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GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: JANUARY 2019

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James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the January 2019 column, Lee Finch considers the impact of the FCA taking over responsibility for the regulation of claims management companies, which takes effect on 1 April 2019.

by *Lee Finch, Gough Square Chambers*

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Background

It will come as no surprise to readers of this column that misconduct is prevalent in the claims management sector. However, this is not a new development; the government has been concerned about the behaviour of claims management companies (CMCs) since at least 2007 when the Claims Management Regulation Unit (CMRU) was established within the Ministry of Justice to tackle unscrupulous marketing and trading practices and other fraudulent activity. It is uncontroversial to suggest that the CMRU has failed to drive unprincipled participants and dishonest practices from the industry: it is widely acknowledged that it lacks the powers and resource required to supervise the industry properly. Moreover, whilst it is possible for consumers and institutions to take direct action against the worst offenders, this is equivalent to a game of whack-a-mole.

In 2015, the government commissioned the Brady Report to investigate poor practice in the claims management sector and to propose recommendations for strengthening regulation of CMCs. The Brady Report confirmed that continued misconduct was occurring including poor value for money, misrepresentation of services offered, nuisance calls and text messages and the inappropriate progression of speculative or fraudulent claims. Obviously, such misconduct affects consumers and industries outside of financial services but the adverse impact of poor CMC behaviour in the financial services sector is difficult to overstate: the Brady Report acknowledged that the banking and insurance industries had been hardest hit by CMC misconduct, and noted that between 2011 and 2015 CMCs had taken over £3.5 billion in charges from payment protection insurance (PPI) claims alone.

Nevertheless, many stakeholders from the financial services industry recognised the value that CMCs can bring to the claims industry and argued that there is a legitimate need for such entities and they should not be regulated out of existence. Indeed, it is clear that CMCs can provide a valuable service to those unwilling or unable to bring a claim themselves.

With the intention of improving CMC behaviour, forcing the worst offenders from the market and protecting consumers and industry alike, the Brady Report made a number of suggestions for improving the future regulation of the claims management sector. These recommendations included the possible transfer of regulatory responsibility to the FCA, which was the course selected by the government. The government also took other, distinct steps, such as introducing a fee cap for PPI claims and introducing a cold-calling ban from September 2018.

Making claims management a regulated activity

The Financial Guidance and Claims Act 2018 transfers regulation of CMCs to the FCA on 1 April 2019. Through amendments to the Financial Services and Markets Act 2000 (FSMA) (including the introduction of section 419A), "claims management services" become a regulated activity from the same date. Activities covered by claims management services include: seeking out, identifying or referring claims or potential claims (which the FCA will cover under one permission); and advice, investigation and representation in relation to a claim (which the FCA will cover under another permission). This regulation covers claims in six sectors including financial services. Importantly, it has been confirmed that CMCs dealing with claims under section 75 of the Consumer Credit Act 1974 (CCA) will be covered by the FCA's regulation of financial service claims firms; this is the first time such activity has been the subject of any regulation.

CMCs undertaking these activities should apply for "temporary permission" before 1 April 2019 and will subsequently have to seek full permission in one of two windows between 1 April 2019 and 31 July 2019.

The FCA consulted on proposed rules for CMCs between June and August 2018 (CP18/15) and published its final rules on 17 December 2018 (PS18/23). The FCA's aim is to regulate CMCs in such a way as to ensure they are "trusted providers of high quality, good value services that help customers pursue legitimate claims for redress, and benefit the public interest".

From the date the FCA takes over regulation, CMCs will, generally speaking, be subject to the FCA's principles (PRIN), threshold conditions (COND), systems and controls requirements (SYSC) and certain prudential and wind-down requirements and general provisions (GEN).

Furthermore, and importantly, an entirely new rulebook has been created to cover CMCs' activities: the Claims Management: Conduct of Business Sourcebook (CMCOB).

Key CMCOB requirements

The new sourcebook covers a wide range of activities and reference should be made directly to the same for the full extent and detail of the new rules, however some of the key requirements can be briefly highlighted.

The best interests rule and other general principles

In line with many other chapters in the FCA's handbook, CMCs will be required to act "honestly, fairly and in accordance with the best interests of its customers" (CMCOB 2.1.1R). The full extent of this and other best interests rules within the Handbook are the subject of some debate, in particular how close this obligation aligns with a typical fiduciary relationship and how this requirement can be reconciled with the inevitable situations in which the CMC's interests are not directly aligned with its customer's interests.

A new obligation that is more straightforward and clear cut is CMCOB 2.1.12R, under which CMCs are required to provide their customers with a right to cancel their contract with the CMC within a 14-day cooling off period. If a customer exercises their right to cancel, any fees they have paid must be refunded and the customer is relieved of any future obligation to pay fees.

One other overarching rule that may be of significant interest to financial services firms who have to deal with CMC driven complaints is CMCOB 2.1.7R. Under CMCOB 2.1.7R, CMCs are specifically precluded from making or pursuing any claim where it knows or has reasonable grounds to suspect that the claim does not have a good arguable basis, is fraudulent or is otherwise frivolous or vexatious. Consequently, from 1 April 2019, if a firm receives a large number of vexatious complaints from the same CMC it should consider reporting this behaviour to the FCA.

Advertising

CMCOB contains the usual "clear, fair and not misleading" rule (CMCOB 3.2.1R) but also sets out some prescriptive rules that are unique to the claims management sector. In particular, CMCOB 3.2.7R provides that where a CMC publishes an advertisement (or, in FCA parlance, a financial promotion) that relates to a claim, which could be made by the prospective customer to a statutory ombudsman or statutory compensation scheme, the CMC must ensure the advertisement also includes a prominent statement to the effect that:

- The customer is not required to use the services of a firm which carries on claims management activity to pursue their claim.
- It is possible for the customer to present the claim themselves for free, either to the person/firm against whom they wish to complain (for example, the financial institution) or to the relevant statutory ombudsman or statutory compensation scheme.

This is designed to prevent CMCs from creating the false impression that their services are required in order for the customer to claim compensation.

Further, if a CMC uses the terminology "no-win, no-fee" or a term having a similar meaning, within an advertisement, it must prominently include details of the fees charged or, if they are not fixed/known, the method by which the fees will be calculated (CMCOB 3.2.9R).

Pre-contract disclosure

The new rules also require CMCs to provide customers with certain "summary information" before entering into claims management contract. This summary information must be provided in a single page document and, in line with requirements across the financial services sector, must be provided in a durable medium (CMCOB 4.2.2(1) R). The content of the summary information document is governed by CMCOB 4.2.2(2)R; the required information includes: a brief description of the service to be provided; a brief description of how the CMC will keep the customer updated; a fee illustration or estimate (see further, CMCOB 4.2.5R); a brief description of the customer's right to cancel; and, where appropriate, a further reminder that the customer does not need to use the CMC's services and could complain directly to a party about whom the complaint is made or to the relevant statutory ombudsman or compensation scheme.

Additional pre-contract disclosure requirements also apply: information and advice on the merits of pursuing the claim (CMCOB 4.2.7R); more detailed information on services and fees (CMCOB 4.2.8R); and an explanation of the impact of the customer's outstanding liabilities to the firm complained of (that is, the possibility of set-off and the need for the customer to pay the CMC out of their own pocket) (CMCOB 4.2.9R).

Post-contract requirements

CMCOB also sets out detailed requirements relating to the transfer of information through the CMC from the complained about firm to the customer and vice versa, in particular, requirements governing the CMC's role in keeping the customer informed (CMCOB 6.1). Notably, CMCs must also obtain specific or renewed consent before taking certain actions (for example, commencing proceedings) (CMCOB 6.1.5(4)(b)R) and must provide revised fee estimates in certain circumstances (CMCOB 6.1.7R).

What this means for the future

The hope is that the impending changes will drive the worst CMCs from the industry and standards will improve; giving consumers a better experience, reducing speculative and fraudulent claims and making claims progression simpler and more efficient for the industry (it is far easier to deal with professional claimant representatives than some of the dishonest and incompetent parties that are currently bringing claims in the name of consumers).

However, a word of warning: with stringent and pro-active regulation by the FCA we now face the unusual position whereby, in certain respects, CMCs will be subject to more stringent requirements (for example, in relation to advertising) and a more interventionist supervisor than solicitors' firms. Consequently, it is possible that some may engage in "regulator shopping" and seek to change their legal status to avoid these new rules.

Finally, the changes coming on 1 April 2019 also include bringing complaints and claims against CMCs within the Financial Ombudsman Service's (FOS) remit, which creates the novel situation where the FOS will be dealing with claims brought by CMCs against financial institutions but will also be the arbiter of claims brought against the CMCs themselves.

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