Regulator Assessment: Qualifying Regulatory Provisions

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

Lead regulator: FCA

Date of assessment: 24/01/2019

Commencement date: 01/04/2019

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? England, Scotland and Wales

Brief outline of proposed new or amended regulatory activity

On 1 April 2019[1] we will become the regulator of claims management companies (CMCs) that are set up or serving customers in England, Wales and Scotland.

Since 2007 the Government has been increasingly concerned about misconduct in the claims management sector. In 2015, it commissioned the independent Brady Review[2] to examine the nature and extent of the problems in the market and make recommendations to improve the way it was regulated.

The Government accepted these recommendations. The Financial Guidance and Claims Act 2018 (FGCA) provides for the transfer of the regulation of CMCs from the existing Claims Management Regulator (CMR), which is part of the Ministry of Justice (MoJ), to the FCA. It also provides for the extension of regulation of CMCs to Scotland.

Parliament has approved secondary legislation that defines which claims management activities will be regulated[3]. It sets out the CMC temporary permissions regime, and the other changes necessary to transfer powers and responsibilities to us.

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[1] http://www.legislation.gov.uk/ukdsi/2018/9780111172964

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/508160/PU1918_claims_management_regulation_review_final.pdf

[3] The scope of the regulation mirrors that of the CMR.

On 17 December 2018, we published a Policy Statement (PS) setting out the final rules and guidance we are making with regards to claims management which comes into force on 1st April 2019. The PS summarises which of our wider rules apply to CMCs, explains the new CMC specific rules, why and how we enforce our rules and the process for CMCs to become authorised by us. The key measures are summarised below:

- **Third-party due diligence** – Some CMCs are categorised as lead generators, these are CMCs that only carry out the activity of identifying or seeking out customers who may have a claim, and/or referring details of a claim or potential claim. CMCs that obtain leads from third parties must identify and keep a record of the organisation which supplied each lead. Additionally, a check of the lead generator must be undertaken to ensure they are authorised and comply with relevant data protection laws.

- **Marketing by CMCs** – Where CMCs advertise a 'no-win, no-fee' or similar service, the advert will have to include a prominent indication of the fees the CMC will charge or how they would be calculated. The advert must also indicate that, where relevant, the customer could pursue the claim for free.

- **Pre-sale disclosure** – CMCs must provide pre-contractual information before entering into a contract with a customer. This will need to be in the form of a single-page, high-level summary of the services the CMC offers. It will need to include concise details of how the CMC will keep the customer updated on their claim's progress as well as information on rights to cancel and terminate the contract including any fees that would be charged for terminating the contract. It will also detail the customers' rights and options to proceed in other ways and to act for themselves at no financial costs. So that potential customers can understand and compare CMC fees they may have to pay we are also requiring CMCs to use 'typical' examples to illustrate fees.

- **Ongoing disclosure** – CMCs must also provide the customer with regular updates about the status of their claim, at least every six months, and inform them of any significant developments in their claim.

- **Additional communication –** In addition to the pre-sale and ongoing disclosure requirements we are obliging CMCs to ask some more detailed questions about the nature of the customer's relationship with the firm they are claiming against. CMCs must also gain and record customer consent before invoicing the customer for a cost which had not been disclosed in the pre-contractual documentation. Customers should be made aware of any step a CMC intends to take to progress the claim if this was not set out in the pre-contract disclosure information.

- **Call recording** – CMCs must record all calls, and electronic communications such as texts and emails with all their customers. CMCs will need to keep the recordings for at least 12 months.

- **Prudential requirements** – CMCs who contract directly with customers will need to meet prudential requirements relating to the type of business they undertake, their total income, their expenditure, and whether they hold client money.

- **Wind down procedures** - CMCs will have to carry out specific procedures if they propose to cease to carry on claims management activity. These include requirements such as telling their customers that they will cease trading and telling the customer if it passes details of the claim to a third party, such as another CMC. We are also requiring that the customer file is returned to the customer.

- **Client money** – CMCs that hold client money must separate this from their own and hold it on trust. Records that identify the client money must remain accurate and up to date.

- **Complaints** – Responsibility for resolving disputes about CMCs is being transferred from the Legal Ombudsmen to the Financial Ombudsmen Service.

Which type of business will be affected? How many are estimated to be affected?

All CMCs operating in England, Scotland and Wales will be affected by these changes. This includes: CMCs regulated by the CMR, unregulated CMCs operating in Scotland, and unregulated CMCs who specialise in making claims under section 75 of the Consumer Credit Act 1974 (s75 CMCs)[4].

We partitioned CMCs, based on annual turnover, into two classes and calculated separate average costs for each class. CMCs with turnover above £1m were defined as Class 1 and those below £1m were Class 2. We estimate a total of 790 CMCs coming into FCA regulation in April 2019, of which 111 are Class 1 firms, and 679 are Class 2 firms. We estimated the firm numbers based on the CMC responses to two surveys and the CMC data we received from the Claims Management Regulator.

Price base year	**Implementation date**	**Duration of policy (years)**	**Business Net Present Value**	**Net cost to business (EANDCB)**	**BIT score**
2018	2019	10	-94.7	11.0	55.0

Please set out the impact to business clearly with a breakdown of costs and benefits

Our rules address both aligning CMCs with high-level standards we apply to all FCA-regulated firms and sector specific, conduct of business rules and guidance aimed to make the sector for claims management work well and address the harms identified.

Our PS and IA do not include an assessment of the direct impacts of the Government's decision to transfer the regulation of CMCs to the FCA. The Treasury has produced its own impact assessment (IA) for this.[5] The Treasury's IA included the costs to the FCA, as well as costs to CMCs from the temporary permissions regime, exit from the current CMR, administration costs for reauthorisation, FCA authorisation fees and complaint transfers. It also included the non-monetised benefits to customers and industry.

To establish the estimated costs of our requirements, we used the CMR's current regulatory framework as the baseline; therefore the costs highlighted below illustrate the incremental increase in costs incurred by CMCs as a result of the transfer of regulation from the CMR to the FCA.

[4] https://www.legislation.gov.uk/ukpga/1974/39/section/75

[5] https://www.parliament.uk/documents/impact-assessments/IA17-005.pdf

The estimates were primarily informed by data from the CMR and our survey of CMCs operating in England, Scotland and Wales. The table below provides a breakdown of the estimated costs to industry we anticipate.

Proposal	**One-off (£m)**	**Ongoing (£m)**
High-level standards – SYSC	0.3 – 0.7	0.8 - 1.1
Conduct standards – Use of lead generators	N/A	0.1
Amending marketing materials	1.0 - 1.1	N/A
Communication – Pre-sale disclosure	0.1	N/A
Communication – Ongoing disclosure	N/A	0.7 - 1.7
Additional communication	N/A	0.6 - 0.8
Call recording	1.0 - 1.1	1.6 - 1.8
Prudential requirements	N/A	2.7 - 5.7
Wind-down procedures	N/A	0.5 - 1.4
Client money	0.1	0.8 - 1.5
Supervision and reporting (SUP)	N/A	0.3 - 0.4
Familiarisation costs	0.7	N/A
Legal review	0.9	N/A
Total	**4.0 - 4.6**	**8.2 - 14.4**

Taking the mid-points of our estimated ranges, we estimate the total one-off industry cost to be £4.3m, and the annual industry costs to be £11.3m, for the 790 CMCs operating in the sector. The costs associated with our requirements pertaining to the rules and conduct standards of CMCs are set out and discussed in more detail below.

High-level standards

There are several high-level standards we are applying when taking over the CMC sector. This is to ensure the standard of behaviour is consistent across all FCA-regulated firms. We are applying: Principles for Businesses (PRIN), Systems and controls requirements (SYSC), General Provisions (GEN), and Threshold Conditions (COND). We do not estimate a cost of complying with COND as these are included in the Government's IA.

As CMCs have been required to comply with similar rules and guidance set by the CMR, we expect the incremental cost of complying with PRIN and GEN to be minimal. For our rules on SYSC, CMCs will need to introduce systems to prevent the risk that can be used to further financial crime.

We calculate that:

- for 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

Based on our prior experience and knowledge, we consider that the average time CMCs would need to set up these procedures, for a single person in charge of compliance, would be around 1 day for Class 2 CMCs, and around 5 days for Class 1 CMCs (accounting for a one-off gap analysis). The ongoing cost to maintain these procedures is estimated to be around 2 days per year for Class 2 CMCs, and around 10 days per year for Class 1 CMCs (which accounts for expanding internal audit functions). We have estimated the cost of this time based on what CMCs reported to us about who was responsible for compliance and their average wages. In response to our CMC survey, 15% of CMCs told us that a compliance officer was in charge of compliance. The remaining 85% of CMCs responded that a director, the CEO, or a person in a similar role was in charge of compliance. Using £48 an hour as the cost of compliance officer time and £68[6] an hour as the cost of director-level time, the weighted-average hourly cost would be £65, corresponding to daily costs of around £450.

We estimate the total industry impact is between £0.3m and £0.7m of one-off costs, and between £0.8m and £1.1m of ongoing costs.

Conduct standards – lead generators

CMCs will be expected to fulfil due diligence requirements on third-party lead generators. These are similar to the current CMR rules, although they are more targeted at the harms we have identified. We therefore do not expect CMCs to face significant additional costs.

For the requirement to keep a record of the organisation which supplied each lead, we asked CMCs in our CMC survey to estimate the additional cost of keeping these records. Taking into account the general margin of error applicable to survey estimates as described in the introduction[7], we estimate the average annual cost to be between £1,300 and £1,400 for Class 1 CMCs, and between £860 and £950 for Class 2 CMCs. The one-off costs to put in place any necessary record-keeping procedures, along with notifications to the FCA of lead generators who should be authorised but are not, are considered to be minimal. Based on our CMC survey data, 36% of Class 1 CMCs (40) and 10% of Class 2 CMCs (68) indicated that they bought or rented leads from third-party lead generators; we therefore estimate that these are the proportions of CMCs facing the incremental costs estimated above.

We estimate that the total industry cost of recording the original source of leads acquired from third parties to be around £0.1m per year (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 whether there are statutory ombudsman or compensation schemes that the customer could use themselves directly and for free.

We estimate total one-off costs for the industry to amend their marketing to meet the new disclosure requirements to be between £1.0m and £1.1m.

For our new requirements, we asked respondents to our CMC survey to show which types of marketing they did and how much they spent on it. We then asked those CMCs that spend money on marketing activities about the cost of changing their marketing under our rules. Taking into account the general margin of error applicable to survey estimates as described in the 'Generating robust estimates' chapter[8], we estimate the average one-off cost to be between £6,500 and £7,200 for Class 1 CMCs, and between £410 and £450 for Class 2 CMCs. We have removed responses whose reported total cost of changing market materials is greater than 5% of their reported revenue; the majority of firms reported the total cost of changing

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[6] The hourly cost of compliance officer time and director-level time is based on FCA analysis of Willis Towers Watson's UK Financial Services Report, adding 30% overheads to account for non-wage labour costs

[7] Page 70 of CP18/15

[8] Page 58 of CP18/15

market material to be less than 1% of their reported revenue. Additionally, many firms reported no cost to changing marketing materials.

Communication – Pre-sale disclosure

In comparison to existing CMR requirements, the most significant addition relates to the requirement for CMCs to provide customers in advance with a brief summary of essential information, including worked examples of likely charges.

We estimate that an average CMC would require around 6 hours of administrative work, and around 3 hours of director time to compile the sheet of essential information, including estimates of charges CMCs need to disclose. Using a range of £13.00 to £14.40 an hour as the cost of CMC employee time and £68[9] an hour as the cost of director-level time, the average one-off costs are estimated to be between £240 and £330. We estimate the average hourly cost of employee time to be between £13.00 and £14.40 based on our CMC survey. Approximately 74% of active Class 1 CMCs (82) and 51% of active Class 2 CMCs (348) contract directly with customers and will therefore be affected by the new rules. We expect the cost incurred by CMCs who are lead generators to be minimal as they will be able to communicate our disclosure requirements with customers over the phone.

We estimate total one-off costs for the industry to be around £0.1m.

Communication – Ongoing disclosure

The requirements to notify information about fees, and alternative dispute resolution schemes, will increase costs to CMCs. This should not entail one-off costs given that CMCs will already have systems in place to contact and notify customers. Regarding ongoing costs, we estimate that on average between 30-50% of customers can be contacted over email, for which costs will be minimal. The other customers are assumed to be contacted by letter, at an average cost of between £1.00 and £1.50 per notification. This range is based on costs arising from postage (≈£0.40), materials (≈£0.10) and the time administrators need to prepare letters (≈£0.70, based on the hourly cost of an administrator's time of £14 and around 3 minutes to prepare the letter).

From our CMC survey, we estimate the average number of claims made by Class 1 and Class 2 CMCs, taking into account the general margin of error applicable to survey estimates as described in the 'Generating robust estimates' chapter[10]. We estimate the average number of claims to be between 14,300 and 15,800 for Class 1 CMCs, and 580 and 640 for Class 2 CMCs. We further assume that in 5% of these claims, CMCs become aware of alternative dispute resolution mechanisms and will incur additional notification costs. This assumption is informed by claims volumes reported in our CMC survey. In particular, the majority of reported claims relate to financial services, for most of which the Financial Ombudsman Service (the Ombudsman Service) would be available as an alternative dispute resolution mechanism. Therefore, we anticipate that no additional notification would be required for most claims. 74% of Class 1 CMCs (82) and 51% of Class 2 CMCs (348) in the sector that contract directly with customers are assumed to be affected by this rule.

Under these assumptions, the annual cost to industry would amount to between £0.7m and £1.7m.

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[9] The hourly cost of compliance officer time and director-level time is based on FCA analysis of Willis Towers Watson's UK Financial Services Report, adding 30% overheads to account for non-wage labour costs

[10] Page 58 of CP18/15

Additional communication

In publishing the final rules, we set out a number of additional communication requirements for CMCs to undertake as part of their pre-contract and ongoing disclosure to their customers. Collectively, we estimate that these communications will add around 1.5 minutes of telephone communication per claim. These communication requirements may therefore add around £0.6m - £0.8m in ongoing costs to the industry. We have based this estimation on the following assumptions:

- Class 1 CMCs will process on average 14,300-15,800 claims per year, while Class 2 CMCs will process on average 580-640 claims per year.
- The hourly staff cost is assumed to be £13 - £14.40 based on the firm survey conducted pre-consultation.
- If there is a decrease in claims after the PPI deadline we expect the ongoing compliance cost associated with this requirement to decrease.

Call recording

CMCs that do not currently record calls and those that do, but retain records for fewer than 12 months, will face additional costs as a result of call recording requirements. We do not expect CMCs to incur additional costs associated with our record keeping requirements where they are similar to those of the existing regulator. However, as recording and retention of telephone calls is a significant new record keeping requirement we have estimated an additional cost.

Using our CMC survey data, we have estimated the percentage of CMCs that record and retain recordings separately for Class 1 and Class 2 CMCs. Of the respondents that intend to obtain FCA authorisation, 25% of Class 1 CMCs (28) and 77% of Class 2 CMCs (521) are not recording customer calls. Moreover, 50% of Class 1 CMCs (56) that intend to become authorised are yet to store recordings for at least 12 months, compared to 90% of Class 2 CMCs (611). We therefore assume these proportions of firms will incur the relevant costs of compliance. The responses on one-off costs of installing recording equipment and the ongoing costs of recording and call storage are set out in the table below.

Policy requirement	# Class 1 CMCs affected	# Class 2 CMCs affected	One-off cost per Class 1 CMC	One-off cost per Class 2 CMC	Ongoing cost per Class 1 CMC	Ongoing cost per Class 2 CMC
Call recording	28	521	£8900-£9850	£1400-£1550	£6200-£6850	£1400-£1550
Call storage	56	611	N/A	N/A	£2550-£2850	£900-£1000
			Total one-off costs		**Total ongoing costs**	
			£1.0m – £1.1m		**£1.6m - £1.8m**	

We estimate that the total one-off costs will amount to between £1.0m and £1.1m, with annual costs of recording and retaining of between £1.6 and £1.8m.

Prudential requirements

The rules will require CMCs, except those that are solely lead generators, to maintain a certain level of capital resources. On the basis of our CMC survey, we estimate that 86% of Class 1 (96) and 56% of Class 2 CMCs (380) will be affected by these rules. Using the average shortfall based on shareholders equity and assuming that all CMCs except those that are solely lead generators are subject to the prudential resources requirements, we calculated the incremental capital requirement for the whole industry would amount to between £36m and £61m. This includes the incremental capital requirement for firms that hold client money.

We looked at the average capital shortfalls of firms in our survey sample, split by Class 1 and Class 2 firms, and applied a range of cost of capital of 7.5% - 9.2%, to arrive at an average cost of compliance of £23,000 – 51,000 for Class 1 CMCs and £1,300 – 2,000 for Class 2 CMCs. We further assumed that 86% of Class 1 CMCs and 56% of Class 2 CMCs are affected by this requirement, based on our inference about the proportion of firms that are not lead generators using the survey data.

Based on the range of estimates for the capital shortfall and assumptions about the cost of equity, the annual cost is estimated to be £2.7m - £5.7m.

Wind-down procedures

Based on historical data on CMR-authorised CMCs, we estimate that between 10% and 15% of active CMCs will wind down every year and it is assumed this trend will continue once regulatory jurisdiction is transferred to us. From our CMC survey we estimate the average number of claims to be between 14,350 and 15,850 for Class 1 CMCs, and 580 and 640 for Class 2 CMCs. We estimate that on average between 30-50% of customers can be notified over email, for which costs will be minimal. The other customers are assumed to be notified by letter, at an average cost of between £1.00 and £1.50 per letter. We calculate the average cost to send information and return documents to a customer is between £2.00 and £3.00 per file. Given these ranges, the average cost for Class 1 CMCs would be between £35,800 and £64,200 and between £1,400 and £2,600 for Class 2 CMCs. We estimate the annual cost to be between £0.5m and £1.4m**.**

Client money

For CMCs that hold client money, we are requiring them 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. Our CMC survey estimated that 64% of Class 1 CMCs (71) and 16% of Class 2 CMCs (109) held client money.

For CMCs who hold client money, we estimate one-off industry costs to be under £0.1m. The ongoing costs are estimated to be between £0.8m and £1.5m. We have set out the breakdown of these costs in the table below.

Policy requirement	# Class 1 CMCs affected	# Class 2 CMCs affected	One-off cost per Class 1 CMC	One-off cost per Class 2 CMC	Ongoing cost per Class 1 CMC	Ongoing cost per Class 2 CMC
Selection of approved bank	71	109	N/A	N/A	£50-£140	£40-£120
Acknowledgement letter	71	109	£30-£100	£30-£100	N/A	N/A
Reconciliation and checks	71	109	£190-280	£90-£180	£2400-£6300	£2100-£3000
Auditor's report	71	109	N/A	N/A	£2500-£3100	£700-£1300
Pay out claims promptly	71	109	N/A	N/A	£850-£2800	£400-1400
			Total one-off costs		**Total ongoing costs**	
			< £0.1m		**£0.8m - £1.5m**	

Dispute resolution

Our 'Dispute Resolution: Complaint's sourcebook' (known as DISP) sets out rules for how CMCs should handle complaints and when complaints must be referred to the Ombudsman Service. This is similar to the current requirements CMCs face; however, CMCs must also include a standard Ombudsman Service explanatory leaflet which we estimate would amount to an annual industry cost of £2,000.

A pack of 25 leaflets costs £5 (i.e. 20p per leaflet). Based on our CMC survey, a Class 1 CMC receives, on average, 155 complaints per year, while Class 2 CMCs receive 8. Therefore, assuming that half of complaints are made by letter, so that each complaint entails a cost of 10 pence, we estimate that the on-going cost per CMC would be £15.50 for Class 1 CMCs and £0.80 for Class 2 CMCs.

Supervision and reporting

In order to inform our supervision of CMCs, we are requiring CMCs to comply with the relevant sections of our Supervision (SUP) manual. The costs of complying with SUP outside of notification and reporting requirements should be of minimal significance, as SUP gives guidance on how CMCs should co-operate with the FCA and what approaches the FCA might take when supervising CMCs which are similar to the requirements to co-operate with the CMR.

We consider that the relevant notifications might be required once a year, taking around 5 hours of compliance officer's time, and around 3 hours of CMC employee time for a Class 2 CMC. For a Class 1 CMC, we consider it would taking around 10 hours of compliance officer's time, and around 4 hours of CMC employee time (estimates are based on the FCA's prior experience and knowledge. We use a range estimate of +/- half an hour around these central estimates to provide more robust estimates of costs). To estimate the monetary cost of this requirement, we use a weighted-average hourly compliance cost of £65 (computed in the SYSC section above), and an hourly CMC employee wage of between £13.00 and £14.40 an hour (computed in the pre-sale disclosure section above). Under these assumptions about incremental costs, we estimate the average annual cost for Class 2 CMCs to be between £320 and £410, and the average annual cost for Class 1 CMCs to be between £660 and £740.

Under the assumption that all 111 Class 1 CMCs and 679 Class 2 CMCs face these incremental costs for reporting, the industry-wide annual costs are estimated to be between £0.3m and £0.4m.

Familiarisation costs

In order for CMCs to comply, they will have to familiarise themselves with our rules and guidance. This is particularly important in areas where we have strengthened the rules or specified additional requirements. We have taken into account the familiarisation costs of the material additional requirements we are setting out: CMCOB, the CP, CBA, and the PS containing the final rules.

Although we estimate a one-off cost for CMCs to read the documentation, we have not costed any ongoing costs. This is because CMCs currently must familiarise themselves with anything published by the CMR, as this will no longer be required but rather FCA documentation; we therefore estimate any additional ongoing familiarisation costs to be minimal. There are approximately 220 pages of policy documentation CMCs will have to familiarise themselves with. As much of this text is technical, we assume a reading speed of 3.5 minutes per page, meaning it will take approximately 13 hours to read all documentation. It is further assumed the hourly cost of a compliance officer's or director's time is £65 (this is computed in the section on High-level standards).

We calculate that the average one-off cost would be approximately £840 for both Class 1 and 2 CMCs. Under the assumption that all CMCs incur familiarisation costs, the industry-wide one-off cost would be £0.7m.

Legal review

We also anticipate that firms will also have to conduct a review of approximately 80 pages of legal text. We assume that 2 legal staff at Class 1 CMCs and 1 member of legal staff at Class 2 CMCs will review the legal text, implying a total of around 70 hours at Class 1 CMCs and around 10 hours at Class 2 CMCs for legal staff to conduct the review. The number of legal staff reviewing the documentation by firm size is based on standard FCA assumptions. The estimated time required per legal staff at Class 1 and Class 2 CMCs is based on standard FCA assumptions of 21 hours per 50 pages of legal text at medium-sized firms and 7 hours at small-sized firms. This is based on the expectation that the review is more complex at larger firms. The hourly legal staff cost is assumed to be £64 at Class 1 CMCs, and £51 at Class 2 CMCs. The hourly legal staff cost is based on standard FCA assumptions.
The one-off industry cost of legal review is estimated to be around £0.9m.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

https://www.fca.org.uk/publication/consultation/cp18-15.pdf

https://www.fca.org.uk/publication/policy/ps18-23.pdf