

PS18/23 Claims management: how we will regulate claims management companies

Financial Conduct Authority (FCA)

validated

Description of proposal

As of 1st April 2019 the Financial Conduct Authority (FCA) has been appointed as the regulator of claims management companies (CMCs), serving customers in England, Wales and Scotland. The Financial Ombudsman Service is now responsible for resolving customer disputes about CMCs. CMCs are firms that act as intermediaries between claimants and firms who are being claimed against.

This IA assesses the impacts of the FCA's specific approach to the regulation of claims management companies; it does not include an assessment of the direct impacts of the Government's original decision to transfer the regulation of CMCs to the FCA. These costs are quantified in an impact assessment completed by HM Treasury and validated by the RPC at the time of the decision in 2017¹.

Impacts of proposal

All CMCs which are operating in England, Wales and Scotland will be affected by the changes; the FCA estimates that 790 CMCs will be in scope of FCA's regulation in April 2019.

The key activities that will be regulated are: third-party due diligence; marketing; pre-sale disclosure; ongoing disclosure; additional communication; call recording; prudential requirements; wind down procedures; client money, and complaints.

The FCA has separated CMCs into two classes based on annual turnover to present the costs. These are:

- Class 1 CMCs are those with turnover above £1 million and
- Class 2 CMCs are those with turnover below £1 million.

¹HM Treasury. Financial Guidance and Claims Bill Impact Assessment. June 2017.
<https://www.parliament.uk/documents/impact-assessments/IA17-005.pdf>

High-level standards

The FCA will be applying high-level standards when taking over the CMC sector, this is to ensure that the standard of behaviour is consistent across all FCA-regulated firms. The FCA will be applying: Principles for Businesses (PRIN), Systems and Controls Requirements (SYSC), General Provisions (GEN) and Threshold Conditions (COND). The FCA has not estimated the cost of complying with COND as these are included in HM Treasury's IA.

The FCA expect the incremental cost of complying with PRIN and GEN to be minimal as CMCs have been required to comply with similar rules and guidance set by the Claims Management Regulator (CMR) which is part of the Ministry of Justice (MoJ). The FCA calculates that class 2 CMCs, the average one-off cost would be between £225 and £680, and the average ongoing annual costs would be between £680 and £1,130. For Class 1 CMCs, the average one-off cost would be between £2,030 and £2,480 and the average ongoing annual costs would be between £4,290 and £4,740.

With regards to the cost of compliance, the FCA estimates that the total industry cost of recording the original source of leads acquired from third parties to be between £0.3 million and £0.7 million one-off costs and between £0.8 million and £1.1 million of ongoing costs.

Conduct standards – lead generators

CMCs will be expected to fulfil due diligence requirements on third-party lead generators. For the requirement to keep a record of the organisation which supplied each lead, the FCA estimate that the total industry cost of recording the original source of leads acquired from third parties to be around £0.1 million per year, where there are 40 class 1 CMCs at an average cost of £1300-£1400 per firm and 68 Class 2 CMCs at an average cost of £860-£950 per firm.

Amending marketing material

Where CMCs advertise a 'no-win, no-fee' service, or similar, the advert should indicate what fees the CMC charges if the claim is successful, any cancellation and termination charges and should indicate where there are statutory ombudsman or compensation schemes that the customer could use themselves directly and for free. The FCA estimates total one-off costs of amending marketing to meet the new disclosure requirements at between £1.0 million and £1.1 million.

Communication – Pre-sale disclosure

CMCs will also be required to provide customers in advance with a brief summary of essential information, including worked examples of likely charges. The FCA estimates that an average CMC would require around 6 hours of administrative work and 3 hours of director time to compile a sheet of essential information, including estimates of charges CMCs need to disclose. On this basis, the estimated total one-off costs for the industry are around £0.1 million.

Communication – Ongoing disclosure

There will be requirements to notify information about fees, and use alternative dispute resolution schemes, which will increase costs to CMCs, the annual cost to industry would therefore amount to between £0.7 million and £1.7 million.

Call recording

The FCA estimates that the total one-off costs for call recording, which is a significant new recording requirement, will be between £1.0 million and £1.1 million, with annual costs of recording and retaining between £1.6 and £1.8 million.

Prudential requirements

The rules will require CMCs, except those that are solely lead generators, to maintain a certain level of capital resources. The FCA has estimated that 86% of Class 1 and 56% of class 2 CMCs will be affected by the rules, and that the incremental capital requirement for the whole CMC industry would amount to between £36 million and £61 million. Based on the average capital shortfalls of firms and the associated cost of equity, the annual cost of capital is estimated at between £2.7 million and £5.7 million.

Wind-down procedures

The FCA estimates that 10% to 15% of active CMCs will wind-down every year and it is assumed this trend will continue. The estimated annual cost of this is between £0.5 million and £1.4 million.

Client money

FCA requires CMCs that hold client money to: hold it in one or more client bank accounts; pay out to clients as soon as reasonably practical; appoint a person accountable for client money oversight; and maintain accurate records and accounts of these dealings. For those who hold client money, the estimated one-off industry

costs will be under £0.1 million. The ongoing costs are estimated to be between £0.8 million and £1.5 million.

Dispute resolution

The FCA's Dispute Resolution: Complaint's sourcebook (DISP) sets out rules for how CMCs should handle complaints. CMCs must also include a standard Ombudsman Service explanatory leaflet which is estimated annual industry cost of £2,000.

Supervision and reporting

In order to inform the FCA's supervision of CMCs, the FCA requires CMCs to comply with the relevant sections of its Supervision (SUP) manual. The industry wide annual costs of doing so are estimated to be between £0.3 million and £0.4 million.

Familiarisation costs

In order for CMCs to comply, they will have to familiarise themselves with rules and guidance. Assuming that all CMCs incur familiarisation costs, the industry wide one-off cost of familiarisation is estimated at £0.7 million. Firms will also have to conduct a review of 80 pages of legal text. The one-off industry cost of legal review is estimated to be around £0.9 million.

Quality of submission

The IA provides a clear explanation of the measure with a particularly clear breakdown of the main costs to CMCs.

Furthermore, in the FCA's consultation paper and policy statement, linked to the IA, they have explained that they have been unable to quantify other costs, such as loss of revenue to CMCs and most benefits to customers, so have therefore only been able to assess these on a qualitative level. These documents also provide a thorough cost benefit analysis.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of £11 million. This will be a qualifying regulatory provision that will score under the business impact target. Overall the RPC believes that the FCA has taken a proportionate approach in this case, with thorough analysis based on evidence gathered at consultation.

Other comments

The FCA could helpfully have included:

- an assessment of an impact on competition from the cost of regulation implied on the market, including firms that would exit the market and the effect on competitive forces and cost/benefits for consumers and businesses.
- an assessment of the costs of training employees of CMCs to take complaints calls;
- a better explanation of how the FCA has estimated familiarisation costs, and in particular whether it has correctly accounted for the costs of distributing the information through firms and of providing training where necessary.
- how a review of the regulation of CMCs by the FCA will be conducted and a proportionate discussion of the impacts on small and micro CMCs. (These elements are not required of regulators under the Better Regulation Framework, but would have improved the overall assessment of the FCA's chosen regulatory approach.)

The IA could also be improved by including a more explicit discussion of the FCA's approach to analysing its consultation data and deriving relevant assumptions for the IA, including:

- a summary of the number and quality of consultation responses;
- a description of how the mid-point cost estimates used in the IA were derived;
- an explanation as to how the FCA decided to remove outliers, how many were removed and whether those firms who reported more costs would have been disproportionately affected anyway.

Departmental assessment

| Classification | Qualifying regulatory provision |
|--|---------------------------------|
| Equivalent annual net cost to business (EANCB) | £11.0 million (final estimate) |
| Business net present value | ‑£94.7 million |
| Overall net present value | ‑£94.7 million |

RPC assessment

| Classification | Qualifying regulatory provision |
|---|---------------------------------|
| EANCB – RPC validated ² | £11.0million |
| Business Impact Target (BIT) Score ¹ | £55.0 million |
| RPC rating (of initial submission) | Validated |

Regulatory Policy Committee

² For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.
