA and Ofcom – although the FCA is a member of the CMRU’s Regulatory Consultative Group, so has a basis from which to build.

10.51 A major bank raised concerns that ‘the FCA’s focus will be on compliance with conduct rules and will not undertake the level of relationship management, intelligence sharing and auditing currently being undertaken by CMRU to identify non-compliant behaviour’.

Staff costs

10.52 Staffing costs would be likely to increase as a consequence of staff being transferred to FCA terms and conditions. On average, FCA salaries are higher than those of civil servants and the Staffordshire contractors, so transfer to FCA would probably increase costs. This has an associated impact on the levy, in what could potentially be a shrinking market.

CMRU’s autonomy within FCA

10.53 As an independent non-governmental body (and also a private company limited by guarantee) the FCA would provide greater independence than the existing model. However questions exist over how independent the CMRU would be within the FCA’s wider structure, and whether it would be able to set and execute its own bespoke strategy.

Option 3: Establish a new independent regulatory body

10.54 A new independent Non-Departmental Public Body (NDPB) or an Executive Agency with full regulatory control over all claims management activities could be established. The body could be headed by a chair, appointed by and accountable to the Secretary of State and supported by a Board made up of executives and non-executives. A major bank expressed their support for this option, suggesting in their evidence that the review ‘consider re-establishing the CMRU as an executive agency of the MOJ (albeit this would only continue to operate in England and Wales).’

Advantages

10.55 This would offer greater independence, and would relieve the Secretary of State for Justice of the public regulatory function which does not fit with governance arrangements elsewhere. The objectives of the organisation could be tailored to the specific task of claims management regulation, which would be its sole focus, without the risk of interference from other priorities.

Disadvantages

10.56 There would be a significant cost associated with setting up a new independent regulatory body.

10.57 Given the current drive to reduce the number of public bodies and consolidate the number of regulatory organisations, setting up a new regulator lacks support.

10.58 There is a lack of a clear benefit over the existing structure; the CMRU already operates in a very similar way to an Executive Agency.

10.59 Given the scale of CMC activity has been on a downward trend for several years – a trend which is likely to continue following the potential impact of various incoming reforms – the

governance structure for a standalone, independent regulator may become unbalanced and top-heavy.

Option 4: Dual regulation between FCA and Ministry of Justice

10.60 Under this option, the FCA would take on regulation of claims management sectors which are related to financial services, while the CMRU would remain as the regulator for non-financial sectors (personal injury, employment, criminal injuries, industrial injuries disablement benefit, and housing disrepair).

Advantages

10.61 This arrangement would provide a clear division of expertise. The CMRU would be able to focus its expertise on non-financial claims, while the FCA would only deal with claims which impact upon financial services.

10.62 The FCA would not need to develop expertise in sectors which have no bearing on financial services.

Disadvantages

10.63 Dual regulation can be problematic in practice where some issues lie beyond core organisational priorities for both regulatory bodies, meaning neither deals with them.

10.64 The extent of CMC activity entirely unrelated to financial services is too small to warrant a bespoke regulatory body – non-financial and personal injury CMC activity yielded a total of £3.7m turnover in 2014-15, representing just 0.5% of all CMC turnover. This creates a significant risk of each regulator having very different approaches, powers and resources for regulating different firms within the same industry.

10.65 There is a risk of confusion for consumers about who the regulator is, and where to go for complaint resolution. For example, Citizen's Advice commented that; 'We are also concerned that sharing responsibility between the CMRU and FCA would over-complicate the regulatory landscape, potentially confusing consumers'.

10.66 Regulation of nuisance calls already transcends several regulatory boundaries; CMRU, ICO, SRA and Ofcom all have roles to play. As referenced by the IFT, unless the whole landscape is joined up then any gaps in priorities could potentially result in some issues being left unaddressed.

Option 5: Transfer of responsibility for regulation of CMCs to the Solicitor's Regulation Authority (SRA)

10.67 Given that much of CMC activity is closely related to legal services, some stakeholders suggested that the SRA may be the most suitable claims management regulator.

Advantages

10.68 Much of claims management activity has a strong legal element, and some solicitor firms are vertically-integrated with CMCs

Disadvantages

10.69 During the review, it transpired that the SRA (previously suggested by the FCA as a potential regulator) are not renowned for taking strong action where detriment caused by CMCs has been identified (i.e. in relation to the referral fee ban); it appears that CMC enforcement would not be consistent with the SRA's strategic outlook, and indeed the objectives proposed by this review are not consistent with the organisational priorities of the SRA.

Conclusion

10.70 In principle, the most suitable option would appear to be a new, a stand-alone, independent regulator focused solely on CMC regulation. It could pursue its objectives without risk of the interference or competition from other organisational priorities. It would be free to set priorities directly according to issues in claims management, without having to divert resources to other issues or sectors, and would be well-placed to retain existing knowledge and expertise. In practice, such a recommendation is unlikely to be accepted by Government, given its drive to reduce the number of public and arms-length bodies, and the fact that establishing an entirely new organisation is likely to be more expensive than other options.

10.71 Of the remaining options, strengthening the existing MoJ based regulator and passing responsibility to the FCA are the most credible, and the decision between them is finely balanced; each has strengths and weaknesses.

10.72 The claims management industry is undergoing a period of uncertainty and it is difficult to predict the extent to which existing reforms will change the claims management landscape. In particular, the proposal to increase the small claims track means that claims currently handled by solicitors may in future be handled by CMCs. While the proposed fee cap for financial service claims will reduce incentives for CMCs, it is anticipated that there will be a spike in PPI activity ahead of the FCA's deadline by which consumers would need to make their PPI complaints.

10.73 This changing landscape will mean that the regulator will need to be alive to any new conduct risks that may materialise. The changes to the regulatory regime recommended in this review are likely to cause further disruption to the industry and will also create a risk that the regulator takes its "eye off the ball".

10.74 Strengthening the existing MoJ regime is likely to be less disruptive than other options. In particular, the regulator is more likely to be capable of retaining the skills, knowledge and experience of its existing staff, helping it to understand and adapt to the changing landscape more quickly. Keeping the CMRU within MoJ may also reduce the risk of the regulator being distracted from its existing functions while the new regime is being implemented; under the MoJ, the CMRU would be well-placed to continue delivering its existing functions while it develops its capability to deliver the new policy recommendations. While the CMRU's new fining powers are still relatively new, so conclusions about their effectiveness should be drawn with caution, the early indications are positive and demonstrate the CMRU's ability to implement new powers in an effective and capable manner. As such, retaining the CMRU within MoJ provides a low risk with a high degree of certainty that conduct standards will not slip during transition to the new regime.

10.75 At the same time, the existing regulator's location within MoJ does give rise to practical constraints, particularly as regards staffing and costs. What follows this review will be the most radical overhaul of regulation in the sector since the CMRU was first established. Designing and implementing the reauthorisation process and senior managers regime will be resource intensive

and will require the regulator to expand its policymaking and operational capacity. As described above, the existing CMRU may struggle to deliver this work programme unaided, so the viability of this option is contingent on substantial support from the FCA, given their relevant experience. The FCA's ability to support the CMRU is limited given their need to prioritise functions relating to regulated financial service activity. Similarly, MoJ may not be able to commit necessary resources both in the short and medium term given the substantial and well publicised pressure on all government departments to reduce overall levels of expenditure and headcount. Despite the self-funding nature of CMRU, these pressures are likely to place practical constraints on the ambition of any reforms undertaken by MoJ.

10.76 Meanwhile, the FCA already has well developed and relevant expertise that could be applied since more than 99% of CMC turnover is directly or indirectly related to financial services, such as PPI and PBAs (60%) or the insurance aspect of personal injury claims (40%). Furthermore, it may afford FCA a broader perspective on any future financial services mis-selling scandals and a wider range of power.

10.77 While FCA does not have the same detailed knowledge of the sector as the existing CMRU, it has expertise as a conduct regulator across a wide range of sectors and recently implemented policies similar to those outlined in this review during the transition of consumer credit regulation.

10.78 The overall decision depends on the weight attached to each of the factors outlined above. Taken together, these factors mean that the MoJ option is likely to provide a "safe pair of hands" in the short term, but practical constraints on resources could mean it may struggle to deliver a real step-change. Comparatively, there may be more disruption in the short term if regulation is transferred to the FCA due to the complexities of transferring responsibilities between organisations at the same time as bolstering the regime, but the FCA is likely to be able to deliver a more ambitious reform package overall. On balance, given the wide range of reforms already underway in this area, and the expected turbulence and contraction in the market, the least disruptive option would be for responsibility to remain with MoJ. If, however, the government wants a step change in the regulation of the sector, then the balance would shift in favour of the FCA.

A Acknowledgements

A.1 The review team would like to thank all those who made contributions during the review, either in stakeholder meetings, workshops or via evidence submissions.

A.2 The review team would like to thank the head of the CMRU Kevin Rousell and his team for providing his expertise and counsel to this review, while remaining impartial and unbiased throughout.

A.3 The review team is grateful to the FCA for their time in providing extensive detail about its regulatory approach, particularly in relation to the transfer of consumer credit to the FCA from the OFT.

A.4 Carol Brady would like to thank Will Graham, Mischa Daniel, and Dan Rusbridge for providing support to the review.

B Details of CMC charge cap

B.1 The current MoJ consultation, which closes 11 April 2016 11:45pm, seeks views on proposals to place restrictions on the level of fees that regulated CMCs can charge consumers in the following ways;

- cap the maximum completion fee to 15% (including VAT) for bulk claims (such as mis-sold payment protection insurance claims) with a single lender and cap the overall charge for claims worth more than £2,000 in total to £300
- introduce a maximum 'cancellation' fee of £300 for bulk claims when a consumer cancels their contract with a claims management company after the initial 14 day 'cooling off' period
- ban CMCs from receiving or making any financial payment for referring or introducing a consumer to a third party in relation to a PPI or PBA claim
- ban any fees where no relationship is found between a consumer and a lender
- ban all upfront fees for all financial claims, where CMCs ask to be paid before any work is carried out
- cap the maximum completion fee to 25% (including VAT) of the final amount of compensation awarded in all other types of financial case

Insurance Fraud Taskforce recommendations for claims management

C.1 In the final report of the Insurance Fraud Taskforce published in January 2016,¹ some unscrupulous CMCs came under heavy criticism for encouraging otherwise honest people to fabricate or exaggerate injuries, for example through the use of nuisance calls. Common concerns raised by stakeholders included:

- the recent ban on referral fees has failed to take effect as lawyers continue to receive emails from CMCs offering claimant details and the SRA does not rigorously enforce compliance
- banned CMCs often re-emerge under different guises, in a practice known as “phoenixing”
- marketing companies, MROs and most credit hire companies are not currently regulated
- the CMR does not have adequate resources or powers, and an independent regulator may be better suited to the regulation of CMCs
- the Working Group would welcome better regulation of how and where CMCs obtain data, including those who operate from abroad

C.2 In response to these concerns, the IFT recommended that the government should establish a stronger regime for CMC regulation and ensure that it has adequate resources and powers to do its job effectively. It recommended that in particular the regulator should:

- effectively police the referral fee ban
- prevent the use of “phoenix” companies
- consider how to deal with those organisations providing claims management services outside the regulated sector
- liaise with the ICO regarding the abuse of data protection rules
- maintain a robust regime to ensure those regulated are run by fit and proper persons

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494105/PU1817_Insurance_Fraud_Taskforce.pdf

D Stakeholder contributions

Table D.1: List of evidence submissions received

Organisation	Nature of organisation
Ageas Insurance Ltd	Insurer
AIS Group plc	Accident management company
Alliance of Independent Financial Advisors	Trade association
Allianz UK	Insurer
Association of British Insurers	Trade association
Association of Mortgage Intermediaries	Trade association
Aviva	Insurer
AXA	Insurer
Barclays	Bank
Black Pearl Claims	CMC
British Bankers Association	Trade association
British Insurance Brokers Association (BIBA)	Trade association
Brunel Franklin	CMC
CallCredit Information Group	Credit reference agency
Capital One (Europe) plc	Bank
Citizens Advice	Consumer group
Claims Advisory LLP/Gordon Lockwood	CMC
Claims Solutions DAC Beachcroft Claims Ltd	Solicitors
Consumer Finance Association	Trade association
Direct Line Group	Insurer
DWF plc	Solicitors
Entrust	Regulator
Finance and Leasing Association	Trade association
First4lawyers Ltd	Solicitors
Forum of Insurance Lawyers	Trade association
Hill Dickinson LLP	Solicitors
Horwich Farrelly Solicitors	Solicitors
Ingard IFM	Independent Financial Advisor
Keoghs LLP	Solicitors
Law Society	Trade association
Legal Ombudsman	Ombudsman
Legal Services Consumer Panel	Consumer group
Liverpool Victoria	Insurer
Lloyd's Market Association	Trade association
Lloyds Banking Group	Bank

Organisation	Nature of organisation
London & Country Mortgages plc	Mortgage broker
Maitland	CMC
Motor Accident Solicitors Society (MASS)	Trade association
Motor Insurers' Bureau	Insurance agency
MyCongruent	Actuarial Consultancy
Personal submission	N/A
Personal submission	N/A
Personal submission	N/A
Personal submission	N/A
Personal submission	N/A
Personal submission	N/A
Personal submission	N/A
PPI Advice Ltd	CMC
Real Time Claims Ltd	CMC
Royal Sun Alliance Insurance Group plc	Insurer
Secure Trust Bank	Banks
Slater and Gordon (UK) LLP	Solicitors
The Claims Guys	CMC
UK Cards Association	Trade association
Unison Legal Services	Trade union
We Fight Any Claim	CMC
Weightmans	Solicitors
Zurich	Insurer

Table D.2: Roundtables attendees

Name of organisation
Advertising Standards Authority
Association of British Insurers
Weightmans
Association of Regulated Claims Management Companies
British Bankers Association
British Insurance Brokers' Association
Claims Standards Council
Citizens Advice
Direct Marketing Association
Employment Tribunal - Regional Employment Judge
Financial Conduct Authority
Finance and Leasing Association
Financial Ombudsman Service
Financial Services Compensation Scheme

Name of organisation

Information Commissioner's Office

Legal Ombudsman

Motoring Accident Solicitors

Ofcom

Professional Financial Claims Association

Solicitors Regulation Authority

Unison

