



## **FCA Regulation for Claims Management Companies**

### **Getting to grips with FCA regulation**

#### **A guide for claims management companies**

The key to an authorisation is to work in partnership and face the challenges together and without any secrets. To be effective we, as your advisers need to be aware of everything you intend to do, activity you will undertake and clients you intend dealing with.

The FCA Handbook may appear strange to many who encounter it and this is because the FCA Handbook uses words and phrases that have specific meanings in the Handbook or in legislation; these may be different from, or more precise than, their usual dictionary meanings.

We hope you and this booklet useful.

This guide has been provided free of charge and for guidance only. It does not constitute as a legal document or compliance advice. If you are unsure of your legal and regulatory obligations, you should consult the FCA Handbook.

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This note serves as an introduction to the UK authorisation regime and is not exhaustive. We are happy to advise further on any of the issues highlighted above.





Claims Management Companies (CMCs) play a valuable role in helping customers to seek compensation and redress. Acting as an intermediary between a claimant and an organisation, CMCs help people make informed decisions about their rights and how to pursue claims for redress.

But the quality of service has varied significantly across the sector, with instances of poor practice and unfair customer outcomes. To help restore public confidence and ensure a consistent quality of service, from 1 April 2019 CMCs are authorised and regulated by the Financial Conduct Authority (FCA).

The FCA aims to ensure that CMCs deliver a consistently high quality of service and maintain good conduct at all times. This includes checking that any claims made are for a genuine grievance and that CMCs are benefiting the public interest.

Broadly, the FCA has set out its objectives as follows:

1. to empower customers and instil confidence that the services provided will be appropriate and value for money
2. to help customers secure redress in accordance with a common set of standards
3. to prioritise high standards of conduct and promote public confidence in the sector.

Formerly regulated by the Claims Management Regulator (CMR) under the Ministry of Justice, CMCs may find the transition to the FCA to be challenging.

In some cases, they may need to rethink how their business is governed and controlled at a fundamental level.

The initial challenge will be gaining authorisation from the FCA. This is far from a formality. Some firms will be refused authorisation and others may find that the cost of compliance is just too high.

These CMCs will need to wind up in a timely and orderly manner.

Some market consolidation is to be expected and this will present opportunities for those authorised firms.

The new regulatory landscape will feel alien to many CMCs.

Initially the new regime may feel burdensome, but firms must embrace the FCA's goal to professionalise the sector. When consumer credit firms moved to FCA regulation in 2014, they faced similar challenges and so it's worth looking at the lessons learned there.

Interactions with the FCA, including visits and data requests will require careful preparation and management.

Where significant concerns remain, the FCA may use a range of supervisory tools including Skilled Person reviews, fines and public censure.

In this guide, we have outlined some key practical and regulatory considerations to help CMCs, new or old, prepare for FCA regulation.





## **A change in regulatory oversight**

Each company must obtain its authorisation independently.

Gaining authorisation can be a lengthy process and it's resource intensive. Firms should only apply for the permissions that are relevant to the regulated activities they undertake and for the sectors they operate in.

The regulator will assess each CMC's competence to operate in these specific sectors.

To improve management of the authorisation process, the FCA have staggered the application windows for existing firms according to the sector that firms operate in.

## **Variation of permissions**

Many existing firms will already be authorised by the FCA for different activities in other sectors. These firms had to register for temporary permissions for claims management related services and then apply for a Variation of Permission (VoP) via the FCA's Connect system, in line with the application periods set out above. A new application is not required.

New applicants will be able to request the required permissions immediately.

Whether a CMC has temporary permissions or full authorisation, they are supervised by the FCA from 1 April 2019, after which CMCs must fully comply with the relevant FCA rules.

**CMC sectors and permissions** The FCA will regulate two different groups of claims management activities, across six different sectors.

Based on combined turnover, the financial products and services sector is by far the largest (2017/18: c.£600m), followed by personal injury (2017/18: c.£157m).

The market increased by around 5% in the 12 months to 30 November 2017, with the largest 25 CMCs representing 57% of all turnover.





## **Authorisation and the new landscape**

### **Application period**

Who can apply? All financial services CMCs that advise claimants, investigate claims or represent claimants (but not those who are solely lead generators) will have completed their applications by the 31st July 2019.

For those firms whether start-ups or new to FCA regulation, gaining authorisation is typically tough – and it's meant to be.

The process is designed to check that a firm is genuinely robust enough to conduct regulated activities. The regulator will assess financial and non-financial risks, how realistic the business plan is, and how risk is managed, amongst other things.

The FCA's predecessor, the CMR, has been working closely with the FCA to help it develop a detailed understanding of the market. This includes sharing information and experience of the sector. Firms should expect the FCA's dedicated CMC team to challenge them as part of the authorisation process, using their knowledge and insight of good and bad market practice.

The FCA will assess every CMC against its rules and standards. The process is challenging and firms should take advantage of all resources available to them, including preliminary guidance.

The FCA does not typically offer pre-submission meetings, but it may be an option for particularly complex applications.

Despite this concentration, the FCA will consider each and every application on its specific merits alone.

Applications are rarely seen as complete on initial submission and the FCA will inevitably want and need further information.

The FCA prefers firms to do as much as they can and proactively ensure that the details laid out in the handbook are adhered to. They do not see their role as providing a gap analysis on poorly prepared Regulatory Business Plans, or other forms that will be required.

Once a submission has been adequately prepared and submitted, taking a responsive approach and keeping the process moving forward is essential.

The timeframe for authorisation is limited and it's important to be aware of two key dates:

- the application date, when the FCA acknowledges the submission
- the date the application is accepted as complete.





## **What to expect from the authorisation process**

### **Helping to achieve authorisation**

We are advising start-ups and established companies achieve authorisation in the UK from Investment Advisers and Wealth Management firms, through to Crowdfunders, Fintech and Mortgage or Lending related companies. Our experts advise on the regulatory and operational aspects of this large scale and highly complex project.

Initially, we identify the necessary data from their business plan and a discussion with the client to explore potential business/operating models to determine the permission prole suitable for them. From there, we analysed the necessary regulatory requirements (including prudential, operation and compliance) and the information needed for the regulator(s).

An authorisation decision must be reached within 12 months of the application date, regardless of when the application was marked as complete. So if it takes 10 months for the FCA to accept an application as complete, firms will struggle to get authorised within the remaining two months – in which case it may be better to withdraw the application and start again.

### **Other sources of support:**

- FCA website
- FCA Contact Centre
- Trade bodies and associations

### **Threshold conditions**

There are a number of requirements for successful authorisation. These are known as threshold conditions, which must be met at the point of authorisation and maintained going forward. The conditions are:

Business model Firms applying for authorisation must submit a detailed Regulatory Business Plan (RBP), which describes the proposed business strategy, business model and operating model. The business model must be designed to protect consumers' interests and market integrity, in relation to the regulated activities the firm will perform. It should also outline the firm's governance and risk management processes in relation to the regulated activities performed.





**LS Consultancy can help you in formulating this but need your original plan in writing to create the story and input the regulatory requirements.**

### **Appropriate resource**

This includes financial resources, human resources, IT systems, operational continuity arrangements, and systems and controls governing the conduct of business.

### **Suitability**

The management team needs to be 'fit and proper', and they must ensure that the firm's affairs will be conducted in an appropriate manner.

### **Location of offices**

The registered office, head office and 'mind and management' must be in the UK with significant enough presence to support good governance.

### **Effective supervision**

There cannot be any impediment to effective FCA supervision due to the nature and complexity of the business model / products offered or the business organisation.

### **Meeting FCA requirements**

Historically, the Ministry of Justice has been responsible for directly regulating the activities of businesses providing claims management services.

CMCs have already been subject to a range of statutory conditions, including the conduct rules concerned with consumer information and safeguards. Businesses that have not complied with the conditions of authorisation (e.g. covering conduct rules, client account rules, complaints handling, marketing and advertising guidance) have been subject to enforcement action, including financial penalties and cancellation of their authorisation.





## The High Level Standards

All FCA regulated firms are subject to key principles as laid out in the FCA Handbook, called the High Level Standards:

- Principles for Businesses (PRIN) is the cornerstone of FCA's High Level Standards, including the fair treatment of customers.
- Threshold Conditions (COND) for authorisation and ongoing regulation, including appropriate standards around business models and the suitability of individuals. The Senior Managers and Certification Regime (SM&CR) will also be extended to CMCs.
- Senior Management Arrangements, Systems and Controls (SYSC) including record-keeping and the management of conflicts of interest. The FCA will take into account the nature, scale and complexity of the CMC.
- General Provisions (GEN) includes a description of the firm's regulatory status.

With these standards underlying the FCA's approach, the regulatory framework for CMCs can be summarised as follows:

- High Level Standards
- Supervision
- Prudential standards
- Client money
- Dispute resolution
- Enforcement
- Conduct standards

FCA regulatory requirements are extensive and can result in significant enforcement powers over firms which are not fully compliant.

The framework it is establishing aims to promote higher standards through a coordinated regulatory regime, more extensive requirements and more rigorous supervision. The regulations apply from 1 April 2019 and firms should assess their existing governance framework and undertake a gap analysis against the FCA requirements.





## **Taking part in FCA's thematic reviews**

You may be selected for a visit by the FCA or be required to participate in a wider thematic review.

This does not necessarily mean that there are specific concerns with your business.

The FCA will be looking for good and bad practice and will assess your information and the quality of management on its merits.

## **Conduct Standards (CMCOB)**

CMCs are expected to act in the best interests of their customers. Here are the key requirements relating to these sector-specific conduct standards. Firms should review their policies and procedures in these areas in light of the new rules and guidance and make changes where needed.

## **Call recording**

As recommended by the Brady Report in 2016\*, the most significant change is that CMCs must record all customer calls and retain all electronic communications (including emails and texts).

Recordings should be retained for at least 12 months following the CMC's last contact with the customer. As a result, CMCs may have to implement new systems to ensure that all calls can be easily retrieved.

CMCs will also have to put in place controls to ensure that any communications with customers are not made using externally or publically owned equipment. This may be difficult to control or oversee in practice.

Alongside these requirements, firms will also have to consider their legal responsibilities in respect of the General Data Protection Regulation (GDPR).

\*[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/508160/PU1918\\_claims\\_management\\_regulation\\_review\\_final.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/508160/PU1918_claims_management_regulation_review_final.pdf)





## Pre-contract disclosure

A key change here is the requirement for a one page summary document to be issued to customers to include:

- summary of CMC services
- steps the customers will need to undertake
- fee illustration
- cancellation rights and terms
- other ways to pursue the claim (eg legal expenses insurance policy)
- customer's right to present the claim themselves.

Firms need to review their existing terms and conditions and in particular, pay close attention to the clarity of their fee illustrations.

The FCA are unlikely to publish any further guidance as to how this information should be presented, nor will it endorse a prescribed format.

## Financial promotions

Promotions, such as **advertising** or **marketing materials**, must be **clear, fair and not misleading**. In particular, so-called 'No Win, No Fee' arrangements must clearly set out the charges payable by the customer.

Customers must be made aware upfront where they can make the claim themselves through a statutory ombudsman or compensation scheme (eg the Financial Ombudsman Service).

**Financial promotions that fail to adhere to the rules can pose a material risk to all companies.**

Your financial promotions (including social media) and website are the public face of your business.

As well as your customers they're visible to the Regulator so it's essential you ensure they're compliant – our comprehensive review service can help you ensure just that.

[www.lscprom.co.uk/copy-advice-service](http://www.lscprom.co.uk/copy-advice-service)

## Keeping customers updated

CMCs must keep customers up to date with any 'material developments' in the claim and contact them in any case at least every six months.

The FCA's rules provide some examples of such material developments, but CMCs will have to demonstrate their specific policy is fairly and consistently applied.

If fees are expected to change, then customers must provide their consent and also receive a clear explanation of how final fees are calculated. In addition, if the claim is rejected, then customers should be reminded of their rights to alternative dispute resolution.





## Lead generators

The new requirements place a duty on CMCs to undertake due diligence on any lead generators from whom they accept leads.

CMCs must check and record that the lead generator is authorised and also be satisfied that it has adequate systems and processes in place to comply with data protection legislation (e.g. obtaining customers' consent).

## Supervision and Reporting

The FCA will apply the relevant section of its Supervision manual (SUP) to CMCs in order to monitor and supervise the industry effectively. This is rooted in the overarching obligations of Principle 11 – to deal with the regulator in an open and cooperative way.

The requirements include providing important data and business information such as:

- turnover or details of complaints (annually)
- significant changes, such as changes in control or people
- events such as a breach of data protection regulations.

CMCs will also have an obligation to notify the FCA if, in the course of their due diligence on lead generators, they become aware of other firms conducting claims management activity without authorisation.

Prudential standards and wind-down procedures CMCs (apart from solely lead generators) will be expected to hold significant capital resources to meet their liabilities as they fall due, withstand unexpected shocks and, if necessary, enable an orderly exit from the market.

The requirement is to hold a minimum level of eligible capital of the higher of: i) £10,000 (if annual income is over £1m) or £5,000 (if annual income is less than £1m) and ii) the CMC's Fixed Overheads Requirement (FOR) (based on one sixth of the firm's total annual expenditure).

In most cases, the FOR will apply. This requirement is common to other regulated rms.

There are further detailed provisions to calculate the FOR including:

- deduction of fully discretionary staff bonuses
- deduction of interest paid to customers on client money
- deduction of 20% of total marketing expenditure.

These adjustments to the capital requirement recognise that certain such expenditure would be discretionary in a wind-down scenario.

Furthermore, if the CMC holds client money there is an additional £20,000 capital requirement, since wind-down of such a business will typically be more complex and take longer.

The FCA has also set out wind-down procedures and planning guidance such as key steps that CMCs should consider as part of their impact assessment.





## **Dispute resolution**

The complaints-handling rules and guidance (DISP) are intended to ensure customers' complaints are dealt with fairly, promptly and consistently.

The Financial Ombudsman Service (FOS) will become responsible for resolving customer disputes about CMCs.

When moving under FCA supervision, a CMC must be fully compliant with the client money rules (CASS) where its business model involves the holding of client money.

Meeting CASS requirements can be a challenge and these regulations are detailed and technical, with no materiality or de-minimus thresholds. The regulations are implemented the same way, regardless of the size of the organisation, or the amount of money held on behalf of the CMC's clients.

Furthermore, the CASS regime may feel imposed on CMCs given that the flow of consumer redress payments is not necessarily under their full control. Therefore, CMCs will be caught by the regime even if the handling of client money is peripheral to their business.

Until now, CMCs that handle client money on behalf of their customers have been subject to the Client Account Rules 2006 which cover:

- paying money into client accounts
- taking money out of client accounts
- interest earned
- accounting
- keeping records.

CASS broadly builds on the same themes, but is more prescriptive in its approach. Under transitional arrangements, the FCA's CASS rules apply to existing client money which was held, or received, by CMCs immediately before they obtained their temporary permission or Part 4A permission.

Firms should be aware of key requirements under CASS, which did not apply under the Client Account Rules, such as:

### **CASS Oversight Officer**

CMCs must appoint a person to be responsible for overseeing a CMC's client money operations, reporting to the CMC's governing body and completing client money-related aspects of regulatory returns. As such, this person should have significant seniority and knowledge of the CASS requirements. There is no exemption for firms holding smaller amounts of client money.





## **Segregate clients' money**

As a general principle, CMCs must make sure that they do not use one client's money to pay another client, and systems and controls must be in place to prevent this.

CMCs should hold all client money as a trustee, on the terms of a statutory trust in one or more dedicated client bank accounts. This aims to protect money that is received or held by the firm on behalf of its customers from loss - including in the event of the failure of the CMC.

To formalise this arrangement, a CMC must prepare and receive an acknowledgement letter from the bank in a prescribed format.

Acknowledgement letters can be a challenge for many firms and they have come under scrutiny from the FCA in the past, as a baseline indicator of the firm's wider compliance. All accounts must be held at an approved bank in the name of the CMC and include the word 'client' in the title so as to distinguish them from the firm's own money.

When fees become 'due and payable' to the CMC, the firm should remove these amounts from the client bank accounts to avoid polluting the statutory trust. Similarly, interest earned on client money should be paid to customers. These requirements may necessitate revisions to customers' terms and conditions.

CMCs must pay money relating to damages, compensation or settlement of a claim to the customer as soon as reasonably practicable after receipt, and take steps to do so within two business days. This is not a strict requirement, for example in the case of cheques, so proving compliance in this area will be subjective.

CMCs must also make every effort to contact customers to pay money which is due to them, and continue to hold and safeguard the client money until it is returned.

## **Maintain accurate records and perform daily reconciliations**

CMCs must keep records and accounts, and at any given time they must be able to distinguish client money held for one customer from that held with another, and from their own money.

This includes the allocation of amounts to individual customers promptly and within two business days following the receipt.

CMCs should make every effort to return money to clients and continue to protect this money until they are able to do so, although there are no specific, hard rules on untraceable clients.

There is a requirement to produce daily (internal and external) reconciliations of client money. This may be onerous and costly for many CMCs and require additional resource. There are detailed rules on dealing with daily shortfalls or excesses in client money following the completion of the internal reconciliation.





## **Annual CASS audit**

CMCs holding client money must appoint an auditor to produce an annual report on compliance with the CASS requirements. Since the rules are detailed, CMCs should expect a tougher and more extensive audit. There is no audit exemption for smaller CMCs.

The report must be submitted to the FCA within four months and CMCs should regard this as a hard deadline, in the absence of prior contact with the regulator.

The FCA regards these audit opinions as an important supervisory tool and will follow up with CMCs where findings are significant or recurring. As such, CMCs should ensure they have clear and timely remediation plans.

The CMR will be attempting to close outstanding audits prior to transition to the FCA. However, if necessary, open issues will transfer across to the FCA.

## **Additional capital requirement**

There is also an additional fixed sum £20,000 capital requirement for all CMCs holding client money.

## **Regulatory change**

Regulatory change can be challenging and moving to a tougher regime under the FCA may require additional effort and a change in mindset.

For CMCs who are new to FCA regulation, becoming authorised and remaining compliant will be a big task and should not be under-estimated.

FCA regulation will demand significant resources, senior management time and planning. We can help you implement a compliance and governance framework in line with your business needs. Regulatory change is never easy, so it is important to find a cost-effective approach which supports your overall business strategy. Drawing on extensive experience from across the financial services sector, both in industry and as auditors, our team can help you and best practice in keeping with regulatory expectations.

Whatever stage of the process you are at, we could help you in the following areas:

- authorisation support
- regulatory compliance (including gap analysis)
- preparation and support for FCA visits and data requests
- regulator mandated reviews
- ongoing compliance support
- regulatory assurance
- client money audits and health-checks
- thematic reviews
- mergers and acquisitions support
- acquisition due diligence.





For more information on these services and how we can help you, please email us [info@LSCPROM.co.uk](mailto:info@LSCPROM.co.uk).

**How can we help?**

**You tell us.** Please ask us about any area you are unsure.

