

Preventing claims management phoenixing by financial services firms

Consultation Paper

CP21/14**

May 2021

How to respond

We are asking for comments on this Consultation Paper (CP) by **21 June**.

You can send them to us using the form on our website at: www.fca.org.uk/cp21-14-response-form

Or in writing to:

The CMC Policy Team
Financial Conduct Authority
12 Endeavour Square London E20 1JN

Email:
cp21-14@fca.org.uk

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1 Summary

Why we are consulting

- 1.1** In this consultation paper we set out our proposals to address the practice we call 'claims management phoenixing' by individuals in financial services (FS) firms. Claims management phoenixing occurs when an individual connected with a wound-up FS firm reappears in connection with a claims management company (CMC), seeking to benefit from the former FS firm's poor conduct by carrying on claims management activities against it. Of the 250 CMCs we regulate with permission to manage FS claims, at least 18 (7%) have connections to former FS firms which could allow individuals from those firms to benefit from the firms' poor conduct.
- 1.2** CMCs exist to help customers make claims for redress when they have suffered loss or damage. In the financial services industry these claims relate to losses caused by FS firms. If individuals from failed FS firms are able to use the claims management regime to benefit from their own poor conduct then:
- public confidence in the regulatory system and the integrity of the market will be undermined
 - FS firms will potentially be incentivised to act against the interests of their customers
 - CMCs who have not benefited from phoenixing may suffer a competitive disadvantage.
- 1.3** The proposals we are consulting on in this paper are designed to prevent these harms by stopping the practice of claims management phoenixing.

Who this applies to

- 1.4** These proposals affect:
- current and former FS firms who carry on activities that are protected by the Financial Services Compensation Scheme (FSCS)
 - current and prospective CMC firms carrying on FCA-regulated claims management activity for claims about financial products and services that are protected by the FSCS

What we want to change

- 1.5** To stop claims management phoenixing we propose to prohibit CMCs from managing FSCS claims if a person connected to the CMC is or was linked to the FS activity that is the subject of the claim. Chapter 3 sets out in detail the circumstances in which we propose to apply this rule.

1.6 We are also proposing that CMCs must notify us of certain connections they have or had with FS activity and with persons involved in FS activity. Chapter 4 sets out the details of the proposed notification requirement.

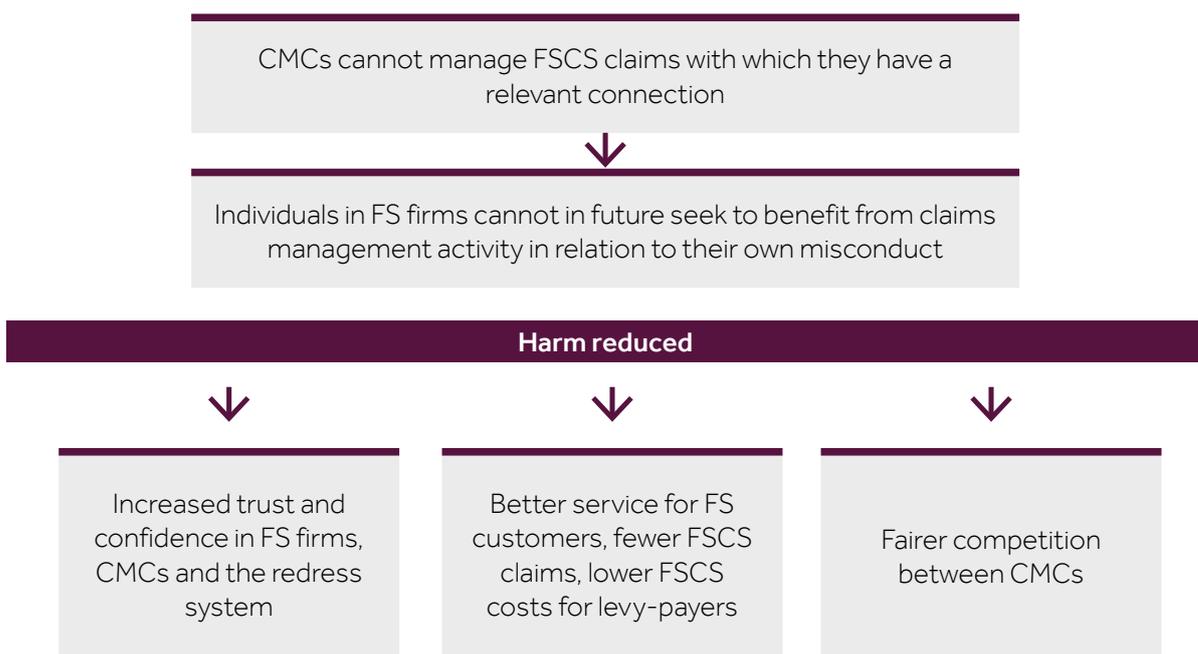
Outcome we are seeking

1.7 By prohibiting CMCs from managing claims with which they have a relevant connection we seek to ensure the following:

- FS firms pay due regard to the interests of customers, treat customers fairly and are not incentivised to treat them poorly; they conduct their business with due care and diligence and, when things go wrong, take responsibility and put things right for their customers.
- CMCs do not seek to profit from past misconduct of individuals connected with the CMC.
- Consumers can be confident that FS firms and CMCs have due regard to their interests and are not seeking to profit from misconduct.
- FS firms can be confident that the FSCS is not used to pay compensation costs that could in some instances have been avoided by FS firms choosing to remain in business rather than phoenixing into claims management activity, and that no part of the compensation paid by the FSCS will go to those who caused the loss for which it is paid.
- CMCs can participate fairly in the market without connections to failed FS firms providing an unfair advantage for some.

1.8 Figure 1 shows how we expect the proposed intervention to result in better outcomes for consumers and firms affected by these proposals.

Figure 1: Causal chain – the intended effect of our proposals



Measuring success

- 1.9** Our proposals will be successful if claims management phoenixing no longer occurs. This will help ensure reduction of the harms in Figure 1. Currently we estimate that at least 220 FSCS claims per year involve phoenixing connections between the firms submitting the claims and the former FS firms against which the claims are made. Our proposed rules aim to reduce that number so that within 2 years of the rules coming into force the number of FCA-regulated CMCs submitting claims with which they have a relevant connection is zero.
- 1.10** Our proposals will also be successful if we have the information needed to identify connections between CMCs and former FS firms, and if enforcement action is available to us in the event that CMCs do carry on claims management activity in respect of such claims.
- 1.11** If the proposed rules come into force, we will measure the number of known cases of claims management phoenixing and the estimated cost to consumers of those cases. We will do that by working with the FSCS to analyse claim data, and by monitoring the information we receive about connections between firms and the individuals associated with them.

Next steps

- 1.12** We want to hear your views. Please send us your responses to the questions in this consultation paper by 21 June 2021. You can use the response form on our website or write to us at the address on page 2 of this paper. We will consider responses carefully before making any rules.

2 The wider context

Introduction

2.1 In this chapter we cover:

- what claims management phoenixing is
- the extent of claims management phoenixing
- the harm we are trying to prevent
- the wider effects of the consultation
- equality and diversity considerations

2.2 The details of our proposals are set out in Chapters 3 and 4.

What is claims management phoenixing?

2.3 Phoenixing occurs when a firm winds up and an individual connected with it re-opens under a new guise to avoid the liabilities of the old firm. Typically, the directors, shareholders or senior staff, whose former firm owes significant sums and/or has engaged in misconduct, reappear in connection with a new firm doing similar business.

2.4 The practice we have termed 'claims management phoenixing' is one we have previously described as a particularly egregious type of phoenixing. It occurs when individuals connected with a wound-up FS firm reappear not in a similar FS firm but in connection with a CMC that carries on regulated claims management activity in relation to the activities of the wound-up FS firm.

2.5 Often the liabilities that the wound-up firm leaves behind include redress liabilities in the form of compensation owed to customers. Individuals involved in claims management phoenixing are able to benefit from the existence of these unpaid redress liabilities through the fees that some consumers pay for claims management services when making claims for redress to the FSCS. The FSCS is the statutory compensation scheme established to pay redress (usually up to £85,000) in certain circumstances to customers of FS firms that cannot meet claims against them. It is funded by levies charged to FS firms that remain in business.

2.6 Claims management phoenixing is egregious because it takes advantage of consumers who have suffered loss and allows individuals not only to continue carrying on regulated activities after they have conducted themselves poorly, but to benefit materially from their own (or their firm's) past misconduct.

2.7 Claims management phoenixing may be 'direct' or 'indirect', and we have seen cases of both.

- Direct phoenixing occurs when the same individual or group of individuals winds up an FS firm and establishes or joins a CMC. For example, we have seen cases where directors of failed FS firms have become directors of CMCs. In these cases, the individuals who were involved in the FS activity of the failed firm can benefit directly by managing claims against that FS activity.
- Indirect phoenixing occurs when there is another kind of link between the CMC and the FS firm. For example, we have seen cases where CMC directors were married to the former directors of failed FS firms. In these cases, the individuals who were involved in the FS activity of the failed firm can benefit indirectly by having close relationships with individuals managing claims against that FS activity.

Case study: Indirect claims management phoenixing by husband and wife

The managing director of an FS firm provided inadequate services to consumers in relation to pension transfers. The FCA raised concerns with the FS firm and it agreed to seek a voluntary variation of its permissions. Soon afterwards the managing director's wife set up a CMC. The FS firm entered liquidation and the managing director was disqualified from acting as a company director.

The CMC that was set up by the managing director's wife submitted FSCS claims on behalf of customers of the FS firm who believed they had suffered loss as a result of the FS firm's conduct. In claim documents submitted to the FSCS the CMC criticised the services provided by the FS firm. For example one claim document said the FS firm facilitated a pension transfer knowing that its unsophisticated client would acquire illiquid and unregulated investments but without adequately explaining the high risks involved.

The FSCS awarded compensation totalling more than £5m to customers of the former FS firm. The CMC charged customers a fee of 15% of compensation awarded.

The CMC had temporary permission for claims management activity which was granted when the FCA began regulating CMCs on 1 April 2019. In response to concerns raised by the FCA the CMC's director provided contradictory information about her husband's role in the CMC and its use of customer data from the FS firm. The CMC also failed to demonstrate that it understood or could meet the regulatory requirements of an authorised firm. We refused the firm's application for FCA authorisation because it did not demonstrate appropriate resources and suitability which are threshold conditions for FCA authorisation. The CMC is no longer permitted to carry on FCA-regulated claims management activity.

2.8 In the case study above we were able to put a stop to claims management phoenixing because the CMC could not demonstrate that it was able to meet threshold conditions for FCA authorisation. This will not be so in all cases of claims management phoenixing.

Extent of claims management phoenixing

- 2.9** Information from the FSCS and our own supervisory activities indicates that claims management phoenixing occurs at a rate that is significant enough to warrant intervention. However, particularly for indirect phoenixing (where connections between firms and relevant individuals might not be obvious or apparent), we do not always have the information needed to identify connections between CMCs and the claims they manage or might seek to manage. Because of that we do not have a complete picture of the extent to which claims management phoenixing is occurring. It is likely to be more prevalent than our current data suggests. We are therefore proposing a notification requirement to help address gaps in our data.
- 2.10** Below we set out the information we have about the extent of claims management phoenixing:
- FSCS data indicates that 1,319 claims involved phoenixing activity over a 6-year period, making an average of 220 claims per year.
 - On those claims the FSCS paid out an average of £3.7m per year, or £17k per claim.
 - Those claims were connected to 30 firms that submitted claims on behalf of consumers to the FSCS; 4 of those firms are currently FCA-authorized CMCs. Although many of the firms that submitted the claims are not current FCA-authorized CMCs, the data show evidence of a tendency amongst some individuals involved in former FS firms to seek to benefit from their former firms' poor conduct by representing their customers in FSCS claims.
 - In connection with those claims 117 individuals had been directors or employees of both the FS firm that carried on the regulated activity that was the subject of the claim and the firm that submitted the claim to the FSCS on behalf of the consumer.
 - 59 of those individuals were connected to CMCs that are currently authorised by the FCA. We are taking action on an individual firm basis in respect of those currently authorised CMC firms.
 - We regulate about 250 CMCs with permission for advice, investigation or representation in respect of FS claims. Of those, at least 18 CMCs (7%) have connections to former FS firms whose actions are the subject of FSCS claims. These 18 firms have not all submitted FSCS claims in relation to their connected FS firms, and we have taken steps to prevent them doing so where possible. But these figures show the potential for individuals connected with FS firms to benefit from CMC activity on claims that are connected to them.
 - 14 of these 18 CMCs have direct connections with former FS firms, for example the CMC directors were directors of the former FS firms, and 4 have indirect connections where, for example, the spouse of a CMC director was a financial adviser in a former FS firm against which FSCS claims are made.
 - We regulate about 270 firms with permission to carry on 'lead generation' (seeking out, referrals and identification of claims or potential claims) but no other claims management activity. Based on our dealings with firms we estimate that roughly 100-150 of those deal with claims and potential claims about financial products and services. The extent to which lead generators have connections with former FS firms is unknown because we do not have information about connections between the firms and individuals carrying on FS activity.
- 2.11** Where we are aware of CMCs with relevant connections to former FS firms, we are taking steps on an individual firm basis to prevent them from managing claims related to those FS firms.

- 2.12** It is likely that the extent of claims management phoenixing is greater than suggested by the figures set out here because we do not have sufficient information to detect all cases of it.
- 2.13** The 1,319 claims identified by the FSCS include only cases of direct phoenixing, where the same individual could be identified as having been personally involved with both the FS firm and the CMC. The FSCS identified these connections using data from Companies House, the Office of National Statistics, the FCA register, the Financial Ombudsman Service, and its own data lab. However, the FSCS could not detect cases where the CMC had an indirect link to the FS firm, for example through a spouse, because it did not have access to information about indirect relationships.
- 2.14** Where we have identified current authorised CMCs with connections to former FS firms, we have done so in ad hoc ways without having information about all such connections. If implemented, the proposed notification requirement in Chapter 4 of this consultation paper will in future provide us with the information necessary to identify direct and indirect connections between CMCs and former FS firms.

The harm we are trying to prevent

- 2.15** In summary we have identified the following harms caused by claims management phoenixing:
- Impact on consumers: FS firms are potentially incentivised to act against their customers' interests – We estimate that the process of making a claim and the limit on the amount that can be claimed cost consumers £2.1m (£10k per claim) on 220 FSCS claims per year which, had claims management phoenixing not been possible, might not have arisen or might have been resolved differently (for example, without the need for a claim to the FSCS)
 - Impact on markets: Reduced trust in FS firms and CMCs is likely to damage public confidence and participation in markets – at least 59 individuals connected with 4 current CMC firms have benefited from managing claims against FS activity by their own former FS firms
 - Impact on fair competition between CMCs: Fair competition between CMCs is undermined – at least 18 of 250 CMCs (7%) with permission to manage FS claims are likely to have preferential knowledge of or access to claims due to claims management phoenixing
- 2.16** We discuss each of these harms in more detail below.

Impact on consumers

- 2.17** Claims management phoenixing can harm consumers by incentivising FS firms to wind up when redress liabilities arise, knowing they have the potential to charge customers further fees for future claims management activity. It could even incentivise FS firms to take a careless approach to providing financial products and services in the first place. We cannot say how much influence the incentive to phoenix has over the actions of FS firms. However, we think it reasonable to expect that if claims management phoenixing were no longer possible:

- consumers would potentially suffer fewer losses if firms were not incentivised to act against customers' interests
- where losses did occur, some claims might have been resolved differently, without a claim to the FSCS being necessary, if the phoenixing incentive had not existed
- where FS firms had to wind up, they would no longer have any disincentive during winding up to help consumers be aware of their options to make a claim.

2.18 In some instances, the conduct that caused the redress liability might not have occurred if claims management phoenixing had not been possible. As set out in the cost benefit analysis at Appendix 2, we estimate that the 1,319 claims to the FSCS that involved phoenixing cost consumers on average £10k per claim in CMC fees, unclaimed losses and monetised time and worry. The FSCS paid out £22.2m on those claims, but FSCS data indicates that a further £7.9m of consumer loss associated with those claims was unable to be paid due to the compensation limit. On most claims, the FSCS can pay no more than £85k per claim, even if consumers have lost an amount greater than £85k, so some consumer losses must go unclaimed. The claims will also have caused consumers worry and lost time. And consumers will have paid an estimated total of £4.5m in CMC fees on these claims, based on recent average charge rates (not taking into account the potential future fee cap proposed in CP21/01). For each claim that is prevented by the prohibition on claims management phoenixing consumers can save an estimated average of £10k. For each claim that is resolved differently (for example without a claim to the FSCS being necessary) consumers can save a proportion of that amount.

2.19 Where redress liabilities do arise, removing the opportunity for claims management phoenixing may result in more FS firms choosing to remain in business rather than winding up, with potentially better redress outcomes for clients than could have been achieved by an FSCS claim.

2.20 Where firms accrue redress liabilities that they cannot pay, those firms are insolvent and may need to wind up, leaving customers to claim compensation from the FSCS where applicable. Prior to and during winding up, the opportunity for claims management phoenixing can disincentivise FS firms from dealing with complaints properly as required by our Handbook (DISP 1.3 and 1.4). It can also disincentivise firms from helping customers know their options to claim redress from the FSCS and from providing information to the FSCS during the winding up. As said in our joint statement with the Information Commissioner's Office and the FSCS on insolvency practitioners and authorised firms, when a firm enters administration the FSCS will work jointly with the insolvency practitioner to identify potential claimants for redress. We would expect FS firms to assist in this process where possible. Guidance in our Handbook (DISP 1.3.6G) says that FS firms who identify recurring or systemic problems in their provision of services should take appropriate and proportionate measures to ensure customers who may have suffered detriment are given appropriate redress or a proper opportunity to obtain it, and firms should consider whether to undertake proactively a redress or remediation exercise, which may include contacting customers who have not complained. It is not a fair outcome for the failing FS firm's customers if individuals from the firm seek to benefit from providing claims management services to those customers instead of dealing properly with complaints and providing assistance during the winding up.

2.21 We do not see that consumers derive any benefit from claims management phoenixing. Drawing attention to poor conduct or service that can be claimed against is not necessary if the poor conduct or service is prevented to start with, or if the FS firm stays in business and provides redress itself, or if the FS firm alerts customers and the FSCS to known redress liabilities at the time of winding up. 'Inside' knowledge of the circumstances underlying the claim is not required for a CMC to help a consumer claim the redress to which they are entitled under the FSCS. If a consumer chooses to use a CMC to help them make a claim to the FSCS, it is not necessary for them to use a CMC with connections to the former FS firm against which the claim is made.

Impact on market confidence

2.22 For a market to function well, there must be trust between users and providers of services. Trust ensures that users and providers have the confidence to make transactions that benefit both. The incentive for individuals in FS firms to profit from claims management phoenixing can create an actual or perceived conflict between the interests of the customer and the interests of the FS firm which undermines trust. As set out at paragraph 2.10 we are aware of 1,319 FSCS claims over a 6 year period that involved suspected claims management phoenixing, 18 current FCA-authorized CMC firms with connections to failed FS firms, and 59 individuals connected to current FCA-authorized CMCs who have benefited from managing claims about FS activity by their own former FS firms. It is likely that the true extent of claims management phoenixing is greater than these figures indicate because we cannot currently identify all cases of claims management phoenixing. The perception that these individuals from FS firms seek to benefit from their own poor conduct is potentially damaging for public confidence in FS firms and participation in the market.

2.23 Having individuals from failed FS firms use the CMC regime to benefit from past misconduct is also likely to undermine the perception of professionalism and soundness in the CMC sector. CMCs are firms that carry on regulated claims management activity. This includes the activities of:

- seeking out, referrals and identification of claims or potential claims (which we call 'lead generation')
- advice, investigation or representation for a financial product or service claim

2.24 In some cases, firms carry on claims management in addition to other regulated FS activities, such as providing independent financial advice.

2.25 One of the aims of our regulation of claims management activity is that we want CMCs to be trusted providers of high quality, good value services that help people pursue legitimate claims for redress. Our priorities in the sector include:

- customers being empowered and confident in choosing a value-for-money service appropriate to their needs
- regulating in a way that prioritises high standards of conduct and improves public confidence in claims management services.

- 2.26** Consumers should be able to choose to use a CMC to help them claim compensation from the FSCS. But where an FS firm caused the consumer's loss, and particularly where the FS firm had a responsibility before winding up to consider helping its customers to obtain redress, paying an individual connected with that FS firm to provide help does not represent good value for money for the customer, who should have been able to expect help from the FS firm already if it was aware of the consumer's loss.
- 2.27** In relation to the 1,319 FSCS claims that we know involved suspected phoenixing, an estimated £4.5m was paid in CMC fees to entities with employees or directors who were involved in the FS firms who had caused the losses and who, as authorised FS firms, had a responsibility to put those losses right at no cost to their customers. Not only is this poor value for money for consumers; ultimately it undermines the confidence the public can have that CMCs have due regard to the interests of customers and treat them fairly.
- 2.28** Also, if any proportion of FSCS claims can be avoided by removing the incentive for claims management phoenixing then the wider financial services market will benefit from lower FSCS costs which reduce the compensation levy that solvent FS firms must pay. The redress payments made by the FSCS are funded by other FS firms who remain in business and who are charged an annual levy to fund the running of the FSCS and the compensation it pays out. FSCS costs for many FS firms have risen in recent years. For example, firms in the levy class of 'Life Distribution and Investment Intermediation' paid a total of £190m in 2019/20, compared with £117m in 2018/19. While we don't attribute this rise to claims management phoenixing, any easing of pressure on the FSCS levy through these proposals will be beneficial to the majority of levy-paying FS firms, who do not seek to phoenix.

Impact on fair competition between CMC firms

- 2.29** CMCs can benefit from fairer competition if some CMCs no longer have preferential access to or advance knowledge of potential claims through connections with former FS firms. Claims management phoenixing creates a competitive disadvantage for the CMCs that do not have such connections with the claims they manage. Although inside knowledge is not necessary for the making of a successful claim, advance knowledge of claims can help CMCs to market their services to consumers and to secure customers. The advantage that some CMCs will have due to phoenixing is unfair because it relies on prior involvement in the FS activity that caused consumers a loss. Although the impact of this is likely to be small (due to the small proportion of CMC firms likely to be involved in phoenixing) it remains unfair for some CMCs to experience such an advantage compared with CMCs who have not phoenixed.

Q1: Do you agree with the harms that we have said arise from claims management phoenixing?

Wider effects of this consultation

- 2.30** We have discussed these proposals with the FSCS and the Financial Ombudsman Service. We have also discussed them with the Solicitors Regulation Authority with a view to ensuring that any differences between regulatory regimes for claims management activity do not cause consumer harm.

Equality and diversity considerations

- 2.31** We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper. Overall, we do not consider that the proposals will have a particular material impact on any of the groups with protected characteristics under the Equality Act 2010. Our proposals should operate to protect any customer of a FS firm or a CMC, irrespective of any protected characteristics.
- 2.32** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them if we decide to make the rules.
- 2.33** In the meantime we welcome your input to this consultation on this.

Q2: Do you agree that the proposals will not materially impact any of the groups with protected characteristics under the Equality Act 2010?

3 Prohibition on managing connected claims

Introduction

- 3.1** This chapter describes our proposal to prohibit CMCs from carrying on claims management activity in circumstances where the CMC has a relevant connection with the claim. And it explains our rationale for the proposal. Our proposal for a notification requirement is at Chapter 4. The draft rules for both proposals are at Appendix 1.

The proposed prohibition

- 3.2** In summary, the prohibition we are proposing is as follows:
CMCs are prohibited from carrying on any regulated claims management activity in respect of a claim or potential claim to the FSCS in the following circumstances:
- a.** Any employee or controller of the CMC, or any member of the CMC's governing body, was directly involved in or had responsibility for managing the FS activity that is the subject of the claim or potential claim; and/or
 - b.** A member of the CMC's governing body is related to a person who was directly involved in or had responsibility for managing the FS activity that is the subject of the claim or potential claim; and/or
 - c.** The CMC or a member of its governing body has transferred or agreed to transfer a financial benefit to a person who was directly involved in or had responsibility for managing the FS activity that is the subject of the claim or potential claim.

Relevant connections between a CMC and a claim

- 3.3** We intend these proposals to address both direct and indirect claims management phoenixing. We also intend them to address lead generation activity, in particular individuals from former FS firms benefiting from providing CMCs with information about potential claims or potential claimants who are former customers of the FS firm.
- 3.4** The prohibition will apply where there is a direct connection, such as a director of a CMC having been the financial adviser who gave the advice that is the subject of the claim. And it will also apply where there is an indirect connection, for example where the CMC director's spouse was the financial adviser who gave the advice that is the subject of the claim, or where financial payment is made from a CMC director to a person who gave or was responsible for managing the advice that is the subject of a claim.

3.5 To prevent indirect claims management phoenixing we propose to specify connections which will trigger the prohibition. Those connections are ones through which financial benefit flows between the CMC and individuals who were directly involved in or had responsibility for managing the FS activity that is the subject of the claim. Those connections are:

- Being related in a specified way to a person who was directly involved in or had responsibility for managing the FS activity
- Having transferred or agreed to transfer a financial benefit to a person who was directly involved in or had responsibility for managing the FS activity

Being related to a person

3.6 For the purposes of our proposals, a person is 'related' to another person if any of the following apply:

- They are that person's spouse or civil partner
- They and that person are in a relationship with the characteristics of the relationship between spouses or civil partners
- They are that person's parent, brother, sister, child, grandparent or grandchild (including step-relations in these categories)

3.7 People who are related in any of these ways have a close familial relationship with each other. An individual who has a close familial relationship with a member of a CMC's governing body is likely to share in the financial benefits that the CMC receives by virtue of their relationship to the CMC, even if they experience those benefits indirectly. When that individual is directly involved in or responsible for managing FS activity that is eligible for FSCS protection, that individual can benefit from their own poor conduct or service through the activities of the CMC.

3.8 We have considered whether this proposal might unfairly prevent CMCs from managing claims in some situations. This could occur in circumstances where the connection between the FS firm and the CMC firm would not result in any shared or transferred benefit. An apparent relationship might exist without any material connection or flow of benefit between the parties. Preventing CMCs from managing claims with which they have no material connection is not a consequence we intend. However, we think this risk is adequately mitigated by the fact that CMCs in this position can apply for a waiver from the rules in the normal way.

Having transferred or agreed to transfer a financial benefit

3.9 We propose that the prohibition applies if the CMC or a member of its governing body has transferred or agreed to transfer a financial benefit to a person who was directly involved in or had responsibility for managing the carrying on of the regulated FS activity that is the subject of the claim. The transfer of financial benefit could be part of an ongoing financial arrangement or it could be ad hoc or one-off payment.

3.10 Where financial benefit is transferred between these parties, a relationship exists through which benefit flows. This relationship means that the person who carried on the regulated FS activity stands to benefit (or might be perceived to benefit) if the CMC benefits from carrying on claims management activity in respect of that regulated FS activity.

- 3.11** It is possible that the person who was directly involved in or had responsibility for managing the FS activity might have reason to receive a financial benefit from the CMC or a member of its governing body for a reason unconnected with the regulated activity or the claims arising from it. That person might not benefit or appear to benefit from any past misconduct. We think the likelihood of this is low and that the risk is adequately managed by the fact that CMCs in this position can apply for a waiver from the rules in the normal way.

Alternative option

- 3.12** We considered proposing the less intrusive option of allowing CMCs to carry on claims management activity on claims where they have a relevant connection providing they do not take a fee for that activity. That way CMCs could provide claims management services to former FS customers of themselves and their connections pro bono rather than be banned from providing the services at all. However, acting in a claim can provide firms with indirect benefits, meaning benefits other than a fee for service. For example, firms acting pro bono could cross-sell other products to the customer, be introduced to friends or family, or receive reputational benefits without having charged a fee. If individuals from former FS firms are able to grow a CMC business on the basis of past poor conduct or service then the harms we have discussed in relation to claims management phoenixing can still occur.
- 3.13** None of what we are proposing is intended to prevent or excuse FS firms from helping their customers to obtain redress from the FSCS, or to prevent or excuse FS firms from helping an insolvency practitioner or the FSCS. As we have said, we expect FS firms to continue to have due regard to customers' interests during wind-up, including by helping to make provision for redress claims where relevant and appropriate. Our concern is that helping the FS firm's own customers to put right losses caused by the FS firm should not be an activity that provides a benefit to an individual who is associated with that FS firm.

Q3: Do you agree that CMCs should be prohibited from carrying on FCA-regulated claims management activity in the circumstances we have proposed?

Scope of the proposed prohibition

Which firms will be affected?

- 3.14** The prohibition will affect firms carrying on any FCA-regulated claims management activity for FSCS claims and potential claims. This includes firms carrying on lead generation activity (seeking out, referrals or identification of claims and potential claims) as well as firms investigating and advising on claims and representing consumers making claims. Although we have not seen cases of individuals from failed FS firms phoenixing into lead generation activity, the same incentive exists.
- 3.15** Firms affected also include EEA firms or Gibraltar-based firms carrying on FCA-regulated claims management activity related to the United Kingdom. Such activity would be based on 'top-up' permission granted by the FCA, in other words an additional permission granted to firms entitled (or formerly entitled) to carry on passported activities.

Q4: Do you agree that the prohibition should apply to the firms we have described here?

Claims and potential claims to the FSCS only

- 3.16** The cases of claims management phoenixing we have seen have generally involved the FS firm having wound up and claims being made to the FSCS. If the firm does not wind up then it has to pay any redress liabilities itself. In theory, an individual could seek to benefit by pursuing claims against such a firm. For example a former employee of an FS firm could carry on claims management activity on claims against the FS firm while the FS firm remains in business. However, if the FS firm is dealing with the liability itself then no cost is imposed on the wider industry. Also, we are not aware of such activity occurring to a significant extent and we believe the existence of the compensation scheme that pays out in respect of former firms creates a unique incentive for phoenixing when a FS firm is wound up. For these reasons, we propose that the prohibition should apply only in respect of claims and potential claims that are or could be made to the FSCS.
- 3.17** For CMCs carrying on the activity of investigating, advising and representing we propose prohibiting management of claims made to the FSCS. The prohibition will not apply to claims made to an FS firm or to the Financial Ombudsman Service, for example, even if the activity that is the subject of the claim is, in theory, an FSCS-eligible activity.
- 3.18** For CMCs carrying on the activity of lead generation we propose to prohibit dealing with claims and potential claims in connection with FSCS-eligible activity. This means that for lead generation the proposed prohibition will apply to claims and potential claims about FSCS-eligible activity even if the FS firm is still in business and the claims can be made to the firm or the Financial Ombudsman Service, for example.
- 3.19** We are not proposing that the prohibition should apply to claims that are not about financial products or services. This is because the phoenixing we have witnessed arises from firms carrying on financial services activity which is covered by the FSCS. In the absence of a scheme such as the FSCS to pay compensation in respect of firms that are wound up in other sectors, there is not the same incentive for an individual to phoenix into claims management activity.

Q5: Do you agree that the prohibition should apply to FSCS claims and potential FSCS claims in the way we have described here?

Pre-existing agreements

- 3.20** For the activity of advice, investigation or representation, we propose that the prohibition will apply to new agreements only. This means that CMCs carrying on this activity will be able to continue to act for customers on claims for which they have an existing agreement at the time the rules come into force. Where firms are already managing a claim, the phoenixing will already have occurred. By prohibiting future claims management phoenixing we hope to prevent future misconduct and winding up. We recognise there is an opportunity to mitigate some potential consumer harm by preventing current customers from paying a CMC fee in phoenixing cases. But we balance that against the inconvenience and disruption consumers will experience if

CMCs cease managing their claims midway through. On balance we think the better option in this case is to apply the prohibition to new agreements only.

3.21 For lead generation activity, we propose that the prohibition on claims management phoenixing, if made, will apply to pre-existing agreements to provide services, as well as new agreements. Where CMCs carry on this activity, there is little risk of disruption to consumers if the prohibition applies to any agreements that were entered before the proposals came into force.

Q6: Do you agree that the prohibition on lead generation should apply to pre-existing and new agreements, and the prohibition on advice, investigation or representation should apply to new agreements only?

Implementation

3.22 We propose that both the prohibition set out in Chapter 3 and the notification requirement set out in Chapter 4 will take effect 1 month from the date the proposed rules are made.

3.23 Using our supervisory knowledge of the CMC sector, we have considered the changes firms will need to make to be compliant and we think they are relatively minor. CMC firms are likely to need to familiarise themselves with the new rules, communicate the rules to staff, and amend some systems or processes to ensure ongoing compliance.

3.24 We think a 1-month implementation period will strike a reasonable balance between allowing firms to prepare and adjust, and mitigating harm caused by phoenixing activity that is already occurring.

Q7: Do you agree that the proposals should take effect 1 month from the date the rules are made?

4 Notification requirement

Introduction

- 4.1** This chapter describes our proposal to require CMCs to notify us of links to FS activity that could mean the CMC has a relevant connection with a claim. We propose that this requirement takes effect at the same time as the prohibition on managing connected claims. The draft rules for this proposal are at Appendix 1.

The proposed notification requirement

- 4.2** We propose that CMCs will be required to notify us of:
- any FS activity in respect of which an employee or controller of the CMC, or any member of its governing body, is or was directly involved in or responsible for managing.
 - any member of the firm's governing body who is related to a person who is or was directly involved in or responsible for managing FS activity.
- 4.3** Under this proposal CMCs will be required to notify us of direct and indirect connections with FS activity that is or could be the subject of a claim. For example, if an employee of the CMC was a director of a FS firm the CMC will be required to notify us of that. And if a director of a CMC is married to a person who provides financial advice, for example, the CMC will be required to notify us of that relationship. Firms will be required to notify us of such activity whether or not any claims have been made in respect of the activity.
- 4.4** We propose to require CMC firms to attest annually to the accuracy of these notifications.
- 4.5** The purpose of this proposal is to provide us with information to monitor potential instances of claims management phoenixing. We considered the less onerous option of requiring firms not to routinely notify us but simply to keep their own register of connections which could be provided to the FCA upon request. However, that would not be sufficient to allow effective regulatory oversight of the proposed prohibition on claims management phoenixing.

Q8: Do you agree that CMCs should be required to notify us as described in this chapter?

Annex 1

Questions in this paper

- Q1:** Do you agree with the harms that we have said arise from claims management phoenixing?
- Q2:** Do you agree that the proposals will not materially impact any of the groups with protected characteristics under the Equality Act 2010?
- Q3:** Do you agree that CMCs should be prohibited from carrying on FCA-regulated claims management activity in the circumstances we have proposed?
- Q4:** Do you agree that the prohibition should apply to the firms we have described here?
- Q5:** Do you agree that the prohibition should apply to FSCS claims and potential FSCS claims in the way we have described here?
- Q6:** Do you agree that the prohibition on lead generation should apply to pre-existing and new agreements, and the prohibition on advice, investigation or representation should apply to new agreements only?
- Q7:** Do you agree that the proposals should take effect 1 month from the date the rules are made?
- Q8:** Do you agree that CMCs should be required to notify us as described in this chapter?

Annex 2

Cost benefit analysis

Introduction

1. The Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made' and an estimate of the costs and benefits, unless they cannot reasonably be estimated or it is not reasonably practicable to produce an estimate. This requirement to produce a CBA for rules made under FSMA does not apply in specified instances, including where the proposed rules would result in no or only a minimal increase in costs for businesses.
2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about an appropriate intervention, taking into account all the other impacts we foresee.
3. The cost benefit analysis is set out in the following sections:
 - Problem and rationale for intervention
 - Affected firms and key assumptions
 - Costs
 - Benefits

Problem and rationale for the proposed intervention

4. As set out in Chapter 2 of this consultation paper claims management phoenixing is likely to cause the following harms:
 - Consumers potentially suffer losses if FS firms are incentivised to act against customer interests.
 - Reduced trust in FS firms and CMCs is likely to damage public confidence and participation in markets.
 - Fair competition between CMCs is undermined if some CMCs have preferential access to or advance knowledge of redress claims.
5. More detail on these harms is in Chapter 2.

6. If we do not implement the proposals in this consultation paper then we expect the FCA-regulated claims management sector for claims about financial products and services will continue to feature claims management phoenixing and the resultant harms described in Chapter 2 of this consultation paper.
7. It is not reasonably practicable to quantitatively estimate the harms described in Chapter 2. If we do nothing, we expect that harms will occur to the same extent they occur now as a result of actual cases of claims management phoenixing. To establish a very rough indication of the order of magnitude of these harms, we estimated the extent of claims management phoenixing and the costs that consumers experience when making the claims on which phoenixing occurs.
8. We received data from the FSCS on 1,319 phoenixing cases covering a period of about 6 years, representing an average of 220 claims per year, with a total of £3.7m paid out per year, or £17k per claim.
9. Amongst about 250 CMC firms that we regulate with permission for advice, investigation or representation in respect of FS claims, we are aware of 18 CMCs (7%) which have relevant connections with former FS firms which are the subject of claims to the FSCS. Of those, 4 firms have indirect connections with the former FS firms, and 14 have direct connections. It is likely that for both direct and indirect claims management phoenixing the number of actual cases is higher than the number of known cases. This is particularly the case for indirect phoenixing because it is more difficult to observe.
10. The financial losses experienced by consumers as a result of claims management phoenixing are not easy to estimate because there are several alternative scenarios which could have occurred had claims management phoenixing not been possible. For example:
 - some claims might have been resolved differently, without a claim to the FSCS being necessary
 - other claims might still have been made by the affected consumers, either direct to the FSCS or with the help of a different CMC
 - some claims might not have arisen at all if the phoenixing incentive did not exist.
11. Table 1 shows our estimates of the costs that consumers have experienced in making the FSCS claims where claims management phoenixing has occurred. The costs relate to the process of making a claim and any amounts that cannot be claimed because they exceed the FSCS compensation limit. Table 1 also shows how we calculated those estimates. In the estimates we assumed that the claims related to pensions or savings/ investments because these claim types dominate the known cases.

Table 1: cost to consumers of making FSCS claims in known phoenixing cases

Cost to consumers of making claims	Cost per year	Basis for estimate
Financial losses unclaimed due to exceeding the FSCS compensation cap	£1.3m	Total consumer loss on the 1,319 claims (where recorded by the FSCS) less compensation paid on those claims (as recorded by the FSCS)
Time lost to make claims	£12k	Analysis done for CP21/01, that consumers spend an average of 9 hours on CMC-managed claims for pensions and savings/investments at a rate of £6.1/hour for consumers' lost leisure time

Cost to consumers of making claims	Cost per year	Basis for estimate
Worry incurred	£28k	Analysis done for CP21/01, that on pensions and savings/investment claims consumers suffer emotional stress per claim at a rate of: 2.22 times the monetised consumer time lost for savings/investment claims; and 2.33 times the monetised time spent for pensions claims
CMC fees paid	£750k	Analysis done for CP21/01, that the average CMC fee for claims against pensions and savings/investment products was 20.3% (which in future would reduce to 16.6% if the proposals in CP21/01 are implemented)
TOTAL	£2.1m	

12. As shown in Table 1 the total estimated cost to consumers of making the 1,319 FSCS claims that are known to have involved phoenixing was about £2.1m per year, or £10,000 per claim. Where, in the absence of phoenixing, consumers would not have suffered any loss at all (because the misconduct would not have occurred), consumers would save the entirety of the estimated average £10,000 per claim. However, where the consumers would still have made a claim, even in the absence of phoenixing, consumers may save a proportion of the £10,000 per claim. For example, if a firm would have continued in business, it might have been in a position to pay out a consumer's claim in full, and the consumer's claim would not have been reduced by the impact of the FSCS claims limit. On the one hand the estimated average of £10k per claim is an upper estimate of harm to consumers, as the harm caused by phoenixing to consumers is only a proportion of those costs. On the other hand it might be an underestimate because it is likely that actual phoenixing cases are more numerous than the number of cases we know about.

13. In summary, we are unable to reliably quantify the harm caused by claims management phoenixing, but to establish an approximate order of magnitude we have estimated the extent of claims management phoenixing and the cost to consumers of claims on which phoenixing has occurred. We used these estimates to help us assess the benefits offered by our proposals as described in paragraphs 27-30 of this cost benefit analysis.

The proposed intervention

14. Chapter 3 of the consultation paper describes our proposed prohibition on claims management phoenixing. Chapter 4 describes the notification requirement we propose to introduce for firms in support of the prohibition. Figure 1 in the consultation paper shows the causal chain for the intervention, illustrating how we think the intervention will benefit consumers.

Affected firms and key assumptions

15. To estimate the number of CMC firms affected by our proposals we used the total population of firms currently authorised with permission for the regulatory activities of: advice, investigation or representation in respect of FS claims (247 firms); and lead generation (seeking out, referrals and identification of claims or potential claims) (266 firms).

16. Firms with lead generation permission may operate in any of the CMC sectors; their permission is not specific to the FS or any other sector. Therefore we are unable to determine how many lead generation firms deal with FS claims. For the purposes of this cost benefit analysis we included all lead generation firms amongst the potentially affected firms. This means we have assumed a total of 513 firms will be affected. The true number is likely to be significantly lower due to the fact that many lead generation CMC firms do not deal with FS claims.
17. To group firms according to size we used data from regulatory returns on employee numbers and definitions from the [Office of National Statistics](#) for micro, small, medium and large businesses. We used 221 returns which was the number of completed returns available for the most recent reporting year.

Table 2: Affected CMC firms by size with average employees and annual turnover

Firm size	Number of employees	Number of firms	Average employees	Annual staff turnover
Micro	0-9	395	3	6%
Small	10-49	84	21	26%
Medium	50-249	27	112	51%
Large	250+	6	319	54%
		513		12%

In line with our [standard costs model](#) we assumed:

- A reading speed of 3 minutes per page, and 300 words per page
 - Staff salaries from the Willis Towers Watson UK 2016 Financial Services Report, adding 30% overheads to account for non-wage labour costs
 - 1,540 working hours per year
18. We have considered the effects of the proposal over the course of a single year. We have not projected the effects over a longer period of multiple years. Any economic downturn is likely to put greater pressure on firms and might exacerbate the incentive to phoenix for FS firms facing redress liabilities, but it is not reasonably practicable to quantitatively estimate how market conditions will change as the macroeconomic environment changes, particularly in the wake of the coronavirus pandemic, or how the market will develop over time.

Costs

Summary of costs

19. Table 3 and Table 4 below show the one-off and ongoing costs for all affected firms (the 'industry'), and for firms of different sizes.

Table 3: Estimated total industry costs for CMC firms

Cost type	Industry	
	One-off	Yearly
Familiarisation and gap analysis	£72,000	
Training (existing staff)	£54,000	
IT project	£365,000	

Cost type	Industry	
	One-off	Yearly
Notification requirement (compliance)		£29,000
Training (new staff)		£9,000
TOTAL	£491,000	£38,000

20. The table below shows estimated costs per firm, including by firm size.

Table 4: Estimated costs by size of firm

	Industry one-off cost	Per firm one-off cost	Industry ongoing cost	Per firm ongoing cost
Large firms	£129,000	£20,000	£6,000	£1,010
Medium firms	£116,000	£4,000	£10,000	£380
Small firms	£196,000	£2,000	£6,000	£70
Micro firms	£52,000	£130	£15,000	£40

* The total appears different between tables 3 and 4 due to rounding of figures.

One-off familiarisation and implementation costs

21. We expect that if our proposals are implemented then affected CMC firms will incur one-off costs to familiarise themselves with the rules, assess what they need to change, and make changes to comply with the new rules. The total amount of these one-off costs is an estimated £491k. This estimate includes:

- Compliance professionals to read a 20-page policy statement (1 per micro firm, 1.5 per small firm, 4 per medium firm, 6 per large firm)
- Legal professionals to review 10-page legal instrument (1 per micro and small firm, 1.5 per medium firm, 2 per large firm)
- Legal professionals to conduct gap analysis (1 professional for 0.5 hours per micro and small firm, 1.5 professionals for 1 hour per medium firm, 2 professionals for 2 hours per large firm)
- small IT project for small and medium firms (8 project days) and large firms (46 project days) to create systems for ensuring ongoing compliance – to check whether claims can be managed or are subject to the prohibition
- Negligible costs for micro firms to create new compliance processes because we expect firms with very small numbers of staff will be aware of any FS firms against which they may not manage claims
- Briefing for staff on the new rules and associated process/system change (5 minutes per employee at average adviser salary)
- Staff recording information about direct involvement in or responsibility for FS activity for notification purposes (5 minutes per employee at average adviser salary)

Ongoing compliance and reporting costs

22. If we implement the proposals then CMC firms will need to ensure on an ongoing basis that they comply with the prohibition in Chapter 3 and the notification requirement in Chapter 4. The cost of initial training and changing IT systems to facilitate ongoing compliance is included in our estimate of one-off familiarisation and implementation

costs. We estimate in this section some additional, ongoing training cost in light of staff turnover and the ongoing cost of complying with the proposed notification requirement. The total estimate for ongoing costs is an annual £38k. This estimate includes:

- senior officers of the firm recording information about related persons for the annual notification requirement (5 mins per person and 3 people per micro firm, 5 people per small, medium and large firm)
- new staff recording information about direct involvement in or responsibility for FS activity (5 minutes per employee at average adviser salary, estimating the number of employees by multiplying the average number of employees (see Table 2) with employee turnover (see Table 2), where turnover is the ratio of employees who left the firm over the average number of employees in a year. Since some employees left due to wind downs and therefore will not be replaced, this figure will likely overestimate the actual costs)
- compliance officer notifying the FCA annually of related persons (0.5 hours per firm)
- additional onboarding information for new staff (5 minutes per employee at average adviser salary, estimating the number of employees by multiplying the average number of employees (see Table 2) with employee turnover (see Table 2), where turnover is the ratio of employees who left the firm over the average number of employees in a year. Since some employees left due to wind downs and therefore will not be replaced, this figure will likely overestimate the actual costs).

23. We considered whether, instead of making an IT change to facilitate ongoing compliance with the prohibition, a small firm might incur an ongoing cost to manually check compliance on claims. If case advisers in a small firm handled 225 claims per year and spent 1 minute checking each claim, we estimate small firms would incur an ongoing yearly cost of £116 per firm with a total ongoing yearly cost of £10k to the industry.

Other costs

24. We discounted the loss of profit for phoenixed CMCs because it is that profit that creates the incentive for claims management phoenixing and thus causes the harm we are addressing. Similarly, we have not quantified the cost of FS firms familiarising themselves with the rules.

25. Given the number of phoenixing cases we are aware of, we have assumed that CMC firms will not be forced to exit the market if they can no longer manage claims with which they have a relevant connection, and so we do not think the rules adversely impact on competition.

Benefits

- 26.** To break even, the benefits expected from our proposals need to be at least equal to the estimated costs of the proposal. We think this is likely.
- 27.** The benefits we believe our proposals will realise are:
- saved cost of making FSCS claims where removing the incentive for claims management phoenixing means fewer FSCS claims will need to be made
 - increased consumer confidence in FS firms
 - increased confidence in CMCs
 - removal of the competitive disadvantage for CMCs that do not have preferential access to or advance knowledge of redress claims.
- 28.** We consider that the benefits of the proposals are likely to outweigh the total estimated costs of £491k one-off and £38k ongoing. Our estimates of the extent of claims management phoenixing and the cost to consumers of making claims (see Table 1) provide an approximate indication of the order of magnitude of the monetised benefit that could result from removing the incentive for claims management phoenixing. The 18 CMC firms having relevant connections with failed FS firms make up a small but significant number (7%) of the authorised population managing FS claims which indicates the proposals could have a material effect on confidence in CMCs.
- 29.** If removing the incentive for claims management phoenixing meant that 50 consumers in the first year and 4 consumers per year after that were saved from having to make a claim and thus saved £10k each, then the proposals would break even given our estimated total one-off and ongoing costs. However, we think that the unquantifiable benefits of strengthened public confidence and fairer competition between CMC firms are sufficient in themselves to justify both the one-off and ongoing costs of the proposals.

Annex 3

Compatibility statement

Compliance with legal requirements

- 1.** This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under FSMA.
- 2.** When consulting on new rules, the FCA is required by section 138I(2)(d) of FSMA to include an explanation of why it believes making the proposed rules is compatible with:
 - a.** its general duty, under section 1B(1) of FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and which advances one or more of its operational objectives, and
 - b.** its general duty under section 1B(5)(a) of FSMA to have regard to the regulatory principles in s3B of FSMA.
- 3.** The FCA is also required by section 138K(2) of FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies compared with other authorised persons.
- 4.** This Annex also sets out our view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
- 5.** In addition, this Annex explains how we have considered the recommendations made by the Treasury under section 1JA of FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.
- 6.** This Annex includes our assessment of the equality and diversity implications of these proposals.
- 7.** Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRRA.

The FCA's objectives and regulatory principles: Compatibility statement

8. The proposals set out in this consultation paper are primarily intended to advance the FCA's operational objectives of consumer protection and market integrity. They are also relevant to the FCA's competition objective and compatible with the competition duty.

Our objectives

9. These proposals are intended to advance our consumer protection objective, to secure an appropriate degree of protection for consumers. These measures will restrict the ability of CMCs to carry on claims management activity on claims with which they have a relevant connection via a link to the FS firm that carried on the activity that is the subject of the claim. We consider this necessary to advance our consumer protection objective. If FS firms are no longer potentially incentivised to pursue claims management activity where they have outstanding redress liabilities, FS firms will potentially be less likely to seek to exit the market to avoid their liabilities and less likely to provide poor service before exiting and they will be more likely to deal appropriately with redress liabilities that do arise. In considering what intervention is appropriate we have had regard to the 8 considerations listed in section 1C(2)(a)-(h) of FSMA.
10. The proposals are also relevant to our integrity objective. We consider these proposals advance the FCA's integrity objective of protecting and enhancing the integrity of the UK financial system because they aim to address an incentive (claims management phoenixing) which undermines the integrity of financial services markets. Confidence and participation in markets are threatened by unacceptable conduct. These proposals enhance confidence in FS firms, CMCs and the redress system by ensuring the claims management regime is not used by firms to benefit from their own misconduct at the expense of consumers and the firms left to pay the FSCS costs. The proposals should be beneficial for confidence and participation in FS and CMC markets. The proposals reduce the incentive for poor conduct and winding up, which can add to the cost of the FSCS levy and therefore the overall regulatory burden. We considered the elements of integrity in section 1D(2) of FSMA.
11. The proposals are also relevant to our competition objective because they will remove a potential unfair competitive advantage for CMCs with connections to former FS firms.
12. We consider these proposals are compatible with the FCA's strategic objective of ensuring relevant markets function well because they address an incentive that undermines confidence and participation in markets. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by section 1F of FSMA.

The regulatory principles

13. We describe below how, in preparing these proposals, we had regard to the regulatory principles set out in section 3B of FSMA.

The need to use our resources in the most efficient and economic way

14. Our proposals will mean we no longer need to deal with cases of potential claims management phoenixing on a case-by-case basis. They will have minimal effect on FCA resources. We will need to receive and consider information about potential links between CMCs and claims they manage. We do not expect this to be more burdensome than our current practice of receiving and enquiring into such information in an ad hoc way. The prohibition will give us clearer remit to take action when we identify claims management phoenixing.

The principle that a burden or restriction should be proportionate to the benefits

15. The proposals apply a burden to firms that is proportionate to the benefits. CMCs already in business and having no connections to the claims they manage will experience minimal impact. Firms will have to notify the FCA of certain information and ensure they do not breach the prohibition, but they will not need to make significant changes to their operating practices.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

16. The proposals are not expected to negatively impact on sustainable economic growth; any effect on markets is expected to be a strengthening one by removing incentives for poor conduct and firm closure, potentially reducing the burden on the FSCS compensation levy, and enhancing confidence in UK markets. We consider that, if some individuals choose not to carry on claims management activity in future due to our rules, those individuals will be those who are less likely to treat customers fairly and act in their interests.

The general principle that consumers should take responsibility for their decisions

17. While consumers can take responsibility by refusing to employ CMCs that are connected with the FS firms they are claiming against, it is not always possible for consumers to know about connections between the parties. We have seen market failures (in particular information asymmetry) which make it difficult for CMC customers to make informed choices.

The responsibilities of senior management

18. The proposals are consistent with senior managers taking responsibility by removing incentives for those who were directly involved in or had responsibility for managing FS activity to engage in irresponsible conduct (profiting from having provided poor service). Relevant senior management will need to ensure firms comply with our proposed rules, having regard to their responsibilities under the senior managers and certification regime.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

19. We have considered the difference in the businesses carried on by CMCs and FS firms and the subgroups within those categories. Our intervention is aimed at the particular type of CMC activity which acts as an incentive for claims management phoenixing. We have considered mutual societies separately.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

20. We do not think our rules will impact on this.

The principle that we should exercise of our functions as transparently as possible

21. In this consultation paper we have set out our proposals and the rationale for them as transparently as possible. The proposals themselves increase the transparency of how we exercise our functions. A prohibition on claims management phoenixing states our expectations clearly and is more transparent than dealing with claims management phoenixing on a case by case basis with individual firms.

Financial crime

22. In formulating these proposals, we had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by section 1B(5)(b) of FSMA). We do not think our proposals will affect the extent to which this is possible.

Chancellor's recommendations

23. We have had regard to the Chancellor's recommendations for the FCA from March 2021. The proposals are designed to help financial services work well for consumers, in particular by removing an incentive for firms to provide poor service and to avoid redress liabilities. We have mentioned elsewhere the regard we have had to competition. We have endeavoured to allow for growth and innovation by intervening in a proportionate manner. The proposals are unlikely to affect trade or inward investment or climate change.

Expected effect on mutual societies

24. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies. Removing the phoenixing incentive will impact mutual societies who are authorised persons in the same way it will impact other authorised persons. Due to their ownership structures, we think mutual societies are less likely than other authorised persons to pursue a phoenixing strategy.

Compatibility with the duty to promote effective competition in the interests of consumers

25. We have had regard to the FCA's duty to promote effective competition in the interests of consumers. Our proposals will cause an apparent reduction in choice and access to CMCs by prohibiting some current or prospective CMCs from managing certain claims. However, we consider this to be appropriate to the risks of harm posed by the incentive for claims management phoenixing. Furthermore we consider that prohibiting claims management phoenixing will enhance competition between CMCs by removing an unfair advantage enjoyed by CMCs that have connections to the claims they manage. We do not consider that we could achieve the aims of the proposal in any way that would be more beneficial for competition.

Equality and diversity

26. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.
27. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in Chapter 2 of this consultation paper.

Legislative and Regulatory Reform Act 2006 (LRRRA)

28. We have had regard to the principles in the LRRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that we are carrying out our regulatory activities in a way which is:
- transparent: as set out above
 - accountable: we are consulting on our proposals and will carefully consider responses to the consultation before making any rules
 - proportionate: as set out above
 - consistent: our proposals will apply in a consistent manner to all firms considering claims management phoenixing for the purpose of helping former FS customers make claims to the FSCS
 - targeted only at cases in which action is needed: we consider there is significant need for the proposed intervention, as explained in the consultation paper and cost benefit analysis
29. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider that our proposals meet those principles. The proposals are based on preventing claims management phoenixing which we consider acts as an incentive for FS firms to act against the interests of their customers.

Annex 4

Abbreviations used in this paper

Abbreviation	Description
CBA	Cost benefit analysis
CMC	Claims management company
FS	Financial services
FSMA	Financial Services and Markets Act 2000
FSCS	Financial Services Compensation Scheme

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Appendix 1

Draft Handbook text

CLAIMS MANAGEMENT (RELEVANT CONNECTIONS) INSTRUMENT 2021

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers referred to above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*1 month after the date on which this instrument is made*].

Amendments to the Handbook

- D. The Claims Management: Conduct of Business sourcebook (CMCOB) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Claims Management (Relevant Connections) Instrument 2021.

By order of the Board
[*date*]

Annex

Amendments to the Claims Management: Conduct of Business sourcebook
(CMCOB)

In this Annex, underlining indicates new text.

2 Conduct of business

2.1 General principles

...

- 2.1.15 R (1) A firm must not carry on the regulated activity of seeking out, referrals and identification of claims or potential claims in relation to a claim or potential claim if:
- (a) the firm has a relevant connection to the claim or potential claim; and
 - (b) if valid, the claim or potential claim would be a protected claim.
- (2) A firm must not carry on the regulated activity of advice, investigation or representation in relation to a financial services or financial product claim in respect of a claim, or potential claim, to the FSCS, if the firm has a relevant connection to that claim or potential claim.
- (3) The prohibition in (2) does not apply to regulated claims management activity carried on pursuant to an agreement entered into before [Editor's note: date of entry into force of these rules].
- 2.1.16 R An activity is an FSCS-eligible activity for the purposes of CMCOB 2.1.15R to CMCOB 2.1.21G if it falls into one of the categories of activity which could give rise to a protected claim.
- 2.1.17 G Activities which could give rise to a protected claim are the activities referred to in COMP 5.2.1R, when carried on by a participant firm, or an appointed representative of such a firm. Those activities include, for example, the regulated activities which constitute designated investment business (referred to as part of the definition of protected investment business in COMP 5.5.1R(1)). An activity may be an FSCS-eligible activity regardless of whether it has given rise to a claim or potential claim.
- 2.1.18 R (1) A firm has a relevant connection to a claim or potential claim for the purposes of CMCOB 2.1.15R if one of the conditions in (2)-(4) is met.

- (2) A person who:
- (a) is a member of the firm's governing body; or
 - (b) is a controller, or employee of the firm,
was directly involved in, or responsible for the carrying on of, the FSCS-eligible activity giving rise to the claim or potential claim.
- (3) An individual 'A', who is a member of the firm's governing body, is related to an individual 'B' who was directly involved in, or responsible for the carrying on of, the FSCS-eligible activity giving rise to the claim or potential claim.
- (4) The firm, or a member of the firm's governing body, has provided, or agreed to provide, a financial benefit to a person who was directly involved in, or responsible for the carrying on of, the FSCS-eligible activity giving rise to the claim or potential claim.
- (5) A is related to B for the purposes of (3), and CMCOB 2.1.20R(5)(b), if:
- (a) A is B's spouse or civil partner;
 - (b) A's relationship to B has the characteristics of the relationship between spouses or civil partners; or
 - (c) A is B's parent, brother, sister, child, grandparent or grandchild (including step-relations in these categories).

- 2.1.19 G (1) For the purposes of CMCOB 2.1.18R to CMCOB 2.1.20R,
- (a) a person is not directly involved in an activity if the person has a purely administrative or support function, e.g. IT support; and
 - (b) a person may be responsible for the carrying on of an activity without being approved as an SMF manager.

- (2) For the purposes of CMCOB 2.1.18R(4), the financial benefit could be provided while the firm carrying on the FSCS-eligible activity is still a going concern.

- 2.1.20 R (1) This rule applies to a firm which carries on, or has permission to carry on, the regulated activity of:
- (a) seeking out, referrals and identification of claims or potential claims, or

- (b) advice, investigation or representation in relation to a financial services or financial product claim.
- (2) A firm to which this rule applies must provide annual notifications to the FCA, containing the information set out in (3)-(6), about its connections to FSCS-eligible activities.
- (3) The notification must cover any individual who:
- (a) is a member of the firm's governing body; or
- (b) is a controller, or employee of the firm; and
- is or was directly involved in, or responsible for the carrying on of, an FSCS-eligible activity.
- (4) For an individual described in (3), the notification must contain:
- (a) the name of the individual, and individual's role in the firm providing the notification;
- (b) the name of the firm at which the individual is or was directly involved in, or responsible for the carrying on of, an FSCS-eligible activity; and
- (c) the individual's role at the firm described in (b), and the dates between which the individual performs or performed that role.
- (5) The notification must also cover any individual 'A' who:
- (a) is a member of the firm's governing body, and
- (b) is related to an individual 'B' who is or was directly involved in, or responsible for the carrying on of, an FSCS-eligible activity.
- (6) For an individual described in (5), the notification must contain:
- (a) A's name and role in the firm providing the notification;
- (b) B's name, and the relationship between A and B;
- (c) The name of the firm at which B is or was directly involved in, or responsible for the carrying on of, an FSCS-eligible activity; and
- (d) B's role at the firm described in (c), and the dates between which B performs or performed that role.

(7) Firms must send the notification in response to the FCA’s annual data request.

2.1.21 G The notification duty in CMCOB 2.1.20R applies to an FSCS-eligible activity regardless of whether such activity has led to a claim or potential claim.

...

Sch 2 Notification and reporting requirements

...

Sch 2.2 G It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Matter to be notified	Contents of notification	Trigger Event	Time allowed
<u>CMCOB 2.1.20R</u>	<u>Claims management companies with connections to individuals involved in an FSCS-eligible activity.</u>	<u>Names of individuals and firms concerned, the roles performed by those individuals, and the dates during which such were roles performed.</u>	<u>FCA data request</u>	<u>Annual notifications</u>
...

