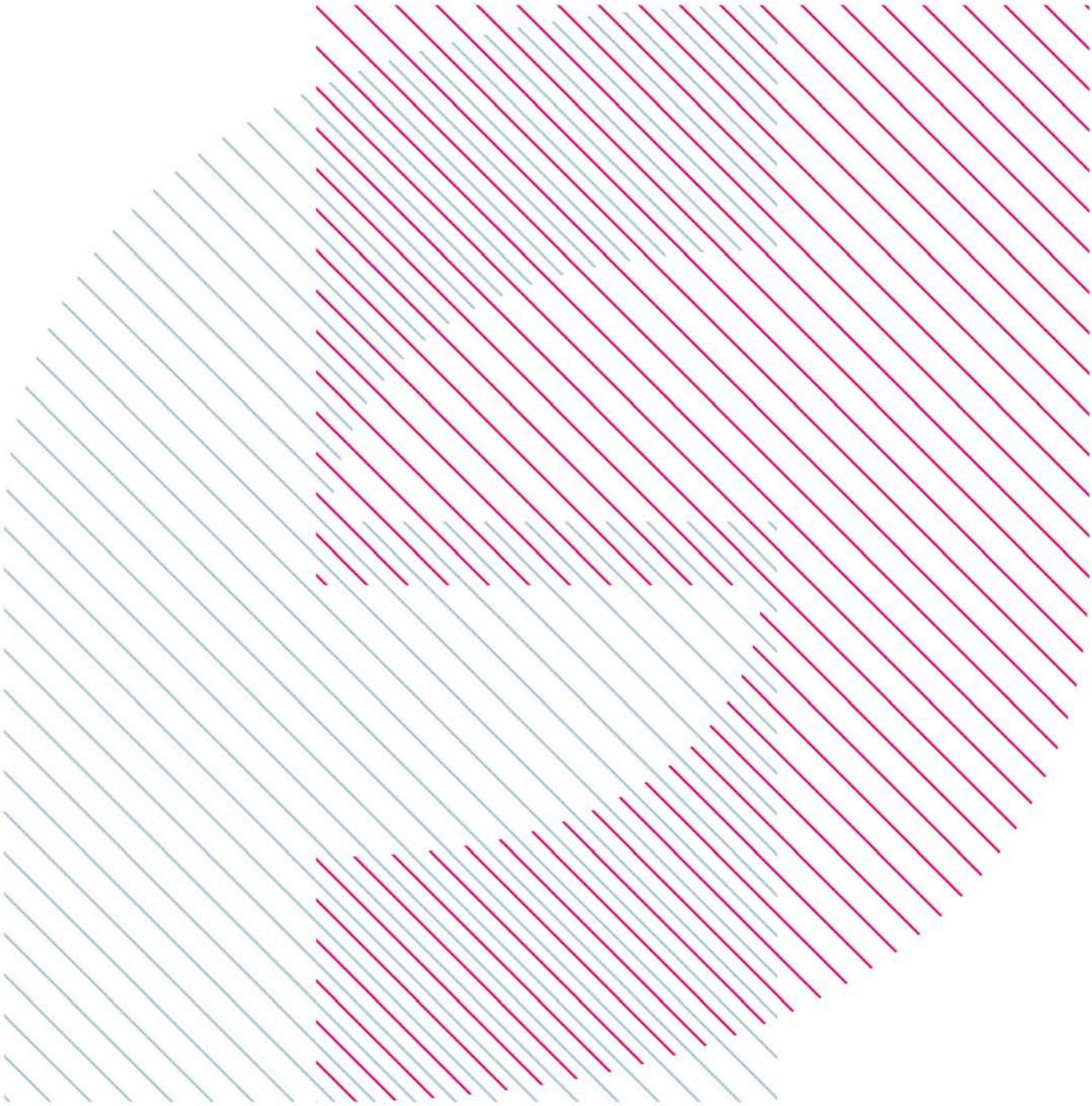
Consultation Response

Financial Conduct Authority

Claims management: how we propose to regulate claims management companies



Legal Ombudsman August 2018

Response on behalf of the Legal Ombudsman

Introduction

1. The Legal Ombudsman (LeO) was established by the Legal Services Act (2007). Our role is two-fold: to protect and promote the public interest by resolving complaints and providing redress when things go wrong in transactions within the legal services market and claims management sector; and to feed the lessons we learn from complaints back to the professions, regulators and policy-makers to allow the market to develop and improve.

2. We welcome the opportunity to respond to the Financial Conduct Authority (FCA) consultation on how it proposes to regulate claims management companies (CMCs).

3. Our interest in this consultation is based on:
    a) eagerness to share the operational insight we have gained from handling consumer complaints about CMCs over a three-year period; and
    b) our desire to see a robust framework of regulation which protects the rights of consumers while still allowing CMCs to operate effectively, and reflects learning from the challenges we have faced.

4. At LeO, we are not champions for the profession or consumers. We see our role as ensuring that there are reasonable options for redress open for consumers, and opportunities for service providers to learn from complaints to improve standards in the sector.

5. We are pleased to note that this consultation addresses many of the challenges that consumers currently encounter when interacting with CMCs. We are keen to minimise the risk of adverse effects on consumers due to CMCs closing down as a result of the transfer of regulation (April 2019) and/or the PPI end date (August 2019).

6. Each of these instances will result in a number of CMCs exiting the market, and at least some of these will be holding customer money (including upfront fees) at the time they close. In our experience, CMCs do not always advise their customers in advance of any closure, and they may not refund fees they had previously taken. We are eager to understand the FCA's plans (in conjunction with the CMR pre-transfer) to limit these effects and safeguard customers who have paid upfront fees to closing CMCs.

7. Our views are presented in greater detail below. These are based upon insight gained through our operational experience and standard feedback mechanisms. We would be open to further discussions with the FCA on any of the matters arising below, if this would prove useful.

Regulation of claims management companies

Q5: Do you agree that CMCs should be obliged to comply with these proposed general conduct of business rules?

8. Yes, we agree with the full proposal.

Q6: Do you agree that CMCs should be obliged to comply with these proposed rules on using third-party lead generators?

9. Yes, although we believe the rule should be extended further. We would like to see CMCs held to account for the conduct of those lead generators that they work with, rather than simply being asked for due diligence.

10. We previously dealt with a business which was essentially a lead generation firm that charged an upfront fee to customers, and then passed the case on to another CMC. In many cases complainants did not know that their claim was being passed on for a different CMC to deal with, as they were speaking to the same individuals at both stages of the process.

11. When customers raised complaints that they had paid an initial fee but there had been no progress on their claim, we were unable to hold the second firm accountable for the actions of the first. This particular situation generated around 900 complaints, and although both CMCs have since gone out of business, we were unable to take action to provide complainants who had already paid fees with full redress.

Q8: Do you agree with our proposal to require call recordings to be kept for a minimum of 12 months from the latest of the events specified at paragraph 4.10 above?

12. We agree with the proposal to require CMCs to record all calls and electronic communications with their customers, but we suggest that 12 months is not long enough. We recommend that this should either be extended to three years (to correspond with the length of time firms will need to retain records of complaints) or to six years (to correspond with time limits to take a complaint to the Financial Ombudsman Service (FOS)).

13. We are concerned with the proposal that CMCs should not have to record communications with third parties – especially financial service providers. These conversations are equally as important as those with customers in providing evidence needed for investigating complaints.

14. We also suggest that in the case of incoming calls, it would be difficult to capture only conversations with customers; it would be impossible to tell who is calling until the conversation has already started. Our concern would be that this might lead to inconsistency in the records kept by CMCs, and so we advocate that all calls be recorded as a matter of course, and retained for the same period of time.

Q10: Do you agree with our proposals for existing pre-contract disclosure requirements?

15. We would be concerned that the proposed level of detail in the one page summary may mean that too much information is included, and key points could be 'buried' or unclear. We would advocate that it is more important for the summary page to be clear than exhaustive.

16. Our suggestion is that a prescriptive template or set format for these summaries is developed, with suitable adaptations for the different areas of service. We believe that this would introduce a level of consistency that can be better relied upon, and would make it easier for CMCs to draw up the summary for their customers. This would be best applied to all CMCs in order to make comparisons easier and guard against new customers being overwhelmed with information.

17. Our demographic research indicates that consumers who use CMCs would benefit from documents written in plain English wherever possible, and so this should be encouraged. We suggest that CMCs should also have to provide this information in alternative languages where a customer requests it.

18. At the Legal Ombudsman, we are aware of a number of CMCs that specifically tailor their business to employment claims for the Polish community. In instances such as these we advocate that CMCs should provide all documents in the appropriate language, in place of the current practice of asking the customer to confirm that the information has been explained to them.

19. We are pleased to see that the proposed FCA requirements stipulate that VAT must be included in any costs information. In addition we suggest that CMCs should be required to include whether the company's fee is based on the gross or net version of the customer's award.

20. Furthermore, the Legal Ombudsman previously upheld a complaint where a CMC did not perform any checks on the solvency of the customer, nor did they inform the customer that their fees could not be taken from the award. The customer did not end up receiving any money themselves from their claim, but had substantial fees owing to the CMC for its work. In this case, the customer was in a worse financial position than if they had not pursued the claim at all.

21. It is therefore crucial that the customer is informed that the CMC's full fee would still be due in situations where some or all of the redress money would be used to repay outstanding debt (including IVA and bankruptcy) or for any other offset. CMCs need to do due diligence to establish whether the customer is bankrupt in advance of any contract being offered, as fees cannot be deducted from the award in these circumstances.

22. We would be eager to see these issues avoided in future by requiring CMCs to make customers fully aware of the relevant regulations in advance of asking them to sign a contract.

Q11: Do you agree with our proposals for ongoing disclosure?

23. Yes, these seem reasonable, and we are pleased to see that updates on costs where a fixed fee was not offered are included in the requirements.

24. However, our experience indicates that consumers' interests are better protected when the way fees are charged and how they are calculated is disclosed at the pre-contract stage as outlined above, rather than as part of ongoing disclosure. This is so that they have sufficient opportunity to consider their options before they decide to progress their claim.

Q12: Do you agree with our proposals for collection of fees by CMCs?

25. We agree, with the caveat that as outlined above, the information regarding bankruptcy and offsetting would ideally be provided early on in the process.

Q14: Do you agree with the new notification requirements and guidance we are introducing into SUP 15?

26. We broadly agree, but recommend that CMCs should be required to inform the FCA of any changes before the event, not after. In particular, any changes in control of firm would be better communicated in writing and always before the event.

27. We have previously had an issue with one individual who took over a number of CMCs and became the director, with little to no idea of the problems that had arisen at that company. This director left thousands of customers who paid upfront fees without representation or any chance of recovering the fees they paid.

28. The current regulatory structure means that an individual who does this manages to avoid the vetting process, and as such is never confirmed to be a fit and proper person. We would be interested to understand whether any directors seeking to take over companies will be vetted under the SM&CR regime in future, and whether the FCA will resist the resignation of a director until a suitable replacement has been approved.

29. Moreover, we would encourage the FCA to consider banning certain known individuals from becoming involved in running CMCs, on the basis of our experience with them. We would be happy to engage in further conversations with the FCA about the feasibility of this, and how such individuals might be identified.

Q17: Do you agree with our proposal to apply bespoke prudential standards to CMCs, other than lead generators, and to separate these CMCs into two groups for the purposes of applying prudential requirements?

30. We agree with the principle, with some caveats, listed below.

Q18: Do you agree with our proposal to set the prudential resources requirement for CMCs, other than lead generators, on the basis of a fixed minimum amount and the fixed overheads requirement? If not, what other approach would achieve the same outcome of ensuring an orderly wind down?

31. We agree with the proposal, as the vast majority of our 'multiple' complaints (where a great deal of complaints are received at one time about the same CMC) have related to the CMC's inability to meet its financial liabilities. This was also the case with both of the Category 1 publications[1] we have made against service providers in our CMC jurisdiction. To mitigate the risk to customers, we recommend that CMCs should be required to notify the FCA at the point at which they are unable to meet their liabilities, or if they are likely to be in this position imminently.

32. We agree that CMCs need to have enough money to meet their liabilities, the minimum for prudential resources, and the client money provision. Additionally, we suggest that minimums should cover both liabilities and potential liabilities.

33. We agree that phoenix firms are problematic. We are interested to hear whether the FCA intends to make directors of CMCs personally liable for any customer redress resulting from their company's service (in the same way solicitor partners are liable for their firm's service) so as to further safeguard customers. Where PII has not been taken out, we would like to see directors submit personal guarantees that they will be liable for any costs of customer redress.

Q19: Do you agree with requiring CMCs that hold client money to have additional prudential resources and/or do you feel the level we propose is appropriate?

34. Yes, we think this is appropriate.

[1]Our Category 1 publications are detailed reports on cases where there has been a pattern of complaints or set of individual circumstances that indicate it is in the public interest that the service provider should be named. The OLC Board decides whether to publish the names of these service providers following extensive consultation. More information can be found on our website.

Q20: Do you agree that CMCs should meet the prudential resources requirement from 1 August 2019?

35. No, we believe that the best approach from a consumer protection standpoint would be to require this from the point of transfer of regulation.

Q21: Do you agree with our proposal that the PII requirements for CMCs that represent customers in personal injury claims be retained but for the PII requirements not to be extended to all CMCs?

36. We agree that this should remain the case. PII should be an option open to all CMCs but not a mandatory minimum.

Q22: Do you agree with our proposal to carry over the minimum terms for the PII policy as set out in the Compensation (Claims Management Services) (Amendment) Regulations 2008?

37. We agree with this proposal on the basis that these instances should be covered by the financial requirements mentioned previously. We suggest that all CMCs should still be subject to these financial requirements even if they have PII, to ensure that they can meet the costs of any excess on the policy.

Q24: Do you agree with our proposals on appointing a CASS oversight officer? If not, why not?

38. Yes, we agree with the proposals.

Q25: Do you agree with our proposals on segregating client money and paying out client money as soon as practicable? If not, why not?

39. We do agree with these proposals, although we suggest that the definition of client money should be extended to include upfront fees which were taken before the upfront fee ban came into effect (where claims are still ongoing). This is the area where we have seen most customer detriment over the past three years.

Q28: Do you agree with our overall proposals for a CMC client money regime? If not, why not?

40. Some clarification on what exactly is meant by a ‘pro rata basis’ in this context would be useful. We believe that all client money should be paid back to customers in full. We agree with the proposals if this is what is meant by them.

Q32: Do you agree with the Ombudsman Service's proposal to grant CMCs outside our regulatory regime access to the voluntary jurisdiction?

41. Yes, we agree on the basis that this would provide more comprehensive cover for consumers.

Conclusion

42. Thank you for the opportunity to comment on the Financial Conduct Authority's proposals for the future regulation of claims management companies.

43. Overall, we are supportive of the robust regulatory regime that the FCA wishes to introduce, and encourage the FCA to consider the extra points raised in this response. We believe this is a singular opportunity to improve on regulatory practice to ensure that consumers are better protected in future and that the sector is held to a high standard of service.

44. We look forward to working with the FCA on these matters in the months to come, through the work of the CMC transfer project group established by HM Treasury. We would be very happy to engage in further conversations about how best to ensure that the public interest is maintained and that the sector continues to strengthen following the transfer of regulation.

For any questions about our response please contact our Parliamentary and Policy Officer at sarah.ritzenthaler@legalombudsman.org.uk.