

# **Restricting CMC charges for financial products and services claims**

**Consultation Paper**

CP21/1\*\*\*

January 2021

## How to respond

We are asking for comments on this Consultation Paper (CP) by **21 April 2021**.

You can send them to us using the form on our website at:  
[www.fca.org.uk/cp21-01-response-form](http://www.fca.org.uk/cp21-01-response-form)

**Or in writing to:**

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

**Email:**

[cp21-01@fca.org.uk](mailto:cp21-01@fca.org.uk)

## Contents

|                   |                                  |     |
|-------------------|----------------------------------|-----|
| <b>1</b>          | Summary                          | 4   |
| <b>2</b>          | The wider context                | 9   |
| <b>3</b>          | Excessive fees                   | 17  |
| <b>4</b>          | Restricting charges              | 21  |
| <b>5</b>          | Enhanced disclosure requirements | 29  |
| <b>6</b>          | General amendments               | 32  |
| <br>              |                                  |     |
| <b>Annex 1</b>    | Questions in this paper          | 37  |
| <br>              |                                  |     |
| <b>Annex 2</b>    | Cost benefit analysis            | 39  |
| <br>              |                                  |     |
| <b>Annex 3</b>    | Compatibility statement          | 108 |
| <br>              |                                  |     |
| <b>Annex 4</b>    | Equality Impact Assessment       | 112 |
| <br>              |                                  |     |
| <b>Annex 5</b>    | Abbreviations used in this paper | 114 |
| <br>              |                                  |     |
| <b>Appendix 1</b> | Draft handbook text              |     |

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## Contents by sector

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This table sets out which chapters are particularly relevant for each sector. This is where you will find the most relevant chapter(s) for your firm.

| Sector                                                                                 | Chapter          |
|----------------------------------------------------------------------------------------|------------------|
| Firms carrying on claims management activity on financial products and services claims | 1, 2, 3, 4, 5, 6 |
| Firms carrying on claims management activity on all claim types                        | 1, 2, 6          |

# 1 Summary

## Why we are consulting

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- 1.1** Parliament gave us a duty to make rules about fees charged by claims management companies (CMCs) for claims about financial products and services. Our duty requires us to make these rules with a view to securing an appropriate degree of protection against excessive charges.
- 1.2** This consultation paper (CP) sets out our proposals to fulfil this duty, and asks a series of questions about our proposals. In summary, we propose to:
- address consumer harm in the claims management market by restricting the fees that can be charged to a consumer for claims management activity in relation to a claim about a non-PPI financial product or service
  - enhance requirements for all CMCs to disclose information to help consumers make an informed choice about using claims management services in cases where the claim may be made under a statutory scheme such as a statutory ombudsman or statutory compensation scheme
  - make minor changes to clarify and improve aspects of our existing rules for CMCs.
- 1.3** We are keen to receive feedback on our proposals. We will take all comments into account before publishing our final rules in a policy statement.

## Who this applies to

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- 1.4** This paper will be of interest to:
- FCA-authorised firms carrying on claims management activity for claims about financial products and services
  - firms considering applying for FCA authorisation to carry on claims management activity in relation to financial products and services
  - trade bodies representing CMCs
  - consumer organisations
  - groups that represent those with protected characteristics
- 1.5** This paper will also interest:
- consumers, in particular anyone who has used, is considering using or decided not to use claims management services
  - FCA-authorised firms carrying on claims management activity in relation to claims about non-financial products and services

## The wider context of this consultation

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- 1.6** Under the Financial Guidance and Claims Act 2018 (FGCA) Parliament transferred regulation of CMCs to the FCA and gave us a duty to make rules about CMC fees for claims relating to financial products and services. The Financial Services and Markets Act 2000 (FSMA) does not define 'financial products and services'; in our view it is not necessarily limited to products and services within the FCA's regulatory perimeter. The duty given to us requires us to make rules with a view to securing an appropriate degree of protection against excessive charges made by CMCs managing financial products and services claims. Parliament also gave us powers, but not a duty, to make such rules for the other CMC sectors we regulate, namely personal injury, housing disrepair, industrial injuries benefit, criminal injury and employment. We have prioritised making rules for the financial products and services CMC sector and will consider using these powers in the other sectors in due course.
- 1.7** These proposals will not apply to claims that relate to payment protection insurance (PPI). PPI claims are already subject to a cap under the FGCA and we are not proposing to change that. In this paper, where we refer to rules about CMC fees, unless we specify otherwise, we are referring to fees charged in relation to claims about non-PPI financial products and services. We will consider in due course whether to alter the existing cap on PPI fees.
- 1.8** In addition to meeting the statutory duty, the proposals in this paper further our statutory objective of protecting consumers and help promote effective competition in the interests of consumers. We want to deliver a CMC market that works well for consumers through our regulatory regime which consists of an authorisations gateway, controlling entry to the regulated market, and rules to ensure fair conduct which we administer through our supervision of authorised CMC firms. These proposals intervene where we have identified market failures that allow CMCs to charge excessive fees that cause consumer harm not addressed by the existing regulatory regime.
- 1.9** To ensure our regulatory regime delivers a CMC market that works well we are also proposing minor changes to a small number of existing rules for CMCs which relate to issues that have arisen since we began regulating CMCs in April 2019. We have identified several areas requiring updating or clarification and we present our proposed changes for those in Chapter 6 of this paper.

## What we want to change

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- 1.10** Our proposals are as follows:
- We propose to cap the fees that may be charged for claims management activities on claims that yield redress in relation to non-PPI financial products and services where the claims are within the redress system. For fees on non-PPI financial products and services claims where the cap does not apply, we require charges to be no more than reasonable.
  - We propose to improve the way CMCs managing claims about financial products and services disclose key information to consumers at the pre-contract stage, to help consumers make better-informed decisions about using CMC services.

- We are also using this consultation to propose minor amendments to the Claims Management: Conduct of Business Sourcebook (CMCOB), Consumer Redress Schemes Sourcebook (CONRED) and the Perimeter Guidance Manual (PERG) to update and clarify existing rules.

**1.11** Details of these proposals are in Chapters 4, 5 and 6.

## Outcome we are seeking

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- 1.12** We want to protect customers of CMCs, who have suffered harm and are owed redress, from paying too much money for claims management services through excessive charges. In some cases the amount to be paid in redress can be a significant portion of savings or retirement income or can be money owed to consumers who are in debt. CMC fees are usually calculated as a percentage of the redress paid on a claim and charged on a no-win-no-fee basis. If they are too large, these fees can prevent redress from effectively achieving its goal of putting consumers back in the position they would have been in had they not suffered any harm. Where consumers have not suffered harm and are not owed redress, we want any CMC fees they pay to be reasonable in relation to the service provided to them.
- 1.13** Consumers should be charged fees which reflect the value of the claims management service they receive. Fees should be restricted to that level and firms should enable consumers to make better-informed decisions about the value of using a CMC and the alternative options available.
- 1.14** We also want to see a continuing improvement in the quality of customer service CMCs provide by encouraging them to have greater regard to the merits of the claims they take on and encouraging them to compete more on price and quality of customer service.
- 1.15** The minor changes we are proposing in Chapter 6 are unrelated to our statutory duty to make rules about CMC fees. They are intended to clarify and update existing rules in CMCOB, CONRED and PERG, to ensure the FCA Handbook is aligned with the FSMA by updating obsolete references, and to remind CMCs of due diligence obligations where they accept leads.

## Our approach to the statutory duty

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- 1.16** To understand firm and consumer behaviour in the CMC market for financial products and services we conducted a survey of consumers and requested information from a sample of CMC firms. We also engaged with key stakeholders, the Financial Ombudsman Service (the ombudsman service) and the Financial Services Compensation Scheme (the FSCS). We used the data we collected to assess the drivers of harm. As set out in Chapters 2 and 3, we found conditions in the market that allow CMCs to charge fees well above the value they provide to individual consumers.
- 1.17** We started by identifying the value that CMCs provide in return for the fees they charge. In assessing value, we took account of two elements:

- a. the value provided to the individual fee-paying consumer, which takes the form of time and effort saved by the consumer and increased confidence
- b. wider societal value, which means benefits that do not necessarily accrue directly to the individual fee-paying consumer. These benefits can be delivered as long as there is a viable market for FCA-regulated CMC activity.

**1.18** We define an excessive charge as one that exceeds the value provided to the individual consumer. We accounted for the wider value to society by ensuring our intervention will not prevent the FCA-regulated CMC market from functioning viably and serving customer needs.

**1.19** In deciding how to secure an appropriate degree of protection from excessive fees, we considered a number of options and determined that a fee cap was most appropriate.

**1.20** We tested a range of potential caps. As described in Chapter 4, we used financial and competition analysis, and considered familiarisation and implementation costs as well as potential unintended consequences.

## Measuring success

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**1.21** We estimate that the proposed cap could deliver consumer benefits of around £9.6m a year. If we implement the fee cap proposed in this CP we will monitor its effects on the CMC market and its consumers. Key indicators of success for the proposed cap and enhanced disclosure rules will be that:

- CMC customers are paying fees that better reflect the value of the service they receive
- CMC customers are able to make better-informed decisions about whether or why to use a CMC
- FCA-regulated claims management activity remains viable for all financial services and product claim types at all levels of redress so that consumers are able to continue using CMCs services

**1.22** We also want to see firms compete under the level of the proposed cap. The level of the cap is not intended to indicate what we consider to be a fair price for all CMC services. Rather, it is the level we think will provide an appropriate degree of protection from excessive charges. We expect CMC firms to charge fees that reflect the value they provide on the claims they manage and we are confident the level of the cap will allow them to do that.

**1.23** We will monitor the effectiveness of the rules through our ongoing supervisory work and we plan to start an evaluation of the fee cap and disclosure rules 2 years after they are in force. We will monitor the impact of the cap on business models, in particular whether firms move to new charging structures and, if they do, whether those charging structures provide fair value to consumers for the fees charged.

**1.24** We do not propose to introduce new regulatory reporting requirements for firms at this stage. This is a relatively small market with about 223 active firms managing claims for non-PPI financial products and services. Therefore a more targeted data gathering approach can inform our understanding of the effect of our proposed rules. When we publish our final rules we will let firms know the data we are likely to need for our review.

- 1.25** We have noted through the course of this work that record keeping by some firms needs improvement. In November 2020 we sent a letter to all firms in the FCA's CMC portfolio, noting, amongst other things, that we have seen issues with firms completing their regulatory returns. We want to see this improve, and we will address it through our supervisory work with firms.
- 1.26** For the general changes we are proposing in Chapter 6 we will measure success through feedback received as part of our general work. Where we propose to add guidance we expect to see a reduction in queries received on those points.

## Next steps

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- 1.27** We want to hear your views. Please send us your responses by 21 April 2021 using the response form on our website, or by writing to us at the address on page 2 of this CP.
- 1.28** We will consider responses carefully before making any rules. We do not currently intend to consider the use of our powers to protect consumers from excessive charges in other FCA-regulated CMC sectors until we have finalised this work on fees for claims about financial products and services.



## 2 The wider context

- 2.1** In this chapter, we set out the wider context of our proposals, including our statutory duty, the nature of the redress system and the CMC market, and the harm we are trying to address.

### Our statutory duty

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- 2.2** The FGCA transferred the regulation of claims management activities to the FCA. It gave the FCA a duty under section 137FD of FSMA to make rules about fees charged by CMCs managing claims that relate to financial products and services 'with a view to securing an appropriate degree of protection against excessive charges'. The rules 'may specify charges by reference to charges of a specified class or description, or by reference to charges which exceed, or are capable of exceeding, a specified amount.'
- 2.3** The FGCA also gave us powers but not a duty to make rules restricting the fees in the other FCA-regulated claims management sectors. Our proposals in Chapters 4 and 5 of this CP, which relate to CMC fees, apply only to CMCs managing claims about non-PPI financial products and services. After we make rules relating to claims for financial products and services we will consider whether there is a need for fee rules covering other claims management activity we regulate, in relation to claims for housing disrepair, criminal injury, employment, personal injury and industrial injuries benefit.
- 2.4** The decision to defer the use of our powers where we do not have a duty was based on the size of each CMC sector and a need to focus on the areas of greatest harm. Data from the Ministry of Justice before the transfer of regulation to the FCA indicated that claims management activity in relation to housing disrepair, criminal injuries, employment and industrial injuries benefit claims accounted for less than 1% of CMC revenue. The personal injury sector is significantly larger, but is likely to change due to impending Government reforms which are now expected in May 2021. We concluded that it would be better to wait for those reforms to be implemented before considering whether to intervene in that area.
- 2.5** The FGCA also capped fees on PPI claims at 20%. This cap remains in place until we make rules to vary it. Due to the period of change the PPI market is undergoing we are not proposing to vary the PPI cap now. Claims that relate to PPI are excluded from the proposals in this CP, and the 20% cap for PPI claims will remain in place.
- 2.6** A statutory fee-cap of 50% (inclusive of VAT) was introduced by the Damages-Based Agreements Regulations 2013 in England and Wales and the Civil Litigation (Expenses and Group Proceedings) (Scotland) Act 2018 (Success Fee Agreements) Regulations 2020 in Scotland. As well as potentially affecting CMCs, these regulations cover legal practitioners. For the reasons set out in this CP, we consider that CMC charges nevertheless remain excessive. Where the fee charged by a CMC falls within the scope of both the existing statutory fee-cap of 50% and a lower fee-cap imposed by FCA rules, the lower fee-cap would apply.

## The role of CMCs in the redress system

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- 2.7** Consumers of financial products and services have the right to make a claim free of charge under the redress system set out in the Redress chapter of the FCA Handbook, and in particular under the sections Dispute Resolution: Complaints (DISP) and Compensation (COMP). The cap we propose in this paper applies to claims about financial products or services that are complaints under DISP, claims under COMP, or claims made where another statutory ombudsman or compensation scheme applies, such as the Pensions Ombudsman. If CMCs manage claims about financial products and services that are not covered by these schemes, their fees will be subject to a separate proposed rule requiring them to be reasonable.
- 2.8** In summary, a complaint under DISP is any oral or written expression of dissatisfaction, whether justified or not, about the provision of, or failure to provide, a financial service, claims management service or a redress determination, which: alleges the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience. Complaints should be made to the firm that provided the financial product or service in the first instance. The redress system requires firms (referred to in DISP as 'respondents') to investigate and respond to claims from consumers. To make a complaint, consumers do not need to know whether firms have breached any rules, and they do not need to make complex legal arguments. The onus is on respondent firms to handle complaints and investigate the circumstances of consumers' dissatisfaction.
- 2.9** If a consumer is unhappy with a respondent's reply to their claim, or if they don't receive a reply within 8 weeks (or 15 days for payment services complaints or electronic money disputes), they have the right to refer their claim to the ombudsman service for an independent investigation and decision. The ombudsman service is a statutory scheme established to independently investigate and decide claims. Consumers may also have recourse to the Pensions Ombudsman, a statutory redress scheme for complaints about personal and occupational pension schemes.
- 2.10** Where the firm that provided the financial product or service is in default, meaning it is unable or unlikely to be able to satisfy claims against it, consumers may in some particular cases set out in COMP make a claim to the FSCS. The FSCS is the statutory scheme established to independently decide claims in cases where the relevant firm has gone into default.
- 2.11** In this system, consumers do not need to use CMCs to make a claim at any stage of the claims process. We do not consider that a CMC will be able to change the outcome of a particular claim. But CMCs can help consumers by managing their claims throughout the claims process. (See Chapter 3 for more on the value that CMCs provide to consumers.)

## The CMC market for financial product and services claims

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- 2.12** There are currently about 223 firms carrying on FCA-regulated claims management activity for non-PPI financial products and services. We estimate that in 2019/20 their revenue was about £38m. We collected data from a sample of CMC firms to understand more about the market. 33 firms provided the data on which we base our proposed fee cap.

**2.13** CMCs generally receive their revenue from fees charged on claims where redress is awarded to the consumer. This charging model is commonly referred to as 'no-win-no-fee'. The fee is generally calculated as a percentage of the redress that the consumer is awarded under the claim. All CMCs in our sample used this charging model when serving individual consumers.

**2.14** The current makeup of the non-PPI financial product and service claims market is dominated by 4 particular claim types: loans, packaged bank accounts, pensions, and savings and investments. As Table 1 shows these categories accounted for 99.6% of claims in our sample by number, with packaged bank accounts being the most numerous.

**Table 1: Claims in our sample by financial product or service category**

| Claim category         | Number of firms in our sample managing claims in this category | Number of claims in our sample in this category | % of claims in our sample in this category |
|------------------------|----------------------------------------------------------------|-------------------------------------------------|--------------------------------------------|
| Loans                  | 9                                                              | 82,240                                          | 33%                                        |
| Packaged bank accounts | 12                                                             | 126,919                                         | 50%                                        |
| Pensions               | 19                                                             | 11,446                                          | 5%                                         |
| Savings & investments  | 15                                                             | 31,266                                          | 12%                                        |
| Insurance              | 3                                                              | 127                                             | 0.1%                                       |
| Mortgages              | 8                                                              | 845                                             | 0.3%                                       |
| Other                  | 4                                                              | 136                                             | 0.1%                                       |

Table 2 below shows that the largest category of claim by total revenue is the pensions category. This is because pension claims typically yield higher amounts of redress. Where CMC revenue is earned as a percentage of redress, revenue will generally be larger from claims yielding greater redress.

**Table 2: CMC revenue in our sample by financial product or service category**

| Claim category         | Total revenue in our sample | % of revenue in our sample | Mean revenue per claim in our sample | Min revenue per claim in our sample | Max revenue per claim in our sample |
|------------------------|-----------------------------|----------------------------|--------------------------------------|-------------------------------------|-------------------------------------|
| Loans                  | £1,281,083                  | 5%                         | £274                                 | £1                                  | £4,381                              |
| Packaged bank accounts | £3,494,546                  | 12%                        | £314                                 | £1                                  | £2,838                              |
| Pensions               | £11,885,783                 | 42%                        | £5,625                               | £9                                  | £87,311                             |
| Savings & investments  | £9,307,859                  | 33%                        | £2,620                               | £1                                  | £68,447                             |
| Insurance              | £28,356                     | 0%                         | £1,379                               | £11                                 | £4,595                              |
| Mortgages              | £1,782,580                  | 6%                         | £12,642                              | £119                                | £25,000                             |
| Other                  | £420,408                    | 1%                         | £9,119                               | £0                                  | £50,138                             |

Table 3 shows the revenue per claim as a percentage of redress for the claim categories with significant numbers of cases. This equates to the percentage fee charged to the consumer. The average for all claims in our sample is 30%.

**Table 3: CMC revenue per claim in our sample as a percentage of redress by financial product or service category**

| Claim category         | Mean revenue per claim in our sample as a % of redress |
|------------------------|--------------------------------------------------------|
| Loans                  | 29%                                                    |
| Packaged bank accounts | 30%                                                    |
| Pensions               | 21%                                                    |
| Savings & investments  | 34%                                                    |

**2.15** Compared with differences in revenue per claim, differences in direct cost for CMCs managing claims are relatively small between claims. This is illustrated by Table 4 which shows figures from 28 firms who submitted usable data on direct costs. (Minimum costs were reported as zero in all 4 categories.)

**Table 4: Direct CMC costs to manage claims in our sample per claim by financial product or service category**

| Claim category         | Mean direct cost to manage a claim in our sample | Max direct cost to manage a claim in our sample |
|------------------------|--------------------------------------------------|-------------------------------------------------|
| Loans                  | £10                                              | £331                                            |
| Packaged bank accounts | £22                                              | £402                                            |
| Pensions               | £590                                             | £6,143                                          |
| Savings & investments  | £158                                             | £5,223                                          |

**2.16** Differences in cost to manage a claim may reflect differences in the complexity of claims, with CMCs telling us that pensions and savings and investment claims are on average more complex than packaged bank account and loans claims. However, compared with the revenue received by CMCs, costs are relatively flat, both between individual claims and between claim types.

**2.17** Types of claims managed by CMCs can be expected to change over time as the problems consumers experience with products and services – and the products and services themselves – change over time. However, we think it unlikely that any new and emerging claim categories will require firms to incur substantially greater costs than they do currently.

**2.18** Although charging rates vary, the revenue for a firm employing a no-win-no-fee charging model is linked to the amount of redress awarded. This means consumers who receive large amounts of redress pay correspondingly large fees for CMC services. So excessive charging is likely to be most pronounced where redress amounts are highest, unless CMCs provide correspondingly higher value through the services they offer on those claims. Chapter 3 of this paper discusses the value that CMC customers and wider society can receive from CMC services. See 'Understanding the value CMCs provide'.

## The harm we are trying to reduce

**2.19** Consumers do not need to use CMCs to make claims for redress, and we do not consider that using a CMC will lead to a more favourable decision, or yield more redress, on any given claim. But when consumers do use them, CMCs can save them time and effort and give them confidence in their claim, reducing worry. CMCs can also play a wider societal role, helping to raise awareness of potential meritorious claims and acting as a check and balance on the conduct and claim-handling of respondent firms in the redress system. In some cases CMCs help consumers get redress who might not otherwise have made a claim.

**2.20** In a well-functioning market, consumers would understand the value that CMCs offer and would decide based on that value whether to use them and how much they were prepared to pay for the service. However, our consumer survey found that many consumers are unable to judge the value of using a CMC. Significant proportions of CMC users had a poor understanding of the claims process. In particular, they:

- lacked information about the services CMCs provide
- over-valued the services that CMCs provide
- misjudged the options available to them in making a claim

**2.21** These results indicate the market is affected by information asymmetry and the behavioural bias of myopia, or present bias. These market failures, or drivers of harm, mean that consumers have considerably less information and understanding about claims and the process of making them than CMCs do. It means that when they are looking to make claims consumers tend to overvalue the time and effort needed, while undervaluing the redress they might receive – and the fee they might pay – in the future. There is also a tendency for consumers to overestimate the services that CMCs provide.

The results of our consumer survey are available on our website. For more detail on the market failures that can drive harm for consumers in the CMC market, see 'Drivers of harm' in the cost benefit analysis at Annex 2.

**2.22** The case study below, while an extreme case, illustrates how information asymmetry and present bias can affect consumers, and how significant the impact can be where consumers suffer large losses.

### Case study: Mr C's pension claim

Mr C was unhappy with advice he received about the transfer of his occupational pension. He contacted a CMC to enquire about making a claim and signed a contract with the CMC to pay 42% of redress including VAT in return for the CMC managing his claim.

Mr C took an active role in the resolution of his claim. It was referred to the ombudsman service and eventually upheld. Mr C was awarded redress of about £218,000 for the loss he had suffered as a result of being mis-advised.

Mr C subsequently complained to the ombudsman service about the CMC's fee and its service. At 42% Mr C would have paid the CMC £92,000, leaving him £126,000 of the £218,000 he had lost.

Mr C told the ombudsman service that he did most of the work on the claim himself and that 'the money we are debating now is absolutely essential to the security of this family, not least my health and the future...'

The ombudsman service acknowledged Mr C's unhappiness about the size of the CMC fee for the work done for him. But Mr C had signed an agreement with the CMC to pay the fee of 42% and the CMC had not failed in the provision of its service. Because of that, the ombudsman service did not uphold Mr C's complaint about the CMC.

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Source: Financial ombudsman service, [www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)

**2.23** We also found that 43% of respondents to our consumer survey did not know they could have claimed direct with the respondent firm, while 57% did not know they could have used the ombudsman service or FSCS. Not shopping around when choosing a CMC was very common; 81% of consumers surveyed did not consider using any other CMC to the one they signed up with, with more than half having been contacted by their CMCs rather than initiating contact themselves. These findings indicate a striking lack of engagement with the sector among a large proportion of CMC customers. By not being aware of options that are free or shopping around to find the best offer available, consumers are considerably more likely to pay excessively for the services they purchase.

**2.24** The lack of engagement also means competitive pressures are not working to lower the fees that consumers are paying in this market. This makes consumers susceptible to excessive charges.

### Case study: Mrs and Mr M's investment

Mrs and Mr M used a CMC to claim redress for a mis-sold investment. They signed an agreement to pay 48% (including VAT) of any redress they were awarded under the claim.

Having found that it mis-sold the investment to Mrs and Mr M, their bank awarded them redress of £56,447 to put them back in the position they would have been in had they not been mis-sold the investment. When the CMC took its fee Mrs and Mr M complained the fee was too high. They also complained that they were misled into using the service and misled to believe that they would not receive redress if they claimed without a CMC.

The ombudsman service found that the terms of the agreement were correctly set out and the CMC had not misled them. The ombudsman said:

'The bank awarded them compensation to make up for money they had lost out on in the past and they want to use this to fund their

retirement. I can understand how frustrating it must be to have to give almost half of it away. But having considered all their points, I've concluded that [the CMC] hasn't done anything wrong.'

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Source: Financial ombudsman service, [www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)

- 2.25** The case of Mrs and Mr M shows how consumers may be affected if they enter an agreement with a CMC without shopping around, without giving sufficient attention to the fee they will have to pay, and without properly understanding the service they will receive or their alternative options.
- 2.26** Vulnerable consumers and some groups of consumers with protected characteristics tend to be particularly susceptible to market failures. CMC customers who are making claims in respect of pensions are likely to be of, or approaching, retirement age, for example where claims relate to transfers under the pension freedoms were introduced for people over the age of 55. Excessive charges could also result in a consumer becoming vulnerable. For example, a consumer who loses a significant proportion of their redress on a pension or a savings and investment claim could cause them to become vulnerable by reducing their income in old age. Almost all (99.9%) of claims for loan products in our sample relate to short-term high-cost credit. Consumers making those claims might have little capacity to give up a share of the redress they are owed. Where consumers are in arrears on loan repayments their redress may be offset against overdue repayments rather than paid out to them. This would leave these consumers, who are in difficult financial circumstances, in need of further funds to pay their CMC fees.
- 2.27** The percentage-based no-win-no-fee charging model used by CMCs can exacerbate harm for some consumers. Fees are calculated against the redress received by the fee-payer, with little reference to the scale of the value of the CMC service being provided. Consumers who have already suffered harm and have therefore had their claims upheld will pay the costs of consumers whose claims are not upheld and who are therefore less likely to have suffered harm. And consumers whose redress is largest – meaning consumers who may have suffered the greatest loss – will pay the highest fees for CMC services. The no-win-no-fee model can also exacerbate present bias by giving the impression the consumer has nothing to lose by using a CMC.

## How it links to our objectives

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### Consumer protection

- 2.28** Our proposals in Chapters 4 and 5 should strengthen protections for consumers who use CMCs. They aim to ensure CMCs charge fees that better reflect the value of the service they are providing, while maintaining a viable market that is able to deliver wider value. We also want to enable consumers to make more informed decisions about whether to use a CMC service, whether to shop around, or whether to claim direct, without a CMC.

### Competition

- 2.29** We want to see a CMC market where customers are empowered to choose a value-for-money service which matches their needs. Our proposals aim to ensure CMCs

compete with fair charges while better informing customers about the costs, the value of the service being offered and the options available to them. While we think a fee cap is necessary to meet our duty to secure appropriate protection against excessive fees, our enhanced disclosure proposals are designed to better empower consumers to make informed choices which will help to promote competition under the fee cap.

## Wider effects of this consultation

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- 2.30** In designing the proposals we have taken into account the need to ensure the market can remain viable across claim types and redress amounts, where firms continue to use the no-win-no-fee charging model. We will monitor whether CMCs respond to our proposals by leaving the market, moving to offer different services, or changing the way they set their fees. We do not want to see certain consumers or claims excluded because the viability of the market is impacted.
- 2.31** We do not expect our proposals will drive CMCs to alter their charging models, but if they do, we will monitor the market to identify any unintended consequences. Other charging models could have advantages, for example being better aligned with the value that the consumer receives. They could also have disadvantages, for example no longer encouraging consumers affected by market failures to make claims without risk of paying a fee if the claim yields no redress.
- 2.32** We will also continue to monitor developments in non-FCA-regulated CMC markets, for example where claims management activity is carried on by solicitors as part of the legal services they provide and those solicitors are regulated by the Solicitors Regulation Authority (SRA). On behalf of the Law Society of England and Wales the SRA is carrying out a duty equivalent to ours, requiring it to make rules with a view to securing protection against excessive claims management fees for firms it regulates. We have discussed our proposals with the SRA and will continue to liaise with a view to ensuring any differences in regulatory regimes do not lead to consumer harm. The Law Society of Scotland, the General Council of the Bar and the Chartered Institute of Legal Executives have powers but no duty to make such rules. We will also take note of any developments there.

## Equality and diversity considerations

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- 2.33** We have considered the equality and diversity issues that may arise from our proposals, including the types of claims likely to be affected and the characteristics of consumers likely to make those claims. We provide our equality impact assessment in Annex 4.
- 2.34** Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. We consider our proposals would especially help older people, who are more likely to have pensions claims, and younger people who are more likely to have loans claims. We will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when publishing the final rules.



## 3 Excessive fees

- 3.1** In Chapter 2, we identified market failures that drive harm in the market. In this chapter we set out our overall approach, and methodology, for estimating the degree to which we see excessive charges in the market.

### Our approach

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- 3.2** As described in Chapter 2, we found conditions that allow CMCs to charge at excessive levels. In order to meet our duty, to secure an appropriate degree of protection against excessive charges, we sought first to define and quantify an excessive charge, and then to determine the extent to which there was evidence that actual harm is occurring. We used that analysis to inform the level at which we should restrict fees.
- 3.3** The market failures described in Chapter 2 mean that consumers find it difficult to judge the value of CMC services and so are at risk of being charged fees that exceed that value. In the context of this harm, we defined an excessive charge in relation to the value that CMCs provide to consumers. That allows us to secure a degree of protection against excessive charges which addresses the particular harm that we have identified. It is also appropriate in the context of a redress system that exists to give consumers a straightforward means of accessing redress free of charge. It is appropriate that CMC fees are charged at levels reflecting the benefit that using a CMC provides to consumers in the redress system. As shown in Chapter 2, market failures mean that consumer behaviour cannot be relied on to keep charges at such a level.
- 3.4** We considered other approaches to defining an excessive charge, but found them unsuitable for various reasons. A comparison between the return on capital employed and an estimate of the weighted average cost of capital was not possible, because CMCs were unable to provide necessary data and, where the data was provided, large variations between firms suggested a lack of comparability in capital structure. Moreover, the cause of any excess profitability would need to be determined and would not on its own imply that charges were excessive. A 'cost plus' approach which would define 'excessive' with reference to firm costs plus a reasonable profit margin would also have been affected by data issues, and was not suitable because lack of competitive pressure meant firm costs could be unnecessarily high, and because the number of CMCs and the diversity in their cost bases made determining an efficient cost base impractical. We also lacked a benchmark from another market against which to gauge the appropriate rate of return for claims management services. Markets that were potentially comparable were likely to be affected by similar market failures so could not be depended on to provide a reliable benchmark.

### Understanding the value CMCs provide

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- 3.5** Having expertise in the claims process and the relevant financial products and services helps CMCs provide a streamlined experience for the consumer. This reduces the time and effort that the consumer needs to put in to make a claim. Our consumer survey

indicates that saving time and effort was a significant motivator for consumers' use of CMCs. The survey also indicated that consumers valued the confidence that using a CMC gives them. The confidence associated with having a CMC manage a claim can reduce worry and increase peace of mind. Although some of the increased consumer confidence that results from using a CMC may reflect the market failures described in Chapter 2, we think well-informed customers who do not suffer from behavioural biases can derive some benefit from increased confidence and reduced worry by choosing to use a CMC.

- 3.6** We considered whether the value of a CMC for the individual fee-paying customer can extend beyond saved time and effort and increased confidence, for example by influencing outcomes on individual claims so that consumers receive more favourable decisions or higher redress. However, we concluded, for reasons set out below, that CMCs are not able to influence decisions on individual cases so that an individual using a CMC would receive a better outcome than an individual bringing the same claim on their own.
- 3.7** As set out in Chapter 2, the redress system is designed to ensure that a complaint is merely an expression of dissatisfaction rather than something more complex such as a fully particularised legal claim and complaints are required to be dealt with and investigated fully, impartially and without dependence on complete presentation of a complaint. The ombudsman service [website](#) says that its experience shows no difference in the outcome of complaints whether consumers bring them to the ombudsman service themselves, or use a CMC to complain on their behalf. It says that the ombudsman service is no more or less likely to uphold a complaint referred to it through a CMC.
- 3.8** This view of the value that CMCs provide in the redress system is consistent with the position we set out in PS18/23 where we made rules prohibiting CMCs from stating that they influence outcomes on individual claims where those claims are within the remit of a statutory redress or compensation scheme such as the ombudsman service or the FSCS. There was no significant challenge to the proposal in our consultation (CP18/15) that CMCs must not state that claims made through them have increased chance of success. We also said in the consultation that CMCs can play a useful role for individual customers and can act as a check and balance on the conduct and claim-handling of respondent firms in the redress system, helping to draw attention to instances where the system does not work as it should. We think this is of benefit to consumers collectively, but it does not mean an individual consumer can expect to receive a more favourable outcome on their claim by using a CMC.
- 3.9** CMCs are likely to target particular claim types that might yield high amounts of redress or are likely not to manage claims where redress is expected to be below a particular threshold. Therefore, while uphold rates or redress amounts between CMC claims and non-CMC claims may differ, this does not show that CMCs influence outcomes on individual claims. A decision to uphold a claim and award a particular amount of redress depends on the individual facts of the case and the consumer's circumstances rather than how the claim is presented, or who it is presented by. There is no evidence that shows CMC involvement is responsible for more or less favourable decisions on claims.
- 3.10** We recognise that market failures can mean some consumers would not claim redress at all if it were not for the existence of CMCs, or would not pursue a claim to the ombudsman service. This is often a result of the market failures of information

asymmetry and behavioural bias. In a well-functioning market consumers would realise it is possible for them to make a claim without a CMC. However, we have recognised that in the current market CMCs can be beneficial by helping consumers claim where otherwise they would not. We consider this part of the wider societal value that CMCs can provide.

**3.11** So we believe CMCs can provide the following 2 types of value for financial products and services claims:

- **Value to the individual fee-paying customer** – CMCs can provide value to the individual customer in the following ways:
  - Saving customers time and effort by using expertise in the claims process and in financial products and services to help customers navigate the system and to streamline the process for customers.
  - Increasing customers' confidence, thereby giving them peace of mind and reducing worry.
- **Wider value to society or consumers more generally** – CMCs can provide various benefits that do not necessarily accrue directly to the individual fee-paying consumer. These include the following:
  - Expending and taking on the risk of expending resources on managing claims that do not yield redress. Consumers have the right to have their claims considered and CMCs can help them do that, thus providing value even when claims are not upheld.
  - Raising awareness of potential claims consumers might not otherwise know about. CMCs can help identify and make consumers aware of known problems that give rise to claims for redress.
  - Helping consumers who would not otherwise claim because, for example, they are unaware of the steps to make a claim or how accessible those steps are.
  - Acting as a general 'check and balance' on the redress system. CMCs can help draw attention if the redress system does not work as it should.

**3.12** We think the wider value that CMCs offer is beneficial. We do not want to lose this value by causing FCA-regulated claims management to become unviable. But when the value accrues to non-fee-paying customers, the cost of it should be recovered from fee-paying customers only so far as this is necessary to allow FCA-regulated CMC activity to remain viable. Limiting the recoverability of the cost of servicing unsuccessful claims in this way also has the benefit of promoting the selection of more meritorious claims by CMCs. With this in mind, we consider that an intervention provides an appropriate degree of protection from excessive charges if it prevents the charging of fees that are above both the level necessary for firms to provide a viable service and the value to the individual customer.

## Excessive charges

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**3.13** We estimated individual value by measuring and monetising the saved time and effort and increased confidence received by CMC users. We used data on time spent by CMCs managing claims, time spent on claims by customers of CMCs, and our regulatory judgement about the work required to make a claim. Our estimates include several assumptions, necessitated by limitations in the available data. But we are confident we have made sufficient allowance for imperfections in the data. The cost

benefit analysis at Annex 2 describes how we also estimated the value that CMCs provide in terms of increased confidence. It explains the assumptions we made and our basis for them.

**3.14** We found that more than half of claims in our sample were charged excessive fees when measured against the value delivered to individual consumers. For claims where redress was £1,500 to £24,999, more than 84% of customers in our sample paid an amount that exceeded the individual value they received. For redress of more than £25,000 that proportion rose to 94% and above. The average fee rates charged on these claims – that is, claims where the charge exceeded individual value – was 18% for claims with redress of £50,000 or more, and 30% for claims where redress was less than £1,500. As Table 5 shows, the incidence of excessive charging against individual value was greater among claims yielding higher amounts of redress, even though the average percentage fees charged on those claims was lower.

**Table 5: Estimated value to the individual and fees that exceed that value, by redress band**

| Redress band |         |         | Average value to the individual |                       |                       | Claims where charges are higher than average value to the individual |     |                  |
|--------------|---------|---------|---------------------------------|-----------------------|-----------------------|----------------------------------------------------------------------|-----|------------------|
|              | Lower   | Upper   | Average                         | Average (lower bound) | Average (upper bound) | Number                                                               | %   | Average fee rate |
| 1            | £1      | £1,499  | £128                            | £55                   | £203                  | 6,637                                                                | 50% | 30%              |
| 2            | £1,500  | £9,999  | £385                            | £184                  | £588                  | 6,100                                                                | 90% | 31%              |
| 3            | £10,000 | £24,999 | £1,149                          | £577                  | £1,721                | 1,001                                                                | 84% | 27%              |
| 4            | £25,000 | £49,999 | £2,231                          | £1,142                | £3,319                | 837                                                                  | 94% | 23%              |
| 5            | £50,000 | NA      | £2,286                          | £1,179                | £3,392                | 617                                                                  | 96% | 18%              |

However, as noted above, the value of the CMC service is not just to the individual customer. While this analysis provides an indication of where we were seeing excessive charges against the estimated value provided to individual customers, it is not sufficient alone to determine the level at which we should intervene. To do that we need to account for the wider value that accrues to society and other consumers.

## 4 Restricting charges

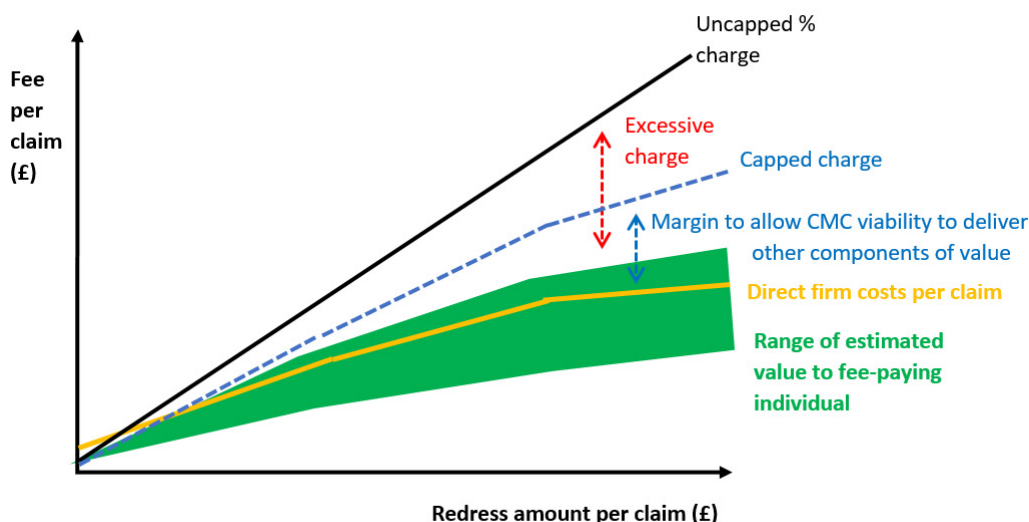
- 4.1** This chapter sets out how we built on the analysis in Chapter 3 to design our proposals to restrict the amount that FCA-regulated CMCs may charge a customer for claims management services that relate to non-PPI financial products and services.

### The proposed restrictions on charges

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- 4.2** We believe the most effective way to mitigate the harm we describe in Chapters 2 and 3 is to limit, through fee caps, the amount a consumer may be charged for FCA-regulated claims management activities for claims relating to non-PPI financial products or services where a statutory scheme such as DISP, the financial ombudsman or the FSCS applies. We propose that the limits will apply to all claims where redress is awarded. This includes fees charged on an hourly basis (if redress is awarded), but the proposed limits are set as a percentage of redress because that is the predominant charging structure in the market. We want to address the fact that, in most cases, harm is likely to be greater where the consumer has received higher levels of redress because fees are calculated as a percentage of redress without reference to the value provided. So the higher the amount of redress, the more restrictive is the maximum percentage of redress that CMCs may charge. We have set our cap at a level which allows competition below the cap. We estimate that the cap will save consumers around £9.6m each year.
- 4.3** Restricting the level of charges is intended to reduce the amount paid by many CMC customers, particularly those who receive large amounts of redress and so are more likely to pay fees that disproportionately exceed the likely value of the service they receive. We have designed the cap to ensure the provision of FCA-regulated CMC services for claims about financial products and services remains viable. Market viability is key to ensuring that consumers can continue to use CMCs to progress financial services claims and CMCs can continue to provide wider benefits to consumers more broadly.
- 4.4** We conducted financial analysis, looking at CMC revenue and costs to assess whether the cap is likely to cause CMCs to exit the market or segments of it. We are not aiming to ensure all existing CMC firms can operate viably, but that there is a viable and competitive market. We note that some existing CMCs appear likely to exit the market irrespective of whether we introduce a fee cap or not, and some will likely need to find efficiencies in their business models if they wish to remain viable under the proposed cap. (More detail on this can be found in the cost benefit analysis at Annex 2).
- 4.5** Figure 2 shows in simplified form how the proposed fee cap works to restrict fees at a level that has regard to the 2 components of value. The proposed cap will mean fees are more proportionate to the value an individual fee-payer is likely to receive, while allowing CMCs to operate in a viable market and continue to provide the wider benefits to society and consumers more generally. By working on a sliding scale the cap restricts fees most strongly where redress amounts are greatest and consumer harm is currently greatest.

**Figure 2: Illustration of how the proposed fee cap will restrict charges**



- 4.6** We are not saying that the level of the cap is a fair price in all cases. Rather this is the level we think will provide an appropriate degree of protection from excessive charges. We expect firms to charge fees that reflect the value they provide on the claims they manage. By setting the cap above the costs to firms of managing claims, and at a level which allows a viable market to exist, we expect firms to be able to compete under the cap.
- 4.7** We do not expect the cap to result in significant unintended consequences for CMCs. Firms might decide to use different charging structures. They might decide to charge, say, an hourly fee rather than a percentage of redress, and they might no longer use a no-win-no-fee basis. Our proposed rules will not prevent firms from using other charging models or from continuing to use the percentage-based no-win-no-fee model, but the cap will still apply on claims where redress is awarded. By restricting fees on all claims where redress has been received, regardless of charging structure, the rules will prevent firms from adopting new business models for the purpose of circumventing the cap.
- 4.8** If CMCs use charging structures which include fees on claims that do not yield redress, our proposals will require those fees to be reasonable in the circumstances. In deciding whether charges are reasonable the CMC must have regard to work done for the customer. This is similar to the rule currently in place in CMCOB 2.1.12(4) for CMC charges when a contract is terminated.

For a detailed description of how we estimated value and used that estimate in setting the level of the proposed cap, see the cost benefit analysis at Annex 2.

## The amount of the proposed cap

- 4.9** The amount of the cap will depend on how much redress is awarded. We have set out 5 bands of redress, each of which has a maximum percentage of consumer redress and a maximum total fee. On any 1 claim the total fee to the customer must not exceed **the lower of** the maximum percentage rate and the maximum total fee. The maximum

total fee in each redress band alongside the maximum percentage rate in each redress band is set at a level that will ensure a smooth transition, with no cliff-edges, between the maximum fees payable in each band. Table 6 shows the amounts applicable to each redress band.

**Table 6: Proposed fee cap**

| Redress band | Consumer redress obtained |           | Max % rate of charge | Max total fee (£) |
|--------------|---------------------------|-----------|----------------------|-------------------|
|              | Lower (£)                 | Upper (£) |                      |                   |
| 1            | £1                        | £1,499    | 30%                  | £420              |
| 2            | £1,500                    | £9,999    | 28%                  | £2,500            |
| 3            | £10,000                   | £24,999   | 25%                  | £5,000            |
| 4            | £25,000                   | £49,999   | 20%                  | £7,500            |
| 5            | £50,000                   | NA        | 15%                  | £10,000           |

For example, if a consumer gets £2,000 in redress, the fee will be subject to the band 2 cap which means it may be a maximum of £560 (28% of £2,000). A consumer who gets redress of £9,000 will pay no more than £2,500 (the maximum total fee for band 2, which is lower than 28% of £9,000).

**Q1: Do you agree with the design of the proposed cap?**

## Scope of the proposed cap

### Which firms will be affected?

- 4.10** The cap will affect firms carrying on any FCA-regulated claims management activity in relation to claims about non-PPI financial products and services where the subject matter of those claims fall within the scope of the statutory redress system, including DISP, the ombudsman service or the FSCS or another statutory redress scheme such as the Pensions Ombudsman scheme. This includes lead generation activities as well as investigating and advising on claims and representing consumers making claims, where those services result in fees being charged to consumers. The proposed rules will apply to EEA firms or Gibraltar firms providing FCA-regulated claims management services in the United Kingdom. Such services 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 passporting activities.

### Which fees will be covered by the cap?

- 4.11** The cap will apply only to fees charged to a consumer where the claim being managed yields monetary redress. That means that where a claim is not upheld, or is upheld but does not result in a monetary award to the consumer, the cap will not apply.
- 4.12** The cap will apply to charges under all contracts whether or not the contracts were entered into before our rules come into force. It will apply to contracts with all types of consumer, whether individual consumers or businesses.
- 4.13** The cap will apply to the total cost of claims management services to the consumer for a single claim. This means that, where multiple claims management services are



provided and/or multiple firms are involved in providing claims management services, the total charge to the consumer for all of those services will not be permitted to exceed the cap.

- 4.14** Currently most firms charge on a no-win-no-fee basis so there is usually no fee to pay when redress is not awarded. Where a claim does not yield redress but a fee is still charged, firms must not charge the customer an amount in excess of what is reasonable in the circumstances and reflects the work undertaken by the firm. This includes, for example, a situation where the firm charges by an hourly rate rather than a share of redress and a fee is payable even if the claim does not yield any redress.
- 4.15** For more detail on fees that are not subject to the cap, see the section below called 'CMC fees not covered by the cap'.

### **What is the 'total cost of claims management activities'?**

- 4.16** We propose that the cap will apply to the total cost to the consumer of claims management activities. This means the total amount a consumer will pay for all claims management activities received in respect of a single claim. The total cost includes any charges that are classed as disbursements or expenses. A single claim means 1 claim or complaint under COMP or DISP or another statutory redress scheme in relation to 1 respondent firm.
- 4.17** Sometimes a consumer will receive multiple services from a single firm or from multiple firms in relation to the management of a single claim. For example, some firms conduct lead generation activity and pass leads to firms which will then carry on the activity of representing a consumer with a claim. In these instances a lead generation fee might arise. In most cases the lead generation fee is charged and paid on a business-to-business basis. If that is the case then it will be for the firms involved to manage any impact the cap might have on their business models, including on the appropriate level of any business-to-business lead generation fees. If, however, a lead generation fee is charged to the consumer directly then it must be included in the total cost of claims management activities, and that total cost must not breach the cap. In all cases, the consumer must not, for a single claim, be charged more than the relevant cap amount for all services in total.
- 4.18** In practice, the proposed rules will mean firms are aware of any fees charged by other CMCs to their customers. Firms taking on customers are expected to find out from the customer or from the referring firm whether the customer has been charged a fee for any claims management activity in respect of the relevant claim.

### **CMC fees not covered by the cap** ***Fees for claims that do not yield monetary redress***

- 4.19** Claims that do not yield redress will not be subject to the cap. As we have said, where CMCs and their customers have a no-win-no-fee agreement, customers will not be charged fees if they are not awarded redress. However, where an agreement provides for the payment of fees by a customer who does not receive redress, we propose a rule requiring those fees to be reasonable with reference to the work provided by the CMC. In these cases we would expect the CMC to be able to show to the consumer and to us what claims management services the firm has provided and how fees were calculated in relation to those services, for example through a clear invoice. We would also expect



them to be able to explain to us, if required, why the level of fee (such as the amount of any hourly charge) is reasonable, which necessitates appropriate record keeping.

#### ***Fees for PPI claims***

- 4.20** The FGCA capped fees on claims for PPI at 20% of redress received. The PPI cap remains in place until we make rules to vary it. Due to the period of change the PPI market is undergoing, we are not proposing to vary the PPI cap at this time. It will remain in place at 20%.

#### ***Fees for claims that are not about financial products or services***

- 4.21** The FGCA gave us powers but no duty to make rules restricting fees in the non-financial claims management sectors (personal injury, employment, housing disrepair, etc.). Because we have a duty to act in respect of financial services and products claims we have prioritised making rules for those claims. We will in due course consider making rules restricting CMC fees for non-financial claims management.

#### ***Fees for claims outside the statutory redress system***

- 4.22** It is possible that FCA-regulated CMCs will manage claims about financial products and services that are not covered by a statutory redress scheme. The existence of the statutory redress system and its various schemes is an important feature underlying our estimate of the value that CMCs provide for consumers of financial products and services. Where that redress system is not available it is possible that CMCs could provide different value. It is not appropriate to restrict fees for such services on the same basis as fees for services which fall within the statutory redress system. Instead, we propose that any fees relating to claims management activity on claims that fall outside the statutory redress system are subject to our proposed rule that they must be reasonable with reference to work provided by the CMC that can be evidenced.
- 4.23** Fees for claims which could be taken through the statutory redress system but (for any reason) are pursued in some other way will still be subject to the cap. For example, if a claim is pursued through a court when the claim was in the scope of the statutory redress system, fees charged for FCA-regulated claims management activity for that claim will be subject to the cap.

**Q2: Do you agree with the scope of the proposed cap?**

### **Unenforceability**

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- 4.24** We propose that where an agreement breaches the fee cap it will be unenforceable to the extent of the breach, and simple interest at a rate of 8% will apply from the date of any payment that the consumer made in excess of the cap. CMCs will be required to promptly reimburse a customer once any overcharging is identified. The interest rate of 8% is consistent with the rate used in the redress system to put things right for consumers who are reimbursed for a financial loss.

**Q3: Do you agree that agreements which breach the cap should be unenforceable to the extent of the breach and that simple interest at 8% should apply?**

## Implementation

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**4.25** The rules will apply to all contracts entered and all fees arising after the rules come into force. We propose that the rules will come into force 3 months from the date they are made, for both new contracts and existing contracts that were entered into before our rules were made, but where charges are imposed after the rules come into force. This will give firms time to familiarise themselves and their staff with the new rules and to alter any documents, processes or promotional materials that are affected. It will also give firms time to adjust to any changes in expected revenue from pre-existing contracts. We think a 3-month implementation period will strike a reasonable balance between allowing firms to prepare and adjust, and protecting consumers from excessive fees.

**4.26** 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 simple. For example, they might need to reprint paperwork, redraft contracts, obtain legal advice, change parts of a process, provide some retraining of staff. Some CMCs might need to restructure if they think their current structures could put them in financial difficulty.

**Q4: Do you agree with a 3-month implementation period for the cap?**

### Pre-existing contracts

**4.27** From the signing of a contract to the fee becoming payable, the duration of a claims management agreement can span many months. In our sample we saw some claims take as many as 14 months. Our duty to make fee rules extends to fees arising from all contracts, no matter when the contracts were entered into. We are therefore proposing that the cap applies to contracts which were entered into before the rules are made, but where charges are imposed after the rules come into force (pre-existing contracts). We recognise that applying a cap to charges arising from contracts that pre-date our rules will interfere with pre-existing contractual rights of firms. However, where we have said fees are excessive, consumers should not have to continue paying at those levels after our rules come into force. Where fees have already been charged at the time the rules come into force, they will not be subject to the cap, but will count towards the cap for any fees charged after the rules come in to force.

**4.28** We considered whether pre-existing contracts should be subject to a lesser cap or a longer implementation period, to lessen the impact on firms' expected revenue while still protecting consumers from the most egregious cases of excessive charging. However, we concluded that it would reduce consumer protection and would introduce complexity for firms and consumers. On balance, we believe the potential savings to firms resulting from transitional fee rules are not great enough to justify the additional complexity and reduced consumer protection.

**Q5: Do you agree that applying the proposed cap to pre-existing contracts provides an appropriate degree of protection for consumers against excessive charges?**

## Other options considered

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- 4.29** We have considered other ways of addressing the harm we see in this market and meeting our statutory duty to make rules with a view to appropriately protecting consumers from excessive fees.

### A different level of cap

- 4.30** We considered multiple alternative caps. The more intrusive alternatives were inappropriate because they had too great an impact on market viability in one or more segments of the market. A less intrusive alternative we considered was a cap that would be less strong in redress bands 1 and 2, having percentages of 35% and 30% instead of 30% and 28%. This would mean customers with smaller amounts of redress would receive less protection. These claims tend to be loan claims, often high-cost credit, or packaged bank account claims. Although the amount of any excessive fee on those claims is relatively small compared with potential excessive fees on claims for larger amounts of redress, customers may be more likely than average to be vulnerable or made vulnerable by excessive charging. Given that our proposed cap provides better protection in bands 1 and 2 and greater overall benefit than the alternative, and still allows the market in those segments to remain viable, the proposed cap will secure a more appropriate degree of protection for consumers against excessive fees. More information about alternative cap levels we considered is available in Appendix 2 of the cost benefit analysis at Annex 2.

### Capping fees by specific products

- 4.31** More than 90% of CMC-managed claims currently relate to packaged bank accounts, loans, savings and investments, or pensions. Costs and value do vary somewhat between these categories. For example, claims about pensions are on average more costly to manage than claims about packaged bank accounts. We considered capping fees by claim category. We considered having different caps (as a percentage of redress, as a fixed amount and as a combination of both) for specific products. We considered 6 percentage caps between 15% and 40% and 3 absolute caps for each product category in different combinations. For all combinations, we calculated the net adjusted benefit they would provide and ranked them by category. The highest net adjusted benefit was £5m. However, a competition analysis showed that the cap yielding that benefit would likely lead to the complete exit of CMCs from managing packaged bank account and loan claims. The same analysis showed that other product-specific caps would also have too great an impact on market viability.
- 4.32** We also note that claim types will change over time, making the basis of our product-specific caps outdated. Any cap that is specific to claims about a particular financial product or service is likely to become outdated as financial products and services – and claims about them – change over time.
- 4.33** Also, the redress amounts we observed on claims varied substantially within categories of claim as well as between categories of claim. Among the pension-related claims in our sample the highest amount of redress received by a consumer on a claim was £218,000 but the average redress for pension claims in the sample was £27,000. For savings and investment claims the highest redress amount for a claim in our sample was £196,000 whereas the average was £8,000. A cap that treats claims within a product-based category as homogenous will not target excessive fees as effectively

as a cap based on redress amounts which is able to target claims where harm has the potential to be greatest.

- 4.34** Overall we think setting caps according to redress amount will better protect consumers than setting caps by category of claim based on type of financial service or product.

### **Banning the no-win-no-fee charging model**

- 4.35** Stopping CMCs from using a percentage-based no-win-no-fee charging model could help ensure charges are commensurate with value. Charges based on work done, for example, might reflect more transparently to consumers the saved time and effort they receive. However, such an outcome is not guaranteed, and other charging models have their own shortcomings. For example, charges that are not based on the no-win-no-fee model might discourage consumers from claiming at all where it would be in their interests to do so.

- 4.36** We do not think banning the no-win-no-fee charging model would necessarily protect consumers from excessive charges and we think that prescribing a particular charging model for CMCs to use is not proportionate. Our methodology for the proposed cap ensures that claims management using the no-win-no-fee model remains viable. However, firms are free to use other models if they wish to do so. The proposed fee cap protects consumers who receive redress no matter what charging model is used.

### **Tackling consumer biases and information asymmetry**

- 4.37** We considered an information campaign to help consumers be better-informed about CMCs and their role in the redress system. We also considered whether enhanced disclosure rules for CMCs alongside such an information campaign could sufficiently address market failures to provide appropriate protection from excessive charges.
- 4.38** We are proposing some measures to help consumers make better-informed decisions about purchasing CMC services. (See details in Chapter 5 on enhanced disclosure requirements.) We think these proposed measures will help consumers make better decisions about whether to use a CMC which will encourage increased competition under the fee cap. But such measures alone are unlikely to resolve market failures and appropriately protect consumers from excessive charges. Given the inertia we have seen from consumers in our consumer survey, it is unlikely that consumers will become sensitive enough to CMC charges to create strong competitive pressure on CMC firms.
- 4.39** Evidence from our consumer survey about consumer behaviour and evidence from other initiatives to tackle similar market failures suggests that information-based remedies will not be sufficient to resolve the market failures we observe in this case or to meet our statutory duty. Results of other work (such as the UK Consumer Network consumer remedies project) show that disclosure remedies have mixed success and it is unlikely that we could design an intervention that would successfully resolve information asymmetry and consumers' behavioral biases for consumers generally. Likely effectiveness is also limited by the fact consumers do not engage with the CMC market on a regular basis. If consumers use CMC services only very infrequently they are unlikely to develop good knowledge of the services on offer.

## 5 Enhanced disclosure requirements

- 5.1** This chapter sets out 2 further proposals which complement the fee cap outlined in Chapter 4. The first proposal seeks to improve pre-contractual disclosure of fees to consumers. The second seeks to improve consumer awareness of the alternative to using a CMC. Both proposals will only apply to claims that are within the scope of a statutory redress scheme.

### Background

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- 5.2** In Chapter 3 we acknowledge the benefits a well-functioning CMC market can bring to consumers. However, the market failures described in Chapter 2 mean that consumers find it difficult to judge the value of CMC services and are at risk of being charged excessive fees. The 2 proposals in this chapter complement the proposed fee-cap and are intended to improve consumer awareness to enable better-informed decision making.
- 5.3** The FCA's overarching vision for this market is to have a well-functioning competitive market that delivers quality customer service at a price that reflects the value of that service. We also want to see consumers supported in making informed decisions. The enhanced disclosure remedies discussed in this chapter are designed to deliver our vision for the CMC market.

### Enhanced fee illustrations

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- 5.4** When the FCA took on regulation of claims management companies in April 2019, rules were introduced requiring firms to explain the way they would calculate their fee, and to provide an illustration of that fee. (See in particular CMCOB 4.2.5R.) The rules also require firms, that use a charging model which makes reference to the amount recovered for the customer, to provide a fee illustration based on recovery of 3 amounts: £1,000, £3,000, and £10,000.
- 5.5** Our data request found that a number of upheld claims resulted in recoveries of more than £10,000. We also found that 9 out of 10 claims which lead to redress awards of more than £10,000 were subject to excessive charges. Consumers who expect redress well in excess of £10,000 are likely to find it difficult to estimate how much they will have to pay for the CMCs services they receive.
- 5.6** Our research found that consumers generally underestimate how much they will have to pay for CMC services and around a quarter of consumers paid higher fees than they expected. Our consumer research was conducted on claims concluded before the FCA's new disclosure rules came in to force, however the findings are still relevant as the former regulatory framework placed similar requirements on firms. We believe consumers would benefit from the more tailored fee illustration we are now proposing.

- 5.7** We are also conscious that the fee cap proposed in Chapter 4 may result in firms adopting a charging model with fees calculated with reference to the final redress awarded and could result in different percentage rates for different redress amounts. This could make it more difficult for consumers to understand the fees that they may be charged. So we are proposing to improve the pre-contractual disclosure requirements to produce better-informed decisions. Where firms choose to adopt a charging structure in line with our proposed redress bands our current requirements would not be fit for purpose. Our existing rules do not cover the full range of redress bands and may be misleading for consumers who have larger claims for redress.

## Proposal

- 5.8** We propose a change to our existing disclosure rules in CMCOB 4.2.5R which require firms to provide consumers with illustrative fee calculations. We propose that these illustrative fee calculations will need to set out the fees that would be paid by the consumer for the 3 redress bands that are closest to the amount of redress the consumer is likely to get for their claim. Firms will no longer need to provide illustrations for the amounts (£1,000, £3,000 and £10,000) currently specified in our rules. The firm should also indicate which of the 3 illustrative fee calculations most closely reflects the consumer's claim. This is in addition to the existing obligations in our rules in CMCOB 6.1.7R which require firms to provide revised fee calculations as and when information becomes available to the firm that would allow the firm to give a personalised illustration of the fee the consumer is likely to be charged.
- 5.9** The proposed approach, requiring firms to provide fee illustrations as well as an indication of which illustration is likely to apply to them, will mean consumers are more informed about the costs of engaging a CMC.

**Q6:** Do you agree that requiring the proposed further disclosures will improve consumer awareness of the cost of using a CMC?

## Consumer acknowledgement

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- 5.10** Our rules already require firms to include a statement drawing attention to the option to make a claim direct without charge as part of their pre-contract disclosure to the consumer. (See CMCOB 4.2.2R(2)(g).) This provision was included in light of the data collected as part of the [FCA's Financial Lives Survey](#). The survey found that in 2017 only around 35% of UK consumers were aware of the free alternative routes to redress.
- 5.11** Our more tailored consumer research found that awareness of the option to claim direct was even lower for consumers of CMC services. The research found that more than half of consumers who used a CMC were not aware of their ability to make a claim direct to the firm or to a statutory body such as the ombudsman service. This lack of awareness needs to be addressed to enable consumers to make an informed decision about engaging a CMC to manage their claim.

## Proposal

- 5.12** Our existing rules go some way towards informing consumers of the option to claim direct, but these rules can be enhanced to ensure consumers are better-informed when choosing to engage a CMC to progress their claim. In light of the findings from our consumer research we see a need to strengthen our rules requiring firms to seek confirmation that the consumer does not wish to progress their claim direct themselves. In our view this is best achieved by requiring the statement and information about that option to be isolated in the pre-contractual disclosure, and that the consumer confirms, by way of separate confirmation, they would like to continue engaging a CMC despite understanding they have the option to progress their claim for free, by themselves.

**Q7:** Do you agree that isolating the statement about claiming direct, and requiring a separate declaration from the consumer will help to improve customer awareness of the option to claim without a CMC?

## Implementation

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- 5.13** We propose that the rules for both of these provisions will come into force 3 months from the date they are made. This will give firms time to familiarise themselves and their staff with the new rules and to alter any contracts, documents, processes or promotional materials that are affected, while ensuring consumers receive the benefit of the proposals as soon as possible.

**Q8:** Do you agree with the 3-month implementation period for our proposed enhanced disclosure requirements?

## 6 General amendments

- 6.1** In 2018 we consulted on and made rules for the regulation of the CMC sector (see consultation in CP18/15 and policy statement in PS18/23). Since taking on responsibility for regulating the sector, we have identified some areas where we consider clarification will be helpful. In this chapter, we propose minor amendments to the Claims Management: Conduct of Business Sourcebook (CMCOB), Consumer Redress Schemes Sourcebook (CONRED) and the Perimeter Guidance Manual (PERG). Unlike the proposal set out in the previous chapters, these changes will apply to all sectors of regulated claims management activity.
- 6.2** The text of the proposed amendments, and the statutory powers they will be made under, are set out in Appendix 1.
- 6.3** We also remind firms of their due diligence obligations when dealing with a lead generator (both domestic and overseas), including its engagement in cold calling.

### Minor amendments to CMCOB and PERG

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#### **Prudential requirements: professional indemnity insurance (CMCOB 7.1.1G(3))**

- 6.4** In PS18/23, we confirmed the requirement to have professional indemnity insurance (PII) will not be extended to all CMCs. PII only applies to CMCs that represent customers in personal injury claims, as the most common type of claim in a personal injury case is professional negligence – a key harm we want to continue to address. As a result, the PII requirements under CMCOB 7.4 apply to CMCs who carry on “advice, investigation or representation in relation to a personal injury claim”.
- 6.5** However, the guidance in CMCOB 7.1.1G(3) says the chapter includes requirements for CMCs to have PII if they carry on “advice, investigation or representation in relation to a criminal injury claim”. This was an oversight, and the guidance should have referred to personal injury claim.
- 6.6** We propose to amend the guidance so that it refers to a ‘personal injury claim’ rather than a ‘criminal injury claim’, as was the original policy intent.

#### **Prudential requirements: eligible prudential resources - reserves (CMCOB 7.3.2R(3)(1))**

- 6.7** We require CMCs to calculate prudential resources only from the items which are eligible to contribute to its prudential resources as set out in the table in CMCOB 7.3.2R. In relation to reserves, the table in CMCOB 7.3.2R(3) requires a CMC to make a number of adjustments to its reserves for the purpose of calculating capital resources.
- 6.8** In particular, paragraph (1) under item 3 in the table in CMCOB 7.3.2R requires a CMC to deduct any realised gains or, where applicable, add back in any unrealised losses



on debt instruments held, or formerly held, in the available-for-sale financial assets category.

- 6.9** The reference to 'realised' (gains) is an error. We propose to amend the rule so that it refers to 'unrealised' (gains), as was the original policy intent.

### **General principles (CMCOB 2.1.14R(1))**

- 6.10** For a claim in respect of a payment protection contract, CMCOB 2.1.14R(1) prohibits a CMC from charging a fee to a customer before the later of 2 specific scenarios: "(a) the customer withdrawing or deciding not to pursue the claim; and (b) the settlement of the claim".
- 6.11** These are alternative scenarios for when the fee cannot be charged, and the rule specifies 'later of'. It is incorrect for the rule to apply in both cases. So, we propose to amend the 'and' to 'or', as was the original policy intent.

### **Financial promotion and related activities: invitation or inducement (PERG 8.4.4G)**

- 6.12** Section 21 of FSMA regulates communications which have a promotional element. In PERG 8.4.4G we apply an objective test in the form of 2 limbs to decide whether a communication is an invitation or an inducement that leads firms to 'engage in investment activity' or to 'engage in claims management activity'.
- 6.13** The second limb of the objective test, PERG 8.4.4G(2) only refers to 'engage in investment activity'. We propose to add 'engage in claims management activity' so that it properly reflects the text in the earlier paragraph of the guidance and the original policy intent.

**Q9: Do you agree with the proposed minor amendments to CMCOB and PERG?**

### **Consumer redress schemes (CONRED 1.4.1G)**

- 6.14** Section 404 of FSMA (s404) enables the FCA to make rules to require firms to establish and operate a consumer redress scheme. Section 404E sets out the meaning of consumers for the purposes of sections 404 to 404B. It was amended by the Financial Services and Markets Act 2000 (Claims Management Activity) Order 2018. However, CONRED 1.4.1G, which contains guidance on the scope of a consumer redress scheme made under s404E(2), was not amended accordingly following the change to FSMA. We propose to make the consequential update to the guidance to reflect the current wording of the legislation and update the hyperlink (to s404E(2)) within it.
- 6.15** Similarly, CONRED 1.4.6G provides guidance on the consumers that can be covered by a consumer redress scheme. It includes wording on the meaning of consumer taken from s.404E(1), which was also expanded by the Financial Services and Markets Act 2000 (Claims Management Activity) Order 2018 to include a reference to 'seeking out, referrals and identification of claims or potential claims'. We propose to update the guidance to accurately reflect the legislative changes.

**Q10: Do you agree with the proposed updates to CONRED to bring the relevant provisions in line with the Financial Services and Markets Act 2000 (Claims Management Activity) Order?**

## **Bankruptcy, IVAs and similar arrangements: pre-contract requirements (CMCOB 4.3.1R(6))**

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- 6.16** We require CMCs to ask if a customer is subject to a bankruptcy petition or an individual voluntary arrangement (IVA); has proposed an IVA arrangement which is yet to be approved; is subject to a debt relief order or has any other similar arrangement. CMCOB 4.3.1R(6) achieves this by placing a pre-contractual obligation on CMCs to ask the customer questions regarding such arrangements, and covers the period of an arrangement they are 'subject' to or about to be subject to ('proposed') before engaging the services of a CMC. The policy intention was to cover 'historic' arrangements. The proposed amendments to CMCOB 4.3.1R(6) makes this clearer by asking whether the customer had 'ever been' subject to such arrangements.
- 6.17** Where the customer has outstanding liabilities which any compensation, damages or settlement monies may be off set against, and is bankrupt or in an IVA or similar arrangement, the policy intent is to make them aware that some or all of the compensation award may go towards paying off the debt and the customer will still have to pay the CMC's fee from their own funds.
- 6.18** While we think the rule implies that CMCs undertake due diligence regarding past arrangements, for the avoidance of doubt<sup>18</sup> we propose modifying CMCOB 4.3.1R to clarify that CMCs are required to ask not just about existing bankruptcy, IVAs, or similar arrangements, but historic arrangements as well. However, the change does not alter a CMC's obligation in the event of a positive response from a customer. The CMC is still required to explain to the customer that in the event of a successful claim, the compensation award might, in certain circumstances, be off-set against their outstanding debts.

**Q11: Do you agree with the proposal to modify the rule, which clarifies the obligation for CMCs to also ask customers about historic bankruptcies, IVAs, debt relief orders or similar arrangements?**

## **Regulated and unregulated claims: pre-contract information / advice (CMCOB 4.2.8R(3))**

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- 6.19** The FCA perimeter is set by Parliament and determines which activities require FCA-authorisation and what level of protection consumers can expect. We have come across cases where a CMC is dealing with a claim that is outside the FCA's perimeter, but which subsequently turns into a regulated claims management activity, or vice versa. One example of this is an unregulated 'credit hire' claim linked together with a regulated 'personal injury' claim; the purpose of the credit hire being limited to the provision of a replacement vehicle. CMCs undertaking accident management work come under claims management regulation only if they are involved in seeking out,

identifying and referring 'personal injury' claims, and not if they solely undertake vehicle recovery, vehicle storage, credit hire, or vehicle repair.

- 6.20** Another scenario envisaged relates to claim queries on timeshares (linked to financial products and services). For example, a claim on timeshare mis-selling can turn into a s75 Consumer Credit Act claim if a credit card was used as part of the timeshare purchase. Similarly, a claim to do with a botched installation of solar panels can turn into one for mis-selling of the loan/financing that paid for the solar panels.
- 6.21** It is an important outcome that customers involved in these kinds of claims are aware of the regulatory status of the various aspects of them so they know which aspects of the claim carry important protections, such as personal injury claims connected with CMCs undertaking accident management work, but not with vehicle recovery, vehicle storage, credit hire, or vehicle repair. However, it has become apparent that CMCs do not always make it clear to consumers what is, and what isn't, regulated. Without disclosing this as part of pre-contract information, there is potential harm that the customer will not know the extent of protections they may have. For example, whether they have access to any statutory ombudsman or compensation scheme.
- 6.22** To mitigate this risk we intend to enhance the pre-contract requirement under CMCOB 4.2.8R. We propose to add guidance to this rule reminding CMCs to clarify to customers the terms under which, and the conditions on which regulated claims management activities will be carried out. Specifically, CMCs are expected to tell their customers when they are undertaking 'unregulated' claims management activities for which customers cannot expect certain protections. This will ensure that any protection not afforded for an element of a claim is disclosed clearly for the benefit of customers. This in turn is consistent with the 'clear, fair and not misleading' requirement for financial promotions and communications under CMCOB 3.1.2G and Principle 7 (PRIN 2.1.1R); covering all stages of a firm's interaction with its customers.

**Q12:** **Do you agree with the proposal which places an expectation on CMCs to tell their customers when they are undertaking 'unregulated' claims management activities for which customers cannot expect access to any statutory ombudsman or statutory compensation scheme?**

## Requirements relating to use of a lead generator (CMCOB 2.2.2R)

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- 6.23** In CP18/15, we acknowledged that CMCs carry out a large amount of business by telephone. Due to poor service, misleading sales or aggressive marketing over the telephone, we concluded this is where much of the harm in the market occurs. In addition, a key harm results from cold calling, and where a CMC is not complying with the prohibition on cold calling.
- 6.24** Through the FCA's regulatory work to date in the CMC sector, we have concerns that some CMCs may be using third-country or non-EEA lead generators to avoid the rules (which includes the ban) on cold calling.

- 6.25** We do not think this concern requires the introduction of new requirements, but we want to remind CMCs that accept leads - whether from a UK, EEA, or third-country lead generator - of their due diligence obligations. This includes their engagement in cold calling:
- 6.26** CMCOB 2.2.2R places certain obligations on CMCs that accept or propose to accept sales referrals, leads or data (including details of claims or of customers) from a lead generator.
- 6.27** CMCs must check that the lead generator is authorised (CMCOB 2.2.2R(1)(a)). If this is not the case, then CMCs must satisfy themselves that the lead generator is entitled to carry on seeking out, referrals and identification of claims or potential claims without authorisation, pursuant to CMCOB 2.2.2R(3).
- 6.28** CMCOB 2.2.2R(1)(b) requires CMCs which accept sales referrals to satisfy themselves that the lead generator has appropriate systems and processes in place to ensure compliance with the General Data Protection Regulation (EU) No 2016/679 and the Data Protection Act 2018 (collectively referred to as GDPR) and Privacy and Electronic Communications (EC Directive) Regulations 2003 (PECR). However, if the lead generator is established in an EEA State but has no establishment in the United Kingdom, CMCs are to ensure compliance with the equivalent legislation in that EEA State.
- 6.29** There is also guidance on what is required from CMCs to comply with the rules. CMCOB 2.2.3G(2) states that CMCs should ensure they are aware of any requirements to obtain consent under regulation 21A of the PECR (the cold calling ban), GDPR and any guidance published by the Information Commissioner's Office for data protection legislation and the cold calling ban. We require CMCs to satisfy themselves that the lead generator has the appropriate systems and processes in place to ensure the required customer consents are attained pursuant to PECR and GDPR legislation.
- 6.30** CMCOB 2.2.2R(4) requires CMCs to keep a record of the source of any leads or data. It is important that CMCs record such information as this helps us to identify if a CMC is not complying with the prohibition on cold calling without consent. Having this information allows us to work with the relevant authorities to identify poor practices.
- 6.31** Our rules allow us to take action against a CMC which uses leads generated as a result of cold calling, whether from a UK, EEA, or third-country lead generator. We remind CMCs that they should not be using such leads. If CMCs stop using such leads the incentive for lead generators to cold call should be removed.

## Annex 1

### Questions in this paper

- Q1:** Do you agree with the design of the proposed cap?
- Q2:** Do you agree with the scope of the proposed cap?
- Q3:** Do you agree that agreements which breach the cap should be unenforceable to the extent of the breach and that simple interest at 8% should apply?
- Q4:** Do you agree with a 3-month implementation period for the cap?
- Q5:** Do you agree that applying the proposed cap to pre-existing contracts provides an appropriate degree of protection for consumers against excessive charges?
- Q6:** Do you agree that requiring the proposed further disclosures will improve consumer awareness of the cost of using a CMC?
- Q7:** Do you agree that isolating the statement about claiming direct, and requiring a separate declaration from the consumer will help to improve customer awareness of the option to claim without a CMC?
- Q8:** Do you agree with the 3-month implementation period for our proposed enhanced disclosure requirements?
- Q9:** Do you agree with the proposed minor amendments to CMCOB and PERG?
- Q10:** Do you agree with the proposed updates to CONRED to bring the relevant provisions in line with the Financial Services and Markets Act 2000 (Claims Management Activity) Order?
- Q11:** Do you agree with the proposal to modify the rule, which clarifies the obligation for CMCs to also ask customers about historic bankruptcies, IVAs, debt relief orders or similar arrangements?
- Q12:** Do you agree with the proposal which places an expectation on CMCs to tell their customers when they are undertaking 'unregulated' claims management activities for which customers cannot expect access to any statutory ombudsman or statutory compensation scheme?

- Q13:** Do you agree with our estimate of the costs and benefits of our proposed interventions?
- Q14:** Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

## Annex 2

# Cost benefit analysis

### Introduction

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1. 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'.
2. This annex presents the analysis and estimates of the significant impacts of our proposal, which includes a cap on charges and additional disclosures relating to claims for financial services and products (FS), excluding PPI claims. We provide monetary values for the impacts where we believe it is reasonably practicable to do so.
3. The cost benefit analysis relating to measures designed to secure an appropriate degree of protection against excessive charges is set out in the following sections:
  - Data used
  - Problem and rationale for the proposed intervention
  - Our proposed intervention
  - Our estimates of excessive charging
  - Baseline and key assumptions
  - Summary of costs and benefits
  - Costs
  - Benefits
  - Sensitivity testing

The last section of this annex discusses the costs and benefits of general amendments. Further details of our rationale for action and the approach we are taking are discussed in the consultation paper (CP).

### Data used

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4. We used data from a number of sources to inform the assessment of market failures, excessive charging and effects of candidate interventions. The key data sources are:
  - **Market failures:** data from a bespoke survey of CMC customers commissioned from market research company IFF as well as data from the Financial Lives Survey 2020.
  - **Excessive charging:** data from the bespoke survey, data from responses to our information request to CMCs sent out in December 2019 and CMCs' regulatory returns as of October 2020 as well as information from the ombudsman service and FSCS and internal information from experience with the redress system and with authorising and supervising CMCs.

- **Costs and benefits of candidate interventions:** data from responses to our information request and from regulatory returns.

5. The bespoke survey is described in the technical annex to the [survey report](#). The data gathered through our information request and the data from regulatory returns are described in Appendix 1 of this CBA.
6. In any of the above data sources the number of mortgage, insurance and other claims was too small to be used in any analysis by category of claim.

## Problem and rationale for the intervention

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7. In this section, we describe the drivers of harm and the nature of harm, i.e. excessive charging for claims management activities in relation to financial products and services claims. First, we describe how harm arises, then we discuss how we delineated excessive charging and derived an indicative estimate of the extent of harm, including an assessment of whether vulnerable consumers are disproportionately affected.

### Drivers of harm

8. We found that many customers of CMCs pay excessive charges for claims management because they:
  - lack information about the service CMCs provide
  - over-value the services that CMCs provide, and
  - misjudge the alternative options available to them in making a claim.

These drivers of harm indicate that two key types of market failures are present in the CMC sector: information asymmetries and behavioural biases. These failures contribute to the presence and/or risk of excessive charges by CMCs.

### *Driver 1: asymmetric information*

9. There is evidence of asymmetric information between CMCs and consumers, where consumers have considerably less information and understanding than CMCs about the claims process, the complexity of the claim and likely compensation, and hence fail to anticipate the work involved in the claims process as well as the outcome. In particular, our consumer survey of customers of CMCs found that 56% of the respondents had only some or none of the information they needed to progress the claim, and just 4% said that the amount of paperwork they needed to complete and the amount of compensation they received were about the same as they expected. The share of respondents saying that the amount of paperwork was about the same as expected was 27%; the share responding that the amount of compensation was about the same as they expected was also 27%.<sup>1</sup> (34% of the 599 survey respondents with an FS claim gave either of both of these responses.)
10. In addition, 23% of CMC customers were very dissatisfied with the outcome of their claim, while a further 13% were fairly dissatisfied (regardless of the redress achieved).

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<sup>1</sup> Based on the following questions in our bespoke survey of CMC customers: B2 "Thinking about the paperwork involved with your claim and how much of this the CMC dealt with, did you have to do more or less of this paperwork yourself than you expected?" (all respondents were asked) and B6 "was this...", i.e. the compensation, "more than you expected", "about the same as you expected", "less than you expected", "Don't know" (all respondents who said they had received compensation were asked).



We expect that if consumers had the same information as CMCs at the outset of the claims process, they should have a reasonable expectation of the outcome of the claim. As such, these results are indicative that some consumers are unable to form accurate expectations about the service provided by the CMC and the outcome of the claim due to lack of available information either about the claims process itself or from the CMC.

### ***Driver 2: behavioural biases***

11. Evidence from the consumer surveys also suggests that some behavioural distortions are present, which impede consumers' ability to make choices that are in their best interests. Many consumers in this market seem to exhibit present bias or myopia, meaning that at the point at which they decide to make a claim or use a CMC they place a high value on the time and effort involved when submitting a claim, and a low value on the redress they might get in the future. There is also a tendency for consumers to overestimate the services that CMCs provide.
12. In particular, we find that significant proportions of consumers:
  - may overestimate the complexity of progressing the claim through the firm they complain about or the ombudsman service or FSCS. For example, 26% of respondents to our consumer survey stated that they used a CMC because they did not feel confident enough to deal with the claim themselves. Our knowledge of the redress system suggests that making a claim to a FS firm is straightforward for a customer, since a complaint needs only be an expression of dissatisfaction, and a firm is required under our rules to handle and investigate that complaint. The ombudsman service is required to investigate complaints referred to it. The same applies to claims made to the FSCS. In short, the redress system is designed such that no expertise is required from the claimant.
  - may underestimate their own effort involved when using a CMC. 19% of survey respondents said they had to do more paperwork than expected. There was also significant variation by category of claim, as 32% of respondents with claims relating to loans felt that they had to do more paperwork than expected, compared to just 8% of respondents with claims relating to savings and investments. These results could indicate that consumers with more complex claim types are more likely to anticipate a greater degree of input from their part due to the nature of their claim, whereas consumers with less complex claim types are more likely to overestimate the amount of work that the CMC is able to complete on their behalf.
  - place little value on the charges for claims management, or do not focus on the fee because it is not incurred at the time of engaging the CMC. Charges are hardly ever incurred at the time of signing the contract, but rather when the outcome of the claim and compensation amount has been decided. 32% of survey respondents who paid a percentage fee of the redress awarded to them (not all pay as not all achieve redress) stated that they did not know outright what fee they would be charged.
  - may overestimate their chance of obtaining redress if they use a CMC relative to other channels (over-optimism). The Financial Lives Survey 2020 indicates that 25% of respondents who had made a FS claim directly agreed that they would be more likely to win if they used a CMC, whereas 41% of respondents who had used a CMC agreed with this statement. Combined with the proportion of consumers who were dissatisfied with the outcome of their claim, this could be indicative that consumers have inflated expectations of their chance of success when using a CMC to make a claim.

***Drivers that may be due to both behavioural biases and asymmetry of information - leading to lack of effective competition***

13. Our analysis also suggests the presence of some drivers of harm which could be indicative of both information asymmetries and behavioural biases.
14. Many consumers use CMCs without understanding all the options available to them in making a claim, such as the ability to claim directly to the firm it concerns, use an alternative dispute resolution body<sup>2</sup> (ADR) where the firm has been unable to resolve the claim, or where relevant claiming directly to a compensation scheme<sup>3</sup> where a firm has failed owing redress. 43% of survey respondents were not aware that they could have made their claim directly to the firm, while 57% of respondents were not aware that they could have made a claim to an ADR body where they had been unable to resolve it with a firm. It is unclear whether this information has not been provided to these consumers by CMCs, or whether they have not engaged with the information available to them.
15. We have also found that the vast majority of consumers do not shop around when choosing a CMC. 81% of consumers surveyed did not consider using any other CMC to the one they contracted with; the main reason cited for this was that the respondent had been contacted by the CMC, and that they had not planned on using a CMC prior to that initial contact.
16. These findings indicate a striking lack of engagement with the sector among a large proportion of CMC customers. By not shopping around to find the best offer available, consumers are considerably more likely to be overcharged for the services provided. The lack of engagement also means that competitive pressures are not working to lower the fees that consumers are paying in this market.

**The harm**

17. Harms to consumers arise in several ways.
- Many customers of CMCs pay fees and charges which far exceed the value the claims management activity offers for the individual customer (see the box Quantification of value to customers below for an explanation of how this value is calculated)
  - Some customers take a poorly informed decision when instructing a CMC. This is because they lack the information they need to decide whether progressing their claim through a CMC is the appropriate course of action. Use of a CMC is hence poor value for money for some customers.

In either case fee-paying customers are ultimately harmed because the charges for claims management exceed its value for the customer. Our analysis (set out below) suggests excessive charging of approximately £36.5m (per year) when measured against the value that accrues to individual CMC customers.

18. We consider value of claims management to customers to be both:

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2 ADR bodies for financial services claims are the Financial Ombudsman Service (FOS), and for some complaints about pension schemes, the Pension Ombudsman.

3 The compensation scheme for financial services is the Financial Services Compensation Scheme (FSCS). The FSCS does not provide protection for all types of regulated activities so is only relevant for protected business as set out in the FCA's Handbook (COMP) and PRA's rules for insurance protection and deposit protection.

- value to the individual through saved time and effort and greater confidence due to having a CMC with knowledge of financial services and products and knowledge of the redress system manage their claim, whether the claim is upheld or not.
- wider value to consumers and society more broadly where there is benefit from CMC activity. This includes promoting potential meritorious claims that consumers might otherwise be unaware of, and acting as a general 'check and balance' on the conduct and claim-handling of respondent firms in the redress system. In some cases, CMCs help consumers who might not otherwise have made a claim get redress.

We see charges to the individual customer as excessive if they exceed the value to the individual customer.

19. Below we set out how we derived indicative estimates of the value of CMC services to an individual consumer, based on:

- the time and effort saved,
- the increased confidence

Once we had estimated an average value, we used data from our sample to establish the share of claims currently exceeding the estimated average value for the redress band each claim falls into. This gives us an estimate of the extent of harm (excessive charging). We think using averages is a reasonable proxy. We have not attempted to calculate the value of claims management for customers for every individual claim because most of the necessary information is not available at such a granular level. In our view, the wider value to consumers and society cannot reasonably be fully estimated.

20. As shown in Figure 3 below the proposed cap is not set to the level of our estimated value of using a CMC for individual consumers. Rather, we used the value of using a CMC obtained through this analysis as a starting point only in the design of the cap. We then identified the proposed cap through modelling different specifications of caps and assessing their impacts. When choosing the candidate cap among the many potential specifications we also considered the wider benefits of claims management (qualitatively only).

21. The proposed cap is the specification that provides the highest net adjusted benefits subject to ensuring the CMC market remains viable and the cap provides an appropriate degree of protection for customers at different levels of redress. A viable market will continue to realise the wider benefits of claims management, as well as benefits to individuals (see section Negative effects due to exit... for the discussion of viability/likely exit of CMCs). We have not proposed the cap with the highest net benefit because we were dissatisfied with the low protection it offered for claimants in the lowest redress band (ie in the lowest redress band it restricted charges on a small proportion of the claims where charges are currently above the estimated average value for the individual customer).

### ***Indicative quantifications of value and excessive charges***

#### ***Our approach***

22. Broadly speaking we estimated

- a. the time and effort saved on claims (if upheld or not) using estimates of

- the average time spent by a CMC on a claim (based on data from CMCs)
  - an assumption (based on our regulatory judgment, see paragraph 25) of how much more time a consumer would spend to progress a claim compared to a CMC
  - the average time spent by a consumer progressing a claim with the help of a CMC (based on the bespoke survey)
- b.** the increased confidence by scaling up the monetised value of time and effort saved based on responses to two questions in the bespoke survey

to obtain an estimate of the value of CMC services to customers. This helps us establish the current share of claims where the fees paid exceed the average value of the service to customers and an indicative quantification of this harm. We consider that this approach is appropriate in this market because of the market failures present and the characteristics of the sector (for further detail on the rationale for the approach to establish excessive charging see chapter 3 of the CP).

### Quantification of value of CMC to customers - steps in brief

Our approach to quantification of value to individual customers is set out in detail below. The following provides a brief explanation step by step. The rationale for the assumptions used is explained in detail later.

1. We estimated the average time spent managing a (upheld or not) claim by a CMC per product category using 2 methods. The first method was to use time estimates provided by CMCs themselves.
2. The second method was to derive time estimates from data provided by CMCs on hourly wages and annual staff costs for different claim categories.
3. These 2 methods gave us an upper bound, lower bound, and average of the time spent by CMCs, for each category.
4. We assumed that if a consumer was managing a claim without a CMC they would take twice the time a CMC would spend on it. Again, this yielded an upper bound, lower bound, and average, per category of claim.
5. We estimated the average time actually spent by consumers on a claim in a given category when they use CMCs for that claim, based on our consumer survey data.
6. The time saved by consumers (for an average claim in a given category) is the difference between time spent when claiming directly (in 4) and time spent when using a CMC (in 5).
7. We monetised the time saved in each redress band by multiplying it by £6 (and as a sensitivity test by £19).
8. We calculated the average time saved (across all categories) in each redress band, by weighting the average time saved for a claim in a given category by the number of claims in each category and each redress band.
9. We scaled up this estimate for the monetised value of average time saved based on two questions in the consumer survey to reflect the increased confidence a customer gets when using a CMC, and thereby obtained an estimate of value of CMC services to the consumers by redress bands.

### A. Time and effort saved

- 23.** We estimated the average time spent by a CMC on a claim ("x") based on two types of information provided by CMCs (steps 1 and 2):

Approach (i) - average time spent provided by 18 CMCs and

Approach (ii) - average time spent managing a claim, calculated from staff costs for claims management (including for legal and specialist advice), wages and the number of successful and unsuccessful claims managed available from 29 CMCs (dividing the total staff costs for each category of claims by the hourly wage and the number of successful and unsuccessful claims managed in each category).

- 24.** For both, we used the total number of claims managed by each CMC in each category of claims as weights and calculated a weighted average number of hours spent on a claim in each category of claims. For savings and investments (S&I) and pension claims, approach (i) gave us a lower bound and approach (ii) an upper bound, whereas for package bank accounts (PBA) claims and loan claims, approach (ii) gave us a lower bound and approach (i) an upper bound (step 3).
- 25.** We assumed that a customer managing a claim without a CMC would spend on average twice as much time as the estimated time spent by a CMC on managing a claim in a given category (PBA, pensions etc.). This gave us an estimate for the time spent by the consumer without a CMC ("a") (step 4), see table 2 below. The factor 2 has been assumed based on the FCA's extensive knowledge and experience of the financial services redress system, with an additional check against data from a survey carried out by the Citizens Advice Bureau<sup>4</sup> (see Appendix 2, paragraph 1 and Table 2.0 for details).<sup>5</sup> Since it is not clear whether there is a close relationship between the time spent by CMCs and the time consumers would have spent on a claim without them, this is an approximation.
- 26.** For each category of claims, we deducted the time spent by a consumer using a CMC ("b") (based on our bespoke survey, see table 2 below) from these estimates to generate the time saved (steps 5 and 6).

**Table 1: Calculating time saved**

| Time spent by CMC (hours) | Factor | Time spent by consumer w/o CMC "a" (hours) | Time spent by consumer using a CMC "b" (hours) | Time saved (hours) |
|---------------------------|--------|--------------------------------------------|------------------------------------------------|--------------------|
| x                         | 2      | x * 2                                      | b                                              | a - b              |

- 27.** We then monetised the time saved by using two different estimates for the value of an hour of consumer's leisure time, £6.10, (rounded, in 2020 prices, see Transport analysis guidance data book available [here](#)) based on extensive research by the Department for Transport (step 6), and £19 based on guidance for self-represented litigants.
- 28.** We have used the Department for Transport value of time (VoT) in previous cost benefit analyses, for example when estimating costs to consumers of searching and switching (in work on high cost credit CP18/42 (paragraph 172) and CP18/35 (paragraph 107<sup>6</sup>). The figure of £19 comes from civil court case procedure rules. Practice Direction 46 – Costs Special Cases sets out that the amount which may be allowed to a self-represented litigant is £19 per hour (under rule 45.39(5)(b) and rule 46.5(4)(b)).

4 This survey found that consumers spent an average of 25.3 hours per issue on problems with 'professional services' or 'financial services', see figure. 39 of the [report](#).

5 Choosing a slightly higher factor would likely not change our conclusions. A much higher (implausible) factor, such as 20, would suggest a lesser need for intervention.

6 The Department for Transport's measure of value of leisure time has been used by other Government Departments as well, see for example the Department for Business, Energy & Industrial Strategy's [cost benefit analysis](#) for Smart Meter Roll-out in 2019.

29. For weighting: we calculated the share of claims in each category of claims within each redress band ("s"), see Table 7. For each redress band, we derived an estimate of average time saved by multiplying the share of claims in each category by the estimated monetised time saved for the category, adding these estimates and dividing by the sum of the shares of claims in each category. That is, for each redress band we calculated the monetised time and effort as

$$\frac{[(a_{S\&I} - b_{S\&I}) * \text{£}6.1 * s_{S\&I} + (a_P - b_P) * \text{£}6.1 * s_P + (a_{PBA} - b_{PBA}) * \text{£}6.1 * s_{PBA} + (a_L - b_L) * \text{£}6.1 * s_L]}{(s_{S\&I} + s_P + s_{PBA} + s_L)},$$

with subscript S&I for savings and investments, P for pensions, PBA for packaged bank accounts and L for loans (Tables 2 and 3 show the figures used; step 8).

## B. Greater confidence

30. To factor in the greater confidence which a customer might derive from using a CMC, we scaled up the monetised time and effort saved based on the bespoke survey using the share of respondents who reported they
- used a CMC to progress their claim to reduce their effort involved (as a proxy for time saved; question C2\_C), and
  - used a CMC to progress their claim because they did not feel confident enough to deal with the claim themselves (as a proxy for increased confidence; question C2\_D).
31. For each redress band, we calculated a ratio ("c" in Table 4) of the proxy for greater confidence over the proxy for time saved. We grouped together redress bands 4 and 5 due to the small sample size of survey respondents who received redress within these ranges.<sup>7</sup> For each redress band, we multiplied the estimates of monetised time and effort saved by this ratio to arrive at an estimate for the quantifiable aspects of value (step 9).
32. Tables 2 to 5 show key results on our estimate for the value of using CMC services to consumers using the VoT of £6.10. Table 4 shows the estimates of value to the individual customer and the share of excessively charged claims that will be capped under our proposed cap.
33. The estimated monetised time and effort saved and increased confidence provided us with an estimated value of CMC services to an individual consumer, which gives an indicative threshold above which, for each band of redress, fees paid exceed this measure of value of the service to customers (abbreviated as 'charged excessively' or 'excessive charges' below). Results for the value of an hour of £19 (shown at Appendix 2) suggest a higher value of claims management and a lower prevalence of excessive charging, ranging from excessive charging on 6% of the claims in the lowest redress band to 88% in the highest redress band. Our proposed cap reflects the lower proportion of claims that appear affected by excessive charging (in band 1, for a VoT of £6.10, or bands 1 and 2, for a VoT £19) by capping charges in those bands to a lesser extent than for higher bands.

<sup>7</sup> Reducing the confidence factor for the higher bands 3 to 5 increases the proportion of claims where charges are above the estimated value of CMC services by less than 1 percentage point. This would not lead to a change in the proposed cap.

- 34.** Given the different contexts of the two rates, the £6.10 leisure-time rate appears more appropriate to us because, as well as being the value of time most commonly used across government, we consider that dealing with a CMC claim will likely lead to a less intense preparation and lower stress level than dealing with a court case. We note however, that either rate justifies intervention on the basis of the estimated value of CMC services to the individual customer. If the VoT of £19 is assumed, the proposed cap would constrain charges on between 71% to 94% of the claims where charges are higher than the average value for the individual customer (see Table 2.3 at Appendix 2) and would most likely leave the sector viable. We therefore conclude that the proposed cap would be the same if we assume a £19 VoT, as it would still provide an appropriate degree of protection.
- 35.** Loan claims (almost all of which are high-cost short-term credit claims) fall into the two lowest redress bands. The likely vulnerability of customers with such claims strengthens our case for intervention on claims in these lowest redress bands. (The vulnerability of high cost short term credit customers is apparent from earlier FCA work on high-cost short-term credit (HCSTC), see e.g. our review of HCSTC in CP18/43<sup>8</sup> and also from our vulnerability analysis based on the index of multiple deprivation (IMD), discussed below.)

**Table 2: Key results of the analysis by category of claims**

|                                                         | S&I | Pensions | PBA | Loans |
|---------------------------------------------------------|-----|----------|-----|-------|
| <b>Time spent by consumer without a CMC (a) (hours)</b> |     |          |     |       |
| Average                                                 | 63  | 87       | 10  | 20    |
| lower bound                                             | 32  | 49       | 6   | 10    |
| upper bound                                             | 94  | 124      | 15  | 31    |
| <b>Time spent by consumer with a CMC (b) (hours)</b>    |     |          |     |       |
| average                                                 | 5   | 13       | 3   | 10    |
| lower bound                                             | 4   | 11       | 3   | 7     |
| upper bound                                             | 6   | 15       | 3   | 13    |
| <b>Monetised time saved (a – b) x £6.10</b>             |     |          |     |       |
| average                                                 | 353 | 447      | 45  | 61    |
| lower bound                                             | 170 | 233      | 22  | 16    |
| upper bound                                             | 536 | 662      | 71  | 107   |

Note: S&I: savings and investments.

**Table 3: Interim step: Weighting the time saved (sample)**

|      | S&I          |                                | Pensions     |                          | PBA          |                            | loans        |                          |
|------|--------------|--------------------------------|--------------|--------------------------|--------------|----------------------------|--------------|--------------------------|
| band | nr of claims | weight (s <sub>S&amp;I</sub> ) | nr of claims | weight (s <sub>p</sub> ) | nr of claims | Weight (s <sub>PBA</sub> ) | nr of claims | Weight (s <sub>L</sub> ) |
| 1    | 1,046        | 8%                             | 101          | 1%                       | 8,416        | 63%                        | 3,827        | 29%                      |
| 2    | 2,460        | 36%                            | 444          | 7%                       | 2,963        | 44%                        | 880          | 13%                      |
| 3    | 608          | 51%                            | 547          | 46%                      | -            | 0%                         | 9            | 1%                       |
| 4    | 222          | 25%                            | 625          | 70%                      | -            | 0%                         | -            | 0%                       |
| 5    | 84           | 13%                            | 469          | 73%                      | -            | 0%                         | -            | 0%                       |

<sup>8</sup> CP18/23 found that "They [consumers using high-cost credit] often have unpredictable variations in their incomes and expenses and have limited savings. They are generally higher risk and borrow smaller sums than mainstream consumers. As a result, their cost of borrowing is normally higher. This increases their overall financial burden and could put them at risk of defaulting on other payments, such as rent and bills, and getting further into debt. (paragraph 1.9)

**Table 4: Key results of the analysis by redress band (for the candidate cap)**

| band | ratio (c) | Value estimate: time/effort saved and increased confidence (monetised)* |       |       | share of claims c.e.** | share of claims c.e. capped*** |
|------|-----------|-------------------------------------------------------------------------|-------|-------|------------------------|--------------------------------|
|      |           | average                                                                 | lb    | ub    |                        |                                |
| 1    | 0.7       | 128                                                                     | 55    | 203   | 49%                    | 54%                            |
| 2    | 1.1       | 385                                                                     | 184   | 588   | 90%                    | 81%                            |
| 3    | 1.9       | 1,150                                                                   | 578   | 1,723 | 84%                    | 47%                            |
| 4    | 4.3       | 2,234                                                                   | 1,144 | 3,325 | 94%                    | 68%                            |
| 5    | 4.3       | 2,289                                                                   | 1,181 | 3,398 | 96%                    | 71%                            |

Note: lb: lower bound, ub: upper bound, c.e.: charged excessively against value to the individual customer. \* The formula at paragraph 29 shows how these numbers are derived. \*\* Proportion of claims where the revenue is higher than the estimated value for the given redress band. \*\*\* Proportion of claims with revenue higher than i) the estimated value for the given redress band (i.e. likely charged excessively) and ii) the maximum revenue allowed under the proposed cap. This proportion of claims is therefore a percentage of the claims charged excessively shown in the previous column.

**Table 5: Share of claims charged excessively against value to the individual customer and share of such claims capped by the candidate cap (using the estimates for average value)**

| category | share of claims c.e. | share of claims c.e. capped |
|----------|----------------------|-----------------------------|
| S&I      | 75%                  | 85%                         |
| pensions | 92%                  | 39%                         |
| PBA      | 62%                  | 69%                         |
| loans    | 54%                  | 45%                         |

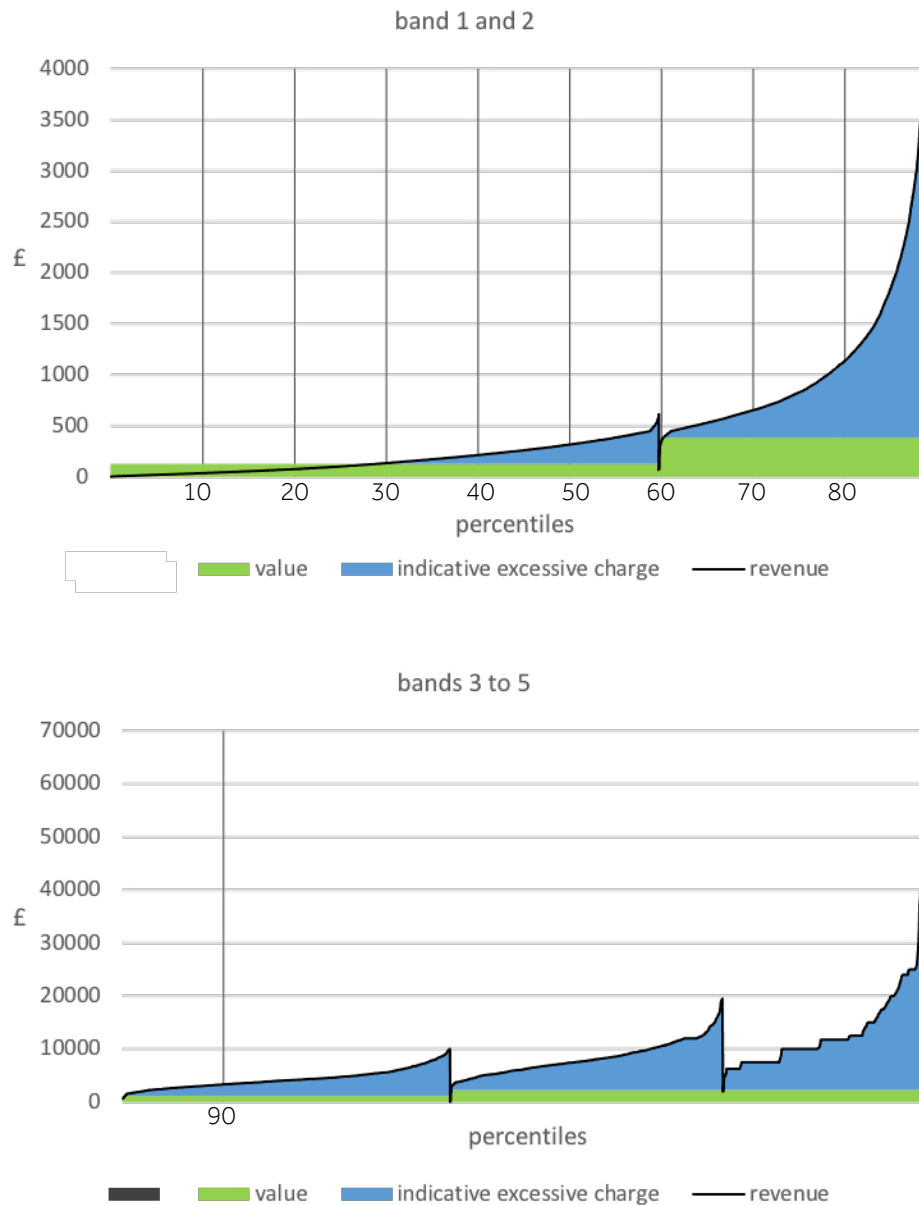
Note: S&I: savings and investments, c.e.: charged excessively against value to the individual customer.

### **Indicative quantification of harm**

36. To illustrate the harm currently present in the CMC market, we have used the estimated average value of claims management to individual customers shown in Table 4 and summed all charges above these thresholds; see Figure 1 where, within each redress band, claims are ordered by revenue.



**Figure 1: Indication of excessive charging against value to the individual customer (for the sample of 32 CMCs<sup>9</sup>)**



**37.**

We scale the results for our sample of CMCs to reflect the indicative harm from excessive charging (against value to individual customer) for FCA-regulated management of FS claims (based on data from regulatory returns as of 26 October 2020). The regulatory data includes returns from 139 CMCs (excluding 31 CMCs which only manage PPI claims). About 273 CMCs are authorised for claims management or have temporary permission and should submit such returns. We estimate that 223 of these are not PPI-only CMCs (because 31 of 170 FS CMCs which have submitted regulatory returns are PPI-only CMCs). As of 26 October, 5 CMCs in our sample had not submitted their regulatory return; see Table 6 below.

9 A small number of claims managed for business are omitted because they are very different from all other claims.

**Table 6: Number of FS CMCs which have submitted reg. returns or are expected to submit those**

|                          | submitted by 26 October | total expected |
|--------------------------|-------------------------|----------------|
| FS CMCs, not PPI only    | 139                     | 223            |
| FS CMCs, PPI only        | 31                      | 49             |
| FS CMCs in sample of 33* | 28                      | 33             |
| FS CMCs in sample of 28* | 27                      | 28             |
| <b>Total</b>             | <b>170</b>              | <b>273</b>     |

Note: \* There are no PPI-only CMCs in our sample.

**38.** We scaled up the revenues in the regulatory returns to account for missing returns. For example, we scaled up the total revenue on FS claims in the regulatory returns available by dividing by 139 and multiplying by 223. For CMCs whose reporting period is shorter than a year, the revenue on FS claims is scaled up to 12 months. The total revenue for our sample of 33 CMCs is £33.1m. The extrapolation results in approximately total revenue on FS claims management of £61.0m (see table 1.12 in appendix 1 for details). We recognise that given the limitations of the regulatory returns these are approximate estimates of the total revenue in this market.

**39.** This suggests that about. £29.7m to £43.8m (average: £36.5m) of CMCs' FS revenue is due to excessive charging (accounting on average for around 71% of their overall revenues of about. £51.2m (extrapolated from our per-claim dataset having excluded claims managed for businesses).

### **Limitations of our estimates of value of CMC services to customers**

**40.** We recognise that there are some limitations in how we have been able to estimate the value of CMC services to customers. The questions in the bespoke survey were not included for the purpose of assessing value and may not be best suited to proxy the increased confidence. However, this is the best solution available to us to reflect this aspect when assessing the value of claims management for customers and is a reasonable approach to do so. The results from the bespoke survey did show us that consumers use CMCs to overcome a lack of confidence, and if we did not account for the increased confidence in our estimation of value, our analysis would suggest presence of more excessive charging by CMCs and would not account for an important component. Avoiding an overly intrusive cap is an important reason for attempting to quantify the increased confidence, notwithstanding the limitations.

**41.** Other aspects of our approach, such as the assumption that consumers spend twice as much time as CMCs on a claim are based on our regulatory judgement.

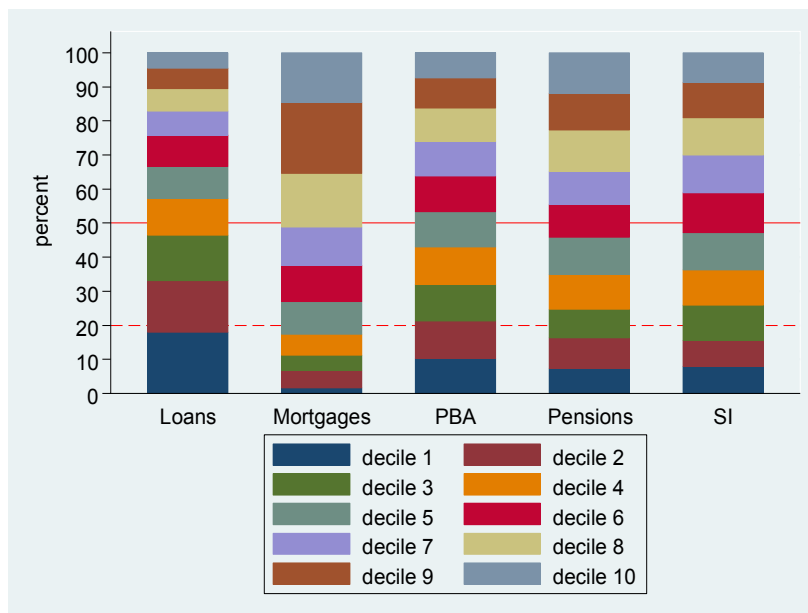
**42.** The results, and the element of increased confidence, are largely based on the main categories of claims within our sample (savings & investments, pensions, PBA and loans). This is because our per-claims dataset and survey dataset include very few entries for other categories of claims. It is not clear whether these results also apply to other categories of claims (such as mortgage claims, insurance claims or any new category of claims that emerges in the future, to which the proposed rules apply). In our view, mortgage and insurance claims fall into the category of complex claims and aren't materially different to S&I claims and pension claims in aspects that matter for the design of our intervention.

43. The wider benefits of claims management are not reasonably quantifiable. We have accounted for these when designing the cap by ensuring that the sector remains viable and will continue to deliver those benefits.

### Vulnerability of consumers affected

44. We assessed the potential vulnerability of CMC customers based on the index of multiple deprivation (IMD) matched to the postcodes included in the per-claim data submitted by our sample of CMCs. The IMD considers different domains of deprivation, most importantly income, employment, education and health. It ranks small areas in the UK by their IMD score and includes the decile each falls into. There is no accepted threshold for the IMD rank below which consumers are considered potentially vulnerable. The IMD (and similar indicators) measure potential vulnerability, not actual vulnerability.

**Figure 2: Deprivation of consumers with a closed claim (IMD, all claims)**



Note: SI: savings and investments; Those in the lowest decile are consumers in the most deprived areas by their IMD score, those in the highest decile live in the least deprived areas.

45. We find that for most categories of claims there is no great variation in deprivation of CMC customers compared to the UK population (see figure 2):
- There is nothing to suggest CMC customers are disproportionately more likely to live in deprived areas than the UK population for S&I claims, pension claims, PBA claims or mortgage claims. However, for pension and savings and investment claims, the issue leading to the claim can have a large impact on the financial situation of consumers and hence their vulnerability. I.e. the redress at stake for such claims may be a better indicator of potential vulnerability than an indicator such as the IMD. Where the claim regards a customer's only pension or the majority of their savings, the impact on the customer's vulnerability can still be large, even if the redress awarded appears low.
  - The analysis shows that more than 30% of customers with a CMC loan claim live in areas which fall into the two lowest deciles of the IMD and about 66% of all CMC

customers with a loan claim live in areas in the lowest five deciles of the IMD. This is plausible because almost all loan claims are HCSTC claims (99.9%).

46. The vulnerability analysis has provided further guidance in the selection of the proposed cap scenario, as the proposed cap ensures that an appropriate share of loan claims is caught by the cap. It suggests the prevalence of vulnerability in CMC customers further strengthens our case for intervening to cap excessive charging of loan claims.

## Our proposed intervention

47. To address the harm described above, we propose to intervene as described in Chapters 4 and 5 of the CP. In summary our proposals are as follows:
- Where fees for claims management activities are charged in relation to a claim that yields monetary redress, the total fees charged to the customer (excl. VAT) must not exceed the lower of the maximum percentage rate and maximum total fee in the relevant redress band in table 7 below. Amounts charged above the cap will have to be refunded and will carry 8% interest.

**Table 7: Specification of the preferred cap**

| band | redress obtained |         | max % of redress charged | max total charge (£) |
|------|------------------|---------|--------------------------|----------------------|
|      | lb (£)           | ub (£)  |                          |                      |
| 1    | £1               | £1,499  | 30%                      | £420                 |
| 2    | £1,500           | £9,999  | 28%                      | £2,500               |
| 3    | £10,000          | £24,999 | 25%                      | £5,000               |
| 4    | £25,000          | £49,999 | 20%                      | £7,500               |
| 5    | £50,000          | max     | 15%                      | £10,000              |

Note: lb: lower bound, ub: upper bound

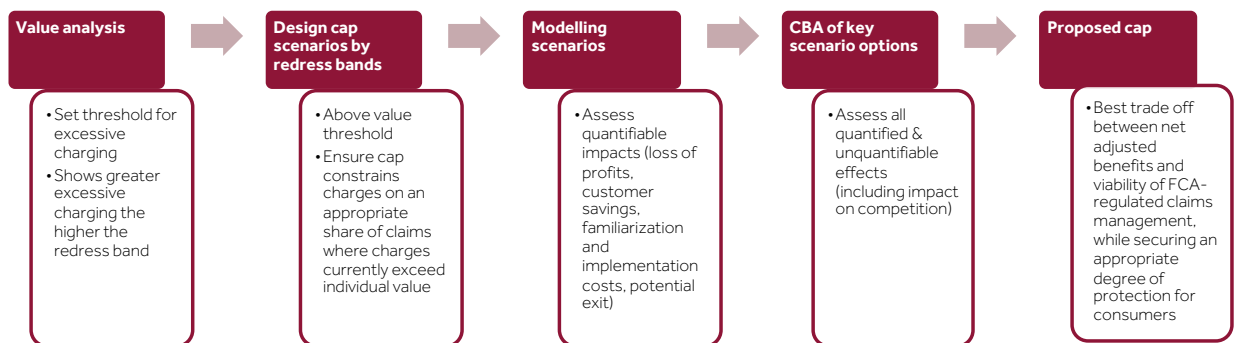
- The cap will apply to non-PPI claims relating to financial products or services that fall within scope of the statutory redress system, including DISP, the ombudsman service, the FSCS or another statutory redress scheme such as the Pensions Ombudsman scheme. It will apply to:
  - contracts that are entered both prior to and after the rules coming into force where the charges arise after the rules come into force;
  - charges in connection with any claim that yields monetary redress (whether charges are calculated as a share of redress or by another method such as an hourly rate);
  - the total charge for claims management on a single claim, whether or not multiple payments, multiple services or multiple providers were involved, and taking into account charges already made by others, including on disbursements such as payment for legal advice or expert witnesses. Where fees have already been charged at the time the rules come into force, they will not be subject to the cap, but will count towards the cap for any fees charged after the rules come into force.
- Where the cap does not apply, firms must not charge the customer an amount in excess of what is reasonable in the circumstances and reflects the work undertaken

by the firm (for example in case of charges by the hour for a claim that does not lead to redress or where FS claims are outside the statutory redress system).

- Where a lead-generation fee is charged (either to the CMC managing the claim or directly to the customer), the maximum amount that can be charged to the customer in fees for a single claim (including any lead-generation fee and all other claims management fees) cannot exceed the proposed cap .
- For new contracts entered into after the rules have come into force:
  - a. Pre-contractual CMC fee illustrations must show the amount CMCs reasonably expect the customer will be charged based on the expected amount of redress if relevant, including VAT if applicable.
  - b. Before entering into new contracts CMCs must have customers attest to the fact that they understand the option to make their claim direct, without a CMC.
- The rules will come into force 3 months after they are made.

48. We used the indicative estimates of excessive charging, expected costs and benefits and regulatory judgement to devise the candidate caps and select the proposed cap shown in table 7 above. Figure 3 below sets out how we arrived at the cap. Details of our rationale are discussed in Chapter 3 of the consultation paper.

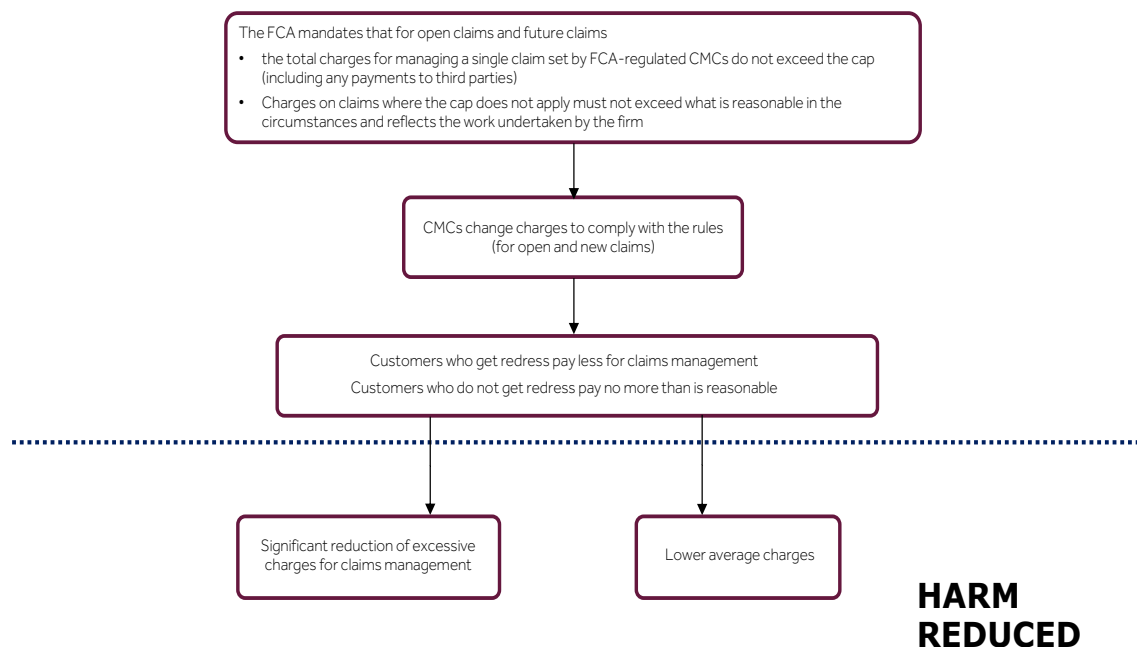
**Figure 3: Approach to choosing the preferred cap**



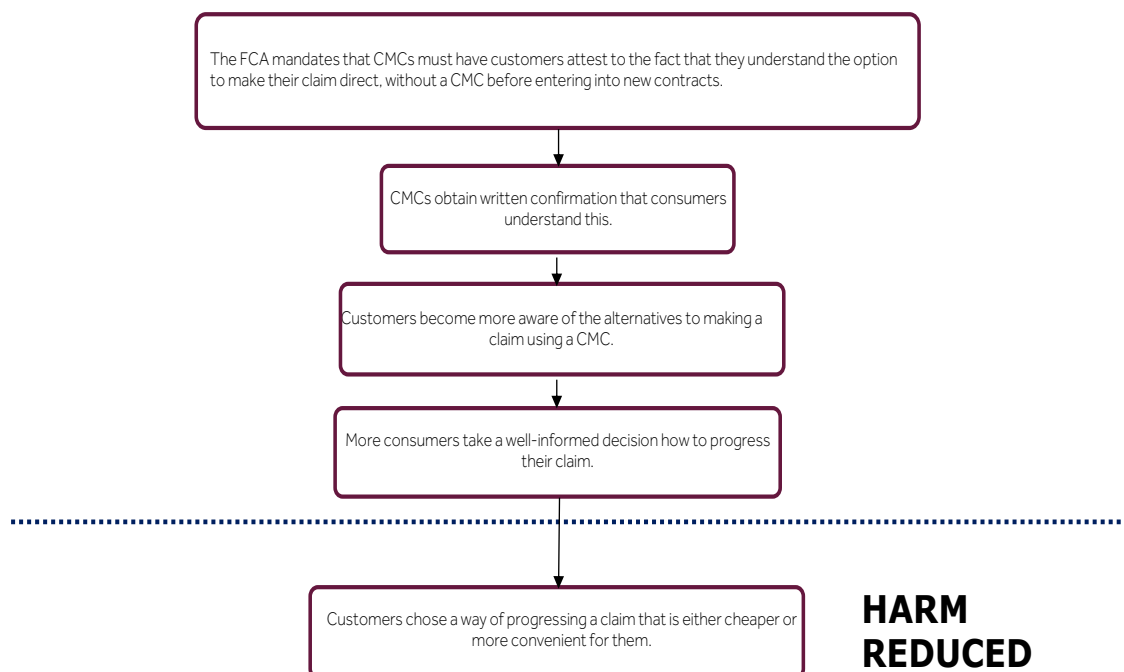
### How our intervention benefits consumers

49. In figures 4 and 5 we set out how we expect our proposed intervention to lead to a reduction in the harm.

**Figure 4: The causal chain for our pricing remedy**



**Figure 5: The causal chain for the attestation**



## Baseline and key assumptions

### *The baseline*

50. The counterfactual for our intervention is the FCA-regulated claims management sector absent our intervention in the years after the proposed rules would have come into force. We are aware that the sector is undergoing transformation, in particular to adjust to the end of PPI claims in their present form due to the PPI timebar<sup>10</sup>, the change in regulator and the coronavirus situation. Predicting how the market will evolve in the face of these challenges is not reasonably practicable.
51. For the purposes of assessing excessive charging as well as the costs and benefits of our intervention, we assume that CMCs will continue operating at the levels observed in the financial years 2018/19 and 2019/20 and present the costs and benefit for 1 year only. Our estimates are for a typical year, when all claims classified as successful by the CMC (abbreviated as 'successful' in the rest of the document) are subject to the candidate cap.
52. Due to the application of the cap to existing contracts where the claim is ongoing, more claims are subject to the cap in the first year after the rules come into force than in a first year if the rule applied only to new contracts. This is because there will be claims already in existence in addition to new claims emerging in the first year. The volume of affected claims may also be higher in subsequent years if some claims existing at the point of implementation are closed in subsequent years rather than the first year. However, more than 90% of claims in our dataset are closed within 12 months. Our cost benefit analysis models a typical year when all claims are subject to the rules.

### *Key assumptions*

53. Our analysis is a static one so we don't attempt to estimate dynamic responses from firms to the proposed cap. We have had to make a number of assumptions to estimate the costs and benefits of our proposed intervention. Many are discussed in the CBA sections where relevant but we highlight some of the main underlying assumptions here:
- The data available is representative of FCA-regulated management of FS claims (noting that our data covers CMCs with a broad range of revenues). Our sample accounts for about 48% to 55% of FCA-regulated revenue on FS claims (48% for the sample of 28 CMCs used to assess profitability and 55% for the sample of 32 CMCs<sup>11</sup> used in other analysis). Details of the regulatory returns data are included in Appendix 1.
  - We assume that CMCs will continue operating at the levels observed in the financial years 2018/19 and 2019/20. The financial year 2018/19 is the period covered by the datasets resulting from our information request. The regulatory returns used to scale results to FCA-regulated claims management cover periods after April 2020 (scaled to 12 months).
  - The number of claims dealt with by CMCs will remain unchanged by the caps, i.e. that demand for claims management will not increase because of the cap. Our consumer survey suggests that demand for claims management is not very sensitive to price. Any inaccuracy introduced by this assumption is hence likely to be very small (see also paragraph 96).

10 We set a deadline of 29 August 2019 for PPI complaints to firms; see [here](#).

11 A CMC which manages claims for businesses is omitted to avoid overstating the coverage of our dataset.

- CMCs will not reduce their quality of service. This is consistent with CMCs' comments (in our data request) on how a fee cap would affect their business models or plans (see section **Poor service** below).
- CMCs will not change the criteria they use to decide whether or not to manage a claim, such as a minimum expected redress (see the discussion at paragraphs 101/2).
- CMCs do not respond to the cap by changing how they manage claims, e.g. to save costs.
- CMCs will not increase their marketing budget should some other CMCs cease to manage claims overall or in some categories (see paragraph 107).
- CMCs which make a short-term loss on a category of claim (revenue < direct costs) will not continue to manage claims in that category, and CMCs which make long-term losses on their claims management business (revenue < total costs) will exit claims management. This applies whether CMCs are loss-making absent any intervention or become loss-making because of it. We appreciate that in reality CMCs will monitor profits or losses over a period of time before they take such a decision and that some might be able to adjust their business and return to profitability. However, we believe a return to profitability isn't very likely in most cases as we are aware that a number of CMCs have decided to wind down but have not seen examples of a return to profitability once a CMC is loss-making (see the discussion at paragraph 75).
- When calculating loss of profits and savings for consumers, we considered only exit from categories of claims (all categories where revenue < direct costs), because exit from claims management (revenue < total costs) is a more long-term decision (see paragraphs 69 and 71).
- CMCs which no longer manage a given category of claims will no longer incur overheads for this category of claims. I.e. we assume that CMCs incur overheads specific to categories of claims and will avoid incurring these overheads if they stop managing a category of claims. This is consistent with the fact that most CMCs managing several categories of claims have provided us with overheads by category of claim (as we asked in our information request).<sup>12</sup> (For 5 of the sample of 28 CMCs used to assess profitability we had to impute overheads for categories of claims; see appendix 1, paragraph 17 for details.) Additionally, we have conducted a sensitivity analysis assuming that CMCs would continue to include all overheads (see paragraph 90).
- We have used the estimates for direct costs per claim provided by the 28 CMCs whose data is used for the financial analysis at face value, accepting any assumptions they made (though frequently after discussion with the CMC).

The potential impact of these assumptions is explained below.

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<sup>12</sup> Data provided by our sample of 33 CMCs suggest that about 23% of overheads are incurred for staff salaries and training, 17% for office space, 13% for other recurring expenses, 12% each for regulatory and compliance costs and IT costs.



## Summary of costs and benefits of the package of proposals

54. Table 8 below sets out the one-off and ongoing quantifiable costs and benefits of the candidate cap for 1 typical year. Because the sector is adjusting to various changes (e.g. the PPI timebar, change in regulator and the coronavirus situation), we do not present the costs and benefit over a longer period of time.
55. We estimated the net adjusted benefits (NAB) to inform our choice among candidate caps, alongside value, viability and other considerations. The NAB for the proposed cap is £8.4m for FCA-regulated management of FS claims (ie for the population), where the loss of profits from restricting charges is excluded from the cost estimates. As the loss of profit is the direct result of ensuring an appropriate degree of protection from excessive charges, and a transfer to consumers, we only count it as benefit.<sup>13</sup> The NAB for the proposed cap is £8.4m for FCA-regulated management of FS claims, suggesting that the candidate cap is net-beneficial. Table 8 below shows the different components of the NAB.
56. Table 9 lists the non-quantifiable costs and benefits of the proposed cap. The scope of most of the unquantifiable effects is small. Jointly they are not sufficiently important to change our conclusion that the proposed cap achieves an appropriate degree of protection, including when unintended consequences are considered. The individual effects are discussed in detail in the sections on costs and benefits below.

**Table 8: Quantifiable costs and benefits of the cap per year (£m)**

|                       |                                                                   | Costs | Benefits* |
|-----------------------|-------------------------------------------------------------------|-------|-----------|
| CMCs                  | loss of profits, constrained charges (excluded in the NAB)        | -9.6  |           |
|                       | loss of profits on categories no longer managed (because of exit) | -1.0  |           |
|                       | F&I costs**                                                       | -0.2  |           |
| Consumers             | Savings on fees                                                   |       | 9.6       |
| Net adjusted benefits |                                                                   |       | 8.4       |

Note: \* a transfer from CMCs to customers, \*\* F&I: Familiarisation and implementation

**Table 9: Non-quantifiable costs and benefits of introducing a cap**

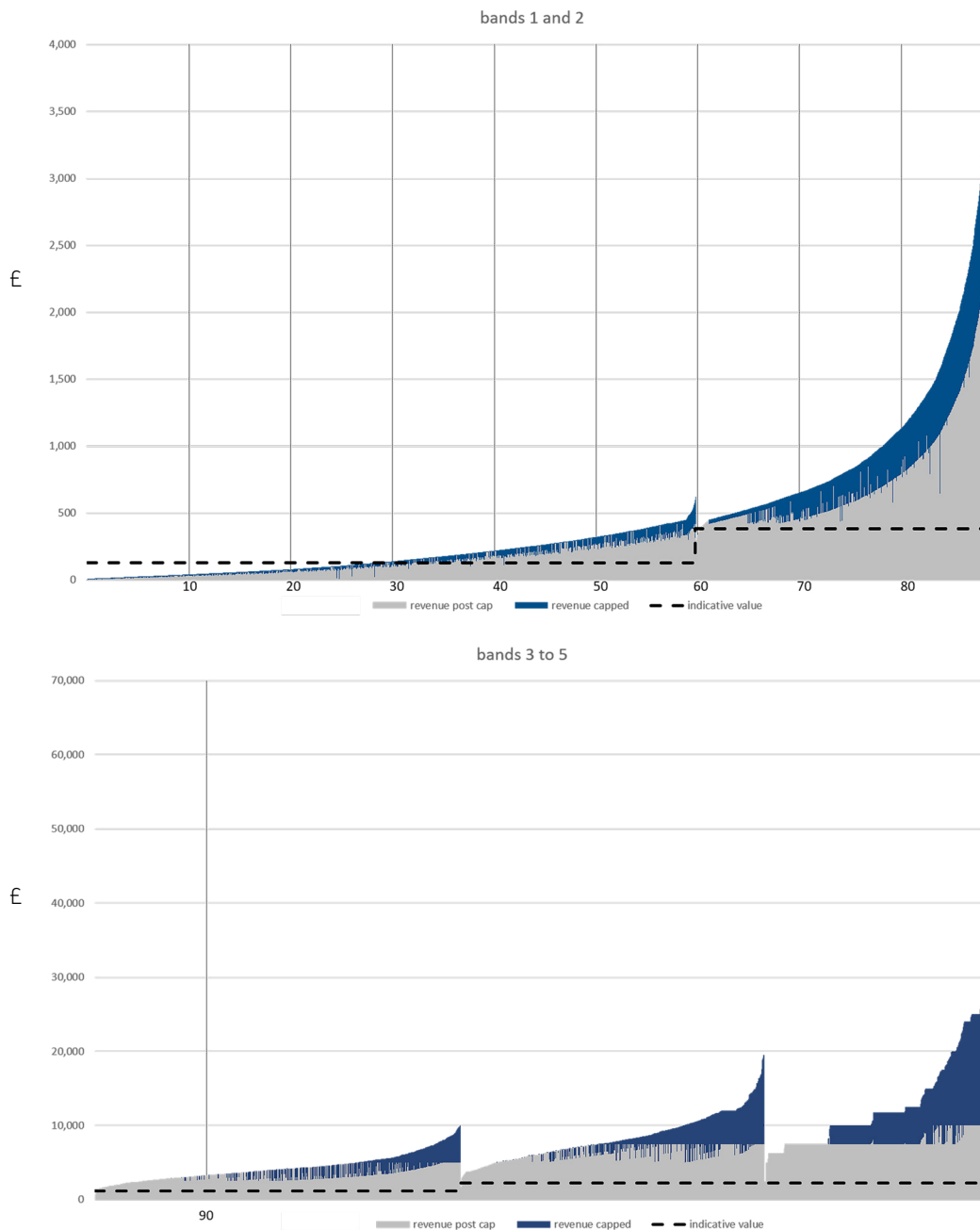
|           |                                                                                                                                                        |
|-----------|--------------------------------------------------------------------------------------------------------------------------------------------------------|
| Consumers | Greater access to justice if consumers make more claims due to lower fees or improved reputation (scope appears small), see paragraph 111              |
|           | Lower awareness of potential claims if there is reduced marketing because of firm exit (scope not clear), see paragraph 103 to 108                     |
|           | Lower access to justice if CMCs introduce or increase thresholds for expected revenue and accept fewer claims (scope appears low), see paragraph 101/2 |
| CMCs      | Higher profits if they attract more claims due to lower fees or improved reputation (scope appears small), see paragraph 111                           |

57. The key assumptions underlying our estimates are set out in the preceding section and any sensitivity analyses are set out in the section Sensitivity testing and in detail in the sections on losses for CMCs, familiarisation and implementation (F&I) costs, and appendices. Results from sensitivity tests do not suggest that one of the alternative caps considered would be preferable.

<sup>13</sup> This loss of profit is considered when assessing whether a CMC will likely exit.

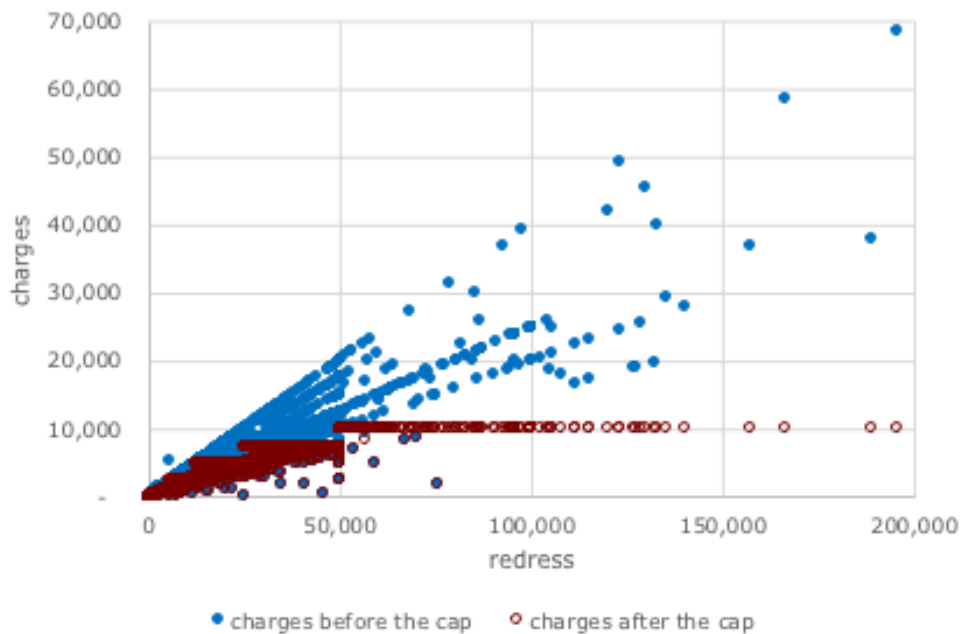
58. Our analysis of costs and benefits indicates that capping CMCs' charges as suggested will lead to a saving on charges of about £9.6m per year for customers of CMCs. Figure 6 below shows the saving to customers (i.e. capped revenue) due to the candidate cap for a sample of 32 CMCs. Figure 7 below illustrates the reduction in charges had the cap applied to the claims in our sample.

**Figure 6: Value and savings to customers due to the candidate cap**



Note: Chart based on 32 firms: a small number of claims managed for business are omitted because they are very different from all other claims. That excludes 1 of the 33 sample CMCs. The vertical axis is slightly truncated to show "value" more clearly. The indicative value is the average value for the individual customer shown in table 4 above.

**Figure 7: Charges plotted against redress before and after the cap (£, sample)**



Note: Some claims with very high redress are omitted to improve readability.

### ***Other rules accompanying the cap***

59. We proxied the costs of getting confirmation that customers are aware of the option to claim without a CMC by the costs of making changes to the customer agreement. Cost estimates provided by CMCs suggest this would cost on average £706 for a CMCs and about £18.9k for all FCA-regulated CMCs managing FS claims. In our view, the benefits of this rule are not reasonably quantifiable. Including these costs, the NAB for the package would be about £8.4m.
60. CMCs already need to inform customers if they have paid a referral fee (CMCOB 4.2.8 (6)) so this clarification does not lead to increased costs or benefits. We believe that asking customers whether they were charged a referral fee in the onboarding conversation (or online form) will cause no or only insignificant additional costs to CMCs.

### ***Costs and benefits of the general amendments***

61. The additional guidance may bring greater clarity for CMCs and consumers. These benefits are not reasonably quantifiable. There are no or minimal (£37.9k) costs from our miscellaneous amendments. Including these costs, the NAB for the package would still be about £8.4m; see paragraph 113 to 116 for details.

### ***Alternative options considered***

62. We considered 13 different specifications of a cap by redress bands and 27 specifications of caps for S&I claims, pension claims, PBA claims and loan claims, i) as percentage of redress, ii) as fixed amount and iii) as a combination of both. We considered 6 percentage caps between 15% and 40% and 3 absolute caps in different combinations (absolute caps of £5k, £10k and £20k for S&I and pension claims and of £500, £750 and £1500 for PBA and loan claims).

- 63.** We have not chosen any of the caps by category of claims which were top-ranked by their NAB because these would likely have led all, or almost all, CMCs to stop managing loan claims and PBA claims because of losses due to the cap. We also considered alternative and complementary interventions but decided not to take them forward. Details are discussed in Chapter 4 of the consultation paper. The following sections discuss the costs and benefits of our proposal in detail.

## Expected costs

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- 64.** This section discusses the expected costs of the proposed intervention, i.e.
- the loss of profits because the cap constrains charges
  - the loss of profits because the cap will likely lead to some exit
  - the impact of key assumptions on our financial analysis
  - F&I costs
  - negative effects due to exit from categories of claims or claims management
- 65.** The proposed cap will reduce profits on FS claims management because
- the cap constrains charging and
  - managing FS claims will no longer be profitable for some CMCs, which will likely exit as a result.

We discuss both effects, limitations of our quantification and sensitivity analysis in detail below.

- 66.** These quantifications are based on per-claim data from our information request from 28 CMCs. Data on direct costs per claim from the remaining 5 CMCs in our sample were not sufficiently granular. We have excluded a small proportion of claims that were managed for business customers because these are very different. Summary statistics for the data used are included in appendix 1. Appendix 3 discusses the technical aspects of this analysis in detail.
- 67.** For the purpose of this assessment we assumed that CMCs would not adjust their business model in response to the cap, e.g. to win more customers through increased advertising. Furthermore, we assumed that customers would not respond to our proposed intervention, e.g. by making a larger proportion of claims without CMCs or by making more claims through CMCs because charges are lower; see the section Key assumptions for details. In our view, it is not reasonably practicable to derive robust estimates of these dynamic effects because information that would allow us to predict reliably how CMCs or consumers would respond is not available.
- 68.** Furthermore, we have only considered those CMCs' claims where, absent a cap, the CMC managing the claims breaks even or makes a profit short-term on the given category of claim (since we assume it would exit the category in case of a loss). We have done this to avoid erroneously attributing losses or exit that would have occurred regardless of our intervention. This assumption and its consequences are discussed in detail below. (The consequences of exit are discussed in detail in a separate section below. Figure 8 in that section illustrates the number of CMCs making a profit (or loss) on the 4 large categories of claims prior to our intervention.)

### **Loss of revenue because the cap constrains charges**

- 69.** The proposed cap constrains charges currently set by CMCs. Hence it reduces their revenue. We have estimated this loss of revenue by comparing the revenue earned absent a cap by all CMCs and the revenue that CMCs would make if the proposed cap applied to claims which CMCs continue to manage after the cap is implemented (i.e. in categories where revenue > direct costs before and after the cap). The resulting loss of revenue (and hence profits) is a cost of about £4.6m to the sample of 28 CMCs (this is the effect 1 discussed in Appendix 3), which translates to a cost of about £9.6m for FCA-regulated management of FS claims. The loss of revenue is the same as loss of profits because we assume that costs remain unchanged for these firms/claims.
- 70.** These losses reflect savings for customers of CMCs, who would pay less for claims management if the cap is in place (i.e. they are a transfer from firms to consumers).

### **Loss of profit to CMCs which no longer manage claims in some categories**

- 71.** When calculating loss of profits, we assume CMCs will exit categories of claims where they make short-term losses. We do not consider exit from claims management altogether (based on long-term profits) because this is likely to be a more long-term decision. Where CMCs become loss-making on categories of claims because of the cap and subsequently exit those categories of claims, they would lose all the revenues they are making absent the cap on those categories of claims. In practice, some exiting CMCs may work through the claims they have already accepted and only lose the portion of revenue on such claims that they would have charged above the proposed cap. Since our aim is to assess effects for a typical year, however, and since loss-making CMCs will eventually exit, we consider that this abstraction is the best reflection of the likely effect of a cap. Summing the estimated profits these CMCs make prior to the cap suggests a loss of about £0.487m for the sample of 28 CMCs (this is the effect 2 discussed in Appendix 3), which translates to a loss of about £1.0m for all FCA-regulated management of FS claims. We discuss what might happen to these claims and other sensitivity analyses below.

### **Impact of key assumptions on our financial analysis**

- 72.** We assume that CMCs will exit (categories or claims management) if they make losses (short-term or in the long-term; see Key assumptions for details). We are conservative by not assuming that loss-making CMCs will stay. This avoids overstating the number of CMCs that will continue to manage claims and hence the viability of FCA-regulated claims management. 11 CMCs in our sample will likely exit regardless of the cap and 4 CMCs because of the cap.
- 73.** Table 10 shows the share of data used in our analyses, which reflects the number and proportion of claims and revenue by the 28 CMCs whose data were used in our financial analysis (which estimates losses to CMCs and profitability before and after a cap). There are two main aspects to our analyses – i) analysis of loss of profits and savings for customers and ii) analysis of exit – and these have different purposes and hence different numbers of claims are used in each case.

**Table 10: Number of claims and revenue used in our analyses**

|                                                                                            | Number of CMCs      | Number of claims | Share of claims | Revenue (£k) | share of revenue |
|--------------------------------------------------------------------------------------------|---------------------|------------------|-----------------|--------------|------------------|
| <b>Loss of profit because the cap constrains charging (effect 1 / a)</b>                   | not applicable (na) | 178,932          | 73%             | 21,050       | 83%              |
| <b>Loss of profit due to likely exit from categories because of the cap (effect 2 / b)</b> | na                  | 1,572            | 1%              | 2,466        | 10%              |
| <b>Claims in categories unprofitable prior to intervention (c)</b>                         | na                  | 63,825           | 26%             | 1,829        | 7%               |
|                                                                                            |                     |                  |                 |              |                  |
| <b>CMCs remaining (i)</b>                                                                  | 13                  | 63,405           | 26%             | 11,342       | 45%              |
| <b>CMCs exiting because of the cap (ii)</b>                                                | 4                   | 20,099           | 8%              | 8,932        | 35%              |
| <b>CMCs unprofitable prior to a cap (iii)</b>                                              | 11                  | 160,825          | 66%             | 5,071        | 20%              |
| <b>Not used (iv)*</b>                                                                      | na                  | 63,726           | 26%             | 1,703        | 7%               |
| <b>Total (a+b+c or i+ii+iii)</b>                                                           | 28                  | 244,329          | 100%            | 25,345       | 100%             |

Note: CMCs which will likely remain in the market in case of the cap are those with a positive LTP (LTP: revenue – total costs) for claims management overall, and a positive STP (STP: revenue – direct costs) for at least one category of claims in case of the cap. CMCs which will likely exit because of the proposed cap make a negative LTP on claims management overall. CMCs which are already unprofitable prior to a cap are those with a negative long-term profit before the cap. Since the number of claims in each category only allowed for a robust analysis for claims relating to S&I, Pension, PBA and loans, we consider STP for these claims only, but LTP for all claims, including e.g. those relating to mortgages or insurance. \*I.e. claims where the category of claims is unprofitable for the CMC before the cap (c) and the CMC is not profitable before the cap (iii). Since claims in iv are those both in c and iii, iv is smaller than c or iii individually.

- 74.** As table 10 shows the analysis of losses of profits and savings for customers is based on about 180,500 (74%) of all claims accounting for 93% of the revenue (a+b). The analysis of exit, which tests the impact of the cap on CMC viability, uses the full dataset to establish which CMCs are in the three groups (i, ii and iii). It focuses on the 17 CMCs that will likely continue to manage claims or exit because of the cap (i+ii). These 17 CMCs managed about 83,500 (34%) claims (accounting for 80% of revenue). We believe our analysis of the quantifiable costs and benefits is robust because the two main elements (loss of profits/savings for customers and likely exit) are based on a large number of claims and large amount of revenue; about £23.5 m (a+b) and £20.3 m (i+ii). Almost all remaining analyses use the same data as our analysis of likely exit.
- 75.** In an alternative analysis of loss of profits to CMCs, we could have included the losses on claims in categories that are loss-making irrespective of the cap; i.e. claims in categories that become unprofitable because of the cap and categories that are unprofitable prior to any cap, lines b and c in table 10 (we have run such an analysis as sensitivity test – see appendix 3, table 3 for effects on profitability). In that case, both the losses and savings because the cap constrains charges would be higher by £1.4m. The NAB would increase by £1.4m under this alternative assumption because these losses reflect savings for consumers.
- 76.** Our consideration of the loss of revenue of CMCs exiting categories of claims does not take into account whether or how these claims would be managed after such exit. Three alternatives are possible in this case:
- a.** no claim
  - b.** claim without a CMC (i.e. direct claim / direct claim, then FOS / FSCS claim)
  - c.** claims through an alternative CMC

In the first two cases, the revenue would be lost to CMCs, in the third an alternative CMC would make revenue on the claim (likely a different amount depending on the charges of this CMC). In the second case, the consumer would save more on fees, but would likely spend more time and effort on progressing the claim.

- 77.** To quantify the net saving in case of a claim without a CMC and/or the loss of revenue/savings because of capped charges if an alternative CMC were used, we would need to know which of the alternatives would apply for each claim. This is not reasonable for us to predict, so we have alternatively considered the evidence we have on what customers might do and how this might affect our assessment.
- 78.** The consumer survey suggests that had the CMC they used declined to progress their claim consumers surveyed would have taken the following alternatives (see figure 4.2. in the survey report):
- 26% to 52% respondents would not have done anything (a)
  - 4% to 17% would have made a direct complaint to the firm (b)
  - 31% to 56% would have made a complaint to ADR<sup>14</sup> (b)
  - 0 to 13% would have made the claim through another CMC (c)
- 79.** Only respondents who had approached the CMC they used (39%)<sup>15</sup> were asked this question. I.e. 37% to 62% (b+c) of 39% would still have progressed their claim. Given the extent of inertia suggested by our bespoke survey, it appears unlikely that a large proportion of the remaining 61% (who did not approach their CMC) would still have made the claim in the absence of the CMC that approached them. Our survey suggests that 54% of customers who make a claim do not look for a CMC, but are contacted by the CMC they use and also that 81% do not consider an alternative CMC to the one they used (see figures 3.2 and 3.6 of the survey report). This suggests that not quantifying the effects for the alternatives has likely no major effect on our analysis.

### Familiarisation and implementation costs

- 80.** In response to our information request CMCs in our sample have provided us with estimates of F&I costs for caps, including a cap designed as percentage of redress up to a fixed amount. For the assessment of candidate caps by redress band we have summed up the F&I costs for all CMCs which will continue to manage FS claims if the proposed cap is implemented. The F&I costs given by these CMCs range from £0 to £43k (with a median of £3k and average of about £6.2k). The total F&I costs are about £81k for the sample of 28 CMCs and about £167k for all FCA-regulated CMCs which manage FS claims. We scaled these costs in the same way as the NAB (see section summary of costs and benefits).
- 81.** Including all F&I costs (regardless of the profitability of the CMCs in the sample prior to the cap or in case of a cap), did not reduce the NAB to a large extent and led to the same ranking of the most beneficial specifications of the cap.

14 The smallest and largest proportion given for direct complaints to the firm and complaints to ADR (b) are for different categories of claim. Hence, the total 37% and 60% is not equal to the sum of the two proportions given. This also applies for b+c, i.e. the total of 37% to 62% given in paragraph 79.

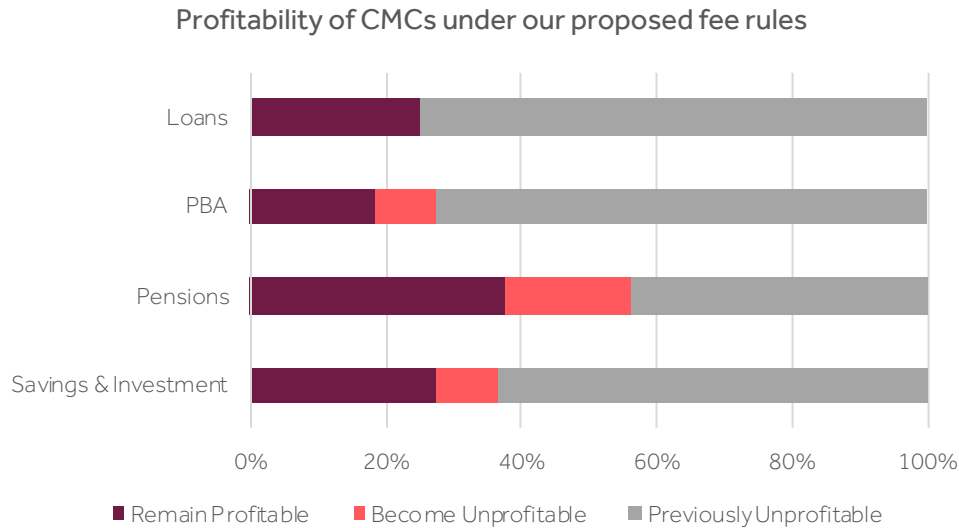
15 Based on responses to question B1 "And thinking about when you enquired about making a claim, if the CMCs you approached had declined to progress your claim, what would you have done instead?". The pilot survey showed that this type of question would not work for respondents who were approached by the CMC.

- 82.** For the analysis of the effects of caps by category of claim we considered the familiarisation costs for CMCs which would likely continue to manage the given category of claim (if their charging would have been constrained by the given cap). The F&I costs are typically small relative to the estimated loss of profits and savings for consumers, in particular for specifications of the cap that yield high savings for consumers.
- 83.** We have assumed that costs for the requirement to change the fee illustration were included in the estimates of implementation costs provided by firms in the data request, because any cap would most likely require changing this illustration in the customer agreement.
- 84.** We believe that the familiarisation costs for the requirement to get written confirmation that consumers understand that they can make their claim without a CMC to the relevant financial services firm or an ADR are marginal to those for the proposed cap and hence insignificant. We have estimated the implementation costs for getting such confirmation based on the costs of making changes to the customer agreement. Estimates for these costs provided by CMCs remaining in the market in case of a cap range from £0 to £3.5k (with a median of £500 and an average of £706). This suggests total costs for such written confirmations of around £9.2k for the sample of CMCs and hence about £18.9k for all FCA-regulated CMCs managing FS claims.
- 85.** Where the cap does not apply, for example charges for unsuccessful claims that are calculated on a per hour rather than on a no-win no fee basis, we require CMCs not to charge in excess of what is reasonable. There are fewer than 10 claims in our sample, which were charged on a basis other than no-win no-fee (charges were calculated by hour). Given the small number of claims, the costs for this requirement are most likely insignificant (even if extrapolated for all FCA-regulated management of FS claims).

### **Negative effects due to exit from categories of claims or claims management**

- 86.** We have chosen the cap to address excessive charges against value for the individual consumer and considered the value to the wider society qualitatively, whilst also maintaining a viable claims management market. There is the possibility, however, that the candidate cap and associated reduction in CMCs' revenue might lead to some CMCs' exit from categories of claims or claims management altogether.
- 87.** Figure 8 below shows the share of CMCs which will likely continue to manage claims, will exit because of the cap or will exit regardless of it, for our sample of CMCs. We anticipate exit from categories of claims when firms make negative profits in the short term (revenue < direct costs) and exit from claims management if they make losses in the long term (revenue < total costs, limitations are discussed in sections on losses for CMCs). Table 11 below also shows the share of claims and revenue accounted for by these three groups of sample CMCs. We use these shares as estimates for all FCA-regulated FS claims management.



**Figure 8: Share of CMCs which are unprofitable prior to the cap, will likely become unprofitable because of the cap or will likely remain profitable in case of the cap**

Note: The figure reflects the number of CMCs given in table 11 below.

**Table 11: Estimated number of CMCs remaining after the cap and their share of claims and revenue (sample)**

|                                                                 | S&I  | Pensions | PBA | Loans | Total |
|-----------------------------------------------------------------|------|----------|-----|-------|-------|
| <b>Number of CMCs currently managing claims in the category</b> | 11   | 16       | 11  | 8     | 28    |
| <b>Number of CMCs remaining</b>                                 | 3    | 6        | 2   | 2     | 13    |
| <b>Proportion of claims</b>                                     | 2%   | 40%      | 34% | 21%   | 26%   |
| <b>Proportion of total revenue</b>                              | 29%  | 57%      | 62% | 49%   | 48%   |
| <b>Number of CMCs exiting*</b>                                  | X1** | 3        | 1   | 0     | 4     |
| <b>Proportion of claims</b>                                     | 57%  | 34%      | 1%  | 0%    | 8%    |
| <b>Proportion of total revenue</b>                              | 60%  | 35%      | 1%  | 0%    | 37%   |
| <b>Number of unprofitable CMCs*</b>                             | X2** | 7        | 8   | 6     | 11    |
| <b>Proportion of claims</b>                                     | 41%  | 25%      | 66% | 79%   | 66%   |
| <b>Proportion of total revenue</b>                              | 11%  | 8%       | 37% | 51%   | 15%   |

Note: \* CMCs exiting are those exiting because of the candidate cap, unprofitable CMCs are those which are likely to exit even in absence of a cap. \*\* Figures are omitted to avoid confidentiality concerns. The total column shows the proportion of claims and total revenue for the 4 categories of claims. Categories of claims where the number of claims was insufficient for a robust analysis are excluded (e.g. claims relating to mortgages or insurance).

- 88.** In each category of claims considered, there are at least 2 CMCs in our sample which make a short-term and long-term profit margin greater than 10% once the cap applies and this translates to at least 6 CMCs in FCA-regulated claims management making a margin of 10% or more. We have used this as an additional test to avoid relying on figures which may include CMCs making margins that might be too small to be sustainable. Scaling based on the regulatory returns available as of 26 October 2020 suggests that a sufficiently large number of FCA-regulated CMCs will continue managing claims in each category (see table 12 below). This reassures us that consumers will still have access to claims management by CMCs.

**Table 12: Estimated number of CMCs remaining and exiting after the cap based on our extrapolated modelling (FCA-regulated claims management)**

|                                                   | S&I | pensions | PBA | loans |
|---------------------------------------------------|-----|----------|-----|-------|
| <b>Number of CMCs remaining</b>                   | 16  | 25       | 10  | 7     |
| <b>of which those with an LT margin &gt; 10%*</b> | 16  | 17       | 10  | 7     |
| <b>Number of CMCs exiting</b>                     | 5   | 12       | 5   | 0     |
| <b>Number of already unprofitable CMCs</b>        | 37  | 30       | 40  | 21    |

Notes: \* The figures for the ST margin are identical to those for LT margins but for pension claims, where an estimated 20 CMCs would make a ST margin of at least 10%. Figures were scaled up by the number of CMCs in the sample in the given category and then multiplied by 1.6 (=223/139) to account for outstanding regulatory returns. E.g. since 11 of the sample CMCs and 37 of the CMCs which submitted a regulatory return manage S&I claims, we calculated that 16 CMCs will remain in that category as  $3 \times 37 / 11 \times 223 / 139$  (=16.19).

- 89.** The number of CMCs still managing claims in each category and making a margin of 10% or more in case of a cap are most likely lower bounds because SRA-regulated CMCs<sup>16</sup> and law firms will also manage claims in these categories. Moreover, some of the unprofitable CMCs might be able to adjust their business model and return to profitability.
- 90.** The results above are derived assuming that CMCs will no longer incur overheads on categories of claims which they will likely exit (revenue < direct costs). We have also run a sensitivity test assuming that CMCs will still incur overheads on categories of claims they will exit. In this case, unprofitable CMCs would make larger losses and remain unprofitable. We found that profitable CMCs would make a smaller profit, but would remain profitable. Hence, the numbers of CMCs that will likely remain in the market or exit remain unchanged.
- 91.** In the following sections, we discuss the possible consequences of exit due to the cap, i.e.
- loss of profits
  - higher fees
  - poorer service
  - lower awareness of the possibility to claims because of reduction in marketing budget

In our view estimating the magnitude of these negative effects is not reasonably possible.

## Loss of profits

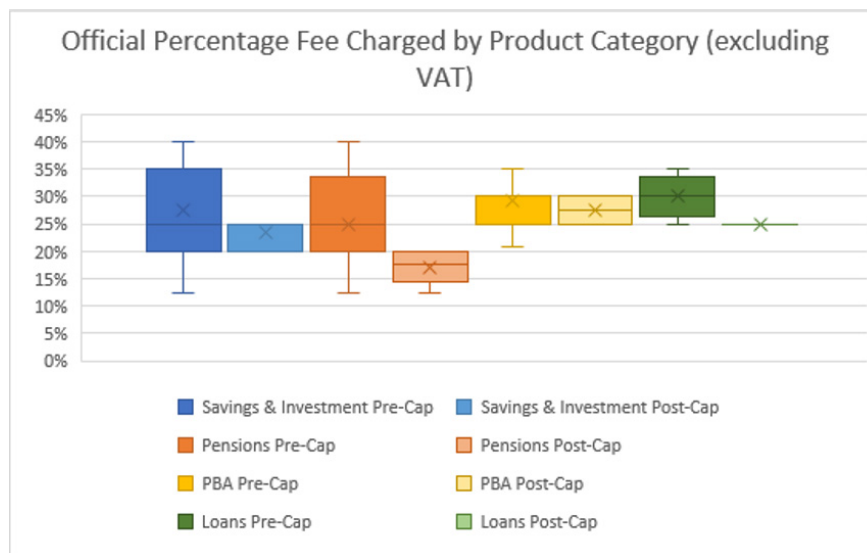
- 92.** The primary impact of exit from claims management, or from certain categories of claim on a CMC, would be the loss of future profits, as well as the cost of winding up the business if the firm were to close entirely. The loss of profits is discussed in sections on losses of profit to CMCs above.

16 The Solicitors Regulation Authority (SRA) regulates law firms, some of which may undertake similar work as FCA-regulated CMCs. The SRA is carrying out a duty equivalent to ours, requiring it to make rules with a view to protecting consumers from excessive CMC fees.

## Higher fees

93. There is a risk that firm exit could lead to lower competition if fewer CMCs compete for some types of claims. The resulting higher fees or reduction in service quality could lead to higher profits for the CMCs remaining, but worse outcomes for consumers using CMCs.
94. Currently CMCs charge a wide range of fees for each category of claims. CMCs which are expected to remain profitable after the implementation of our candidate fee cap, and therefore to remain in the market, are those which currently tend to charge the lowest fees on claims in the different categories, as shown in figure 9 below. Since these lowest-charging CMCs will continue to exert a competitive constraint on each other and the remaining CMCs, we see little scope for a fee increase once the cap is in force.

**Figure 9: Percentage fee charged by category of claims (excl. VAT)**



Note: The thin lines at the top and bottom indicate the minimum and maximum fee without a cap and with the proposed cap. The crosses indicate the average fee, the line in the box the median (i.e. half of the CMCs charge more and half of the CMCs charge less). The lowest 25% of fees charged by CMCs fall below the lower edge of the rectangle, the lowest 75% fees fall below the upper edge of the rectangle. (ie the lower edge of the box indicates the 1<sup>st</sup> quartile and the upper edge the third quartile.)

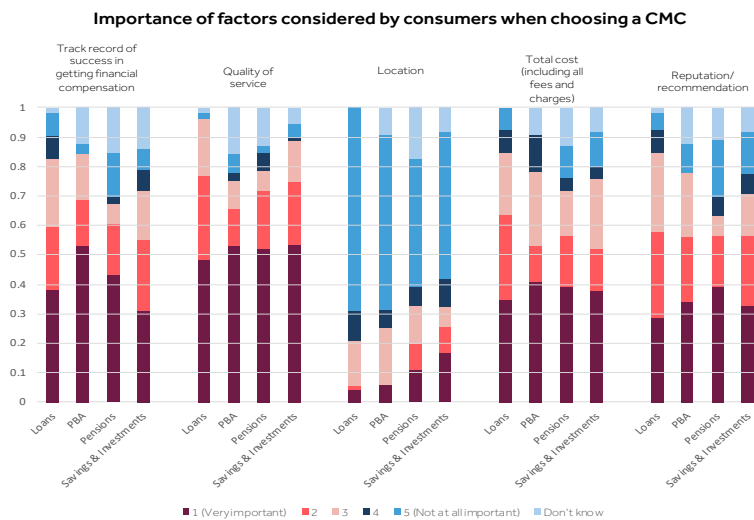
95. The behaviour of consumers using a CMC is unlikely to act as a constraint on CMCs' fees. Customers do not tend to shop around, and a significant proportion of respondents chose to use a CMC because they had been contacted by that firm, and had not intended to use a CMC prior to that contact.
96. The consumer survey showed us that 54% of CMC clients were contacted by the CMC in the first instance, and 81% of consumers did not consider using any other CMC to the one they contracted with. The main reason given for this was that the respondent had been contacted by the CMC, and that they had not planned on using a CMC prior to that initial contact. This was mentioned by 36% of respondents. Finally, 68% of respondents did not consider any alternatives to progressing their claim through a CMC, and 38% of the respondents who approached the CMC they used, said they would not have taken any further actions if that CMC had declined to progress their claim.
97. We also propose to require that CMCs must have their customers confirm that they understand they have an option to make their claims directly or through ADR, without a

CMC, before they enter into a contract. This should improve awareness of alternatives to making a CMC claim. Customers should hence take better-informed decisions on whether to use a CMC. Given customers' apparent inertia, however, it appears unlikely that they become more sensitive to charges by CMCs, and so they would continue not to put pressure on CMC fees.

## Poorer service

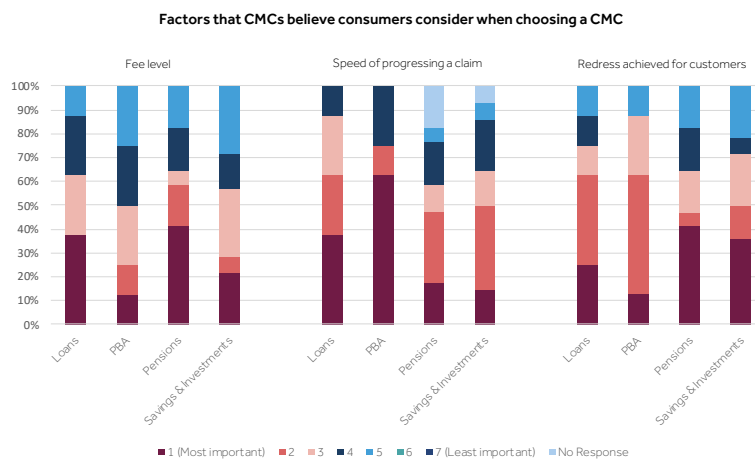
98. Based on responses to our consumer survey, quality of service (such as good communication with the customer and adherence to deadlines) is the most important factor when choosing a CMC. This is reflected in responses from CMCs, with speed of progressing a claim ranking very high (CMCs tended to rank the redress achieved for customers as the most important factor to consumers when choosing CMCs<sup>17</sup>). Figure 10, based on the consumer survey, and figure 11, based on CMC responses to our information request, illustrate.

**Figure 10: Factors considered by consumers when choosing a CMC**



Source: Bespoke consumer survey

**Figure 11: Factors CMCs believe customers care about when choosing a CMC**



Source: Responses from CMCs to our information request

17 This might reflect that some CMCs might not achieve the redress due because they miss deadlines or it might reflect respondents' limited knowledge of the redress system (where the redress on a claim will most likely be the same regardless of whether a CMC is used).

99. In response to our information request, most CMCs indicated that their business model and approach to managing claims would be largely unchanged by a cap. These CMCs tend to charge fees at the lower end of the market.
100. A small minority of CMCs in our sample anticipate an impact on service levels resulting from a fee cap (only 3 out of 33 CMCs in our sample). The most likely effect would be firms reducing the amount of time they spend reviewing and processing each claim. However, given the importance that consumers place on quality of service, most firms responded that they would focus either on reducing their marketing budgets in order to reduce costs, or increasing marketing to raise revenues, if their profits were affected by a prospective fee cap (see below for further detail on effects on the marketing budget). We therefore consider unlikely that the proposed cap will lead to a reduction in the quality of service.

### **Loss of access**

101. There is a risk that customers with lower-value claims could lose access to some CMCs, if firms determine that it would not be worthwhile spending time and resources on a claim that would result in relatively low income. Around 20% of the firms in our sample already impose a threshold on the expected revenue on the claims they accept, particularly for S&I claims and pensions claims. There is a possibility that implementing a fee cap would result in CMCs increasing their threshold or in further firms setting such a threshold.
102. Of the 33 CMCs in the sample, 6 use thresholds (4 for S&I claims, 3 for pension claims, 1 for PBA claims and none for loan claims). Some of these firms may leave the market however, as loss making. Of those that are likely to stay in the market, only 4 use a threshold (3 for S&I claims, 1 for pension claims, and none for loan claims or PBA claims). 3 CMCs indicated that they might impose a threshold in response to a cap (on S&I and pension claims).

### **Lower awareness of possibility to claim because of reduction in marketing budget (in particular for S&I claims)**

103. Another unintended consequence of exit from categories of claims or claims management is the potential reduction in marketing budget. This might reduce consumers' awareness of potential claims they could pursue and hence the number of claims made and redress achieved, leading to consumer harm. The consumer survey indicates that a reduction in marketing could be detrimental to consumers, given that the majority of CMC clients were contacted by the CMC they used, and that around a third of consumers had not planned on using a CMC prior to being contacted by one.
104. To assess the importance of this effect we have estimated the loss of marketing budget due to exit (i.e. the loss of marketing budget of CMCs exiting) and its share of the marketing budget (excluding CMCs which are already loss-making). Scaling up the resulting figure to all FCA-regulated management of FS claims suggests a loss of around 59% of the total marketing budget, amounting to about £1.6m. Estimating the number of claims that might not be made because of this reduction, and the proportion of those claims that would be successful, is not reasonably possible.
105. Table 13 shows that the share of the lost marketing budget for S&I claims is higher than suggested by the proportion of revenue made by CMCs which will likely no longer manage S&I claims. For the remaining categories of claims the share of the marketing

budget lost is roughly in line with the revenue made by CMCs which will likely no longer manage claims in the given category. (Only one of the sample CMCs will likely exit managing PBA claims because of the proposed cap and none will exit managing loan claims because of it.)

**Table 13: Marketing budget potentially lost due to exit (£k)**

| category        | lost marketing, sample | lost marketing, FS claims | share of marketing lost | share of revenue of exiting CMCs* |
|-----------------|------------------------|---------------------------|-------------------------|-----------------------------------|
| <b>S&amp;I</b>  | 586                    | 1,209                     | 99.7%                   | 67.2%                             |
| <b>pensions</b> | 208                    | 430                       | 29.1%                   | 37.8%                             |
| <b>PBA</b>      | 0                      | 0                         | 0.0%                    | 2.0%                              |
| <b>Loans</b>    | 0                      | 0                         | 0.0%                    | 0.0%                              |
| <b>Total**</b>  | 797                    | 1,644                     | 58.7%                   | 43.7%                             |

Notes: S&I: Savings and investments; \*Revenues of CMCs which were loss-making before any intervention are omitted. \*\* The total includes a small loss in marketing budget of about £24k on claims in other categories (for the sample). Of the 28 CMCs in our sample, 4 CMCs will likely exit because of the proposed cap (a small number of CMCs will stop managing S&I claims - details omitted for confidentiality reasons, 3 will likely stop managing pension claims, 1 will likely stop managing PBA claims and none will exit loan claims because of it), see table 11 for details.

- 106.** The figures on marketing budgets provided by CMCs suggest that some CMCs in our sample do not spend on marketing. This might be because they rely on their sales staff to acquire customers instead. However, only 3 of the 13 sample CMCs which do not advertise have indicated sales staff costs (9 sample CMCs in total). It is not clear how important sales staff will be in the future given that a ban on cold-calling came into force in September 2018, i.e. in the period covered by our information request. They might also rely on buying leads (true for 3 of the 13 sample CMCs which did not spend on marketing in FY 2018/19 and for 11 sample CMCs in total). It's also possible that accounting systems for some CMCs are less granular and did not allow them to separately identify marketing costs.
- 107.** We also considered how CMCs which will likely continue managing claims in case of the proposed intervention might adjust their marketing budget (based on their responses to our information request). One of these CMCs told us that they would reduce their marketing budget (but not by how much). One CMC, which did not spend on marketing in FY2018/9, said they would increase their marketing budget to compete more effectively. Those remaining said they would not change their marketing budget, did not comment on marketing or did not spend on marketing in FY2018/9.
- 108.** It is possible that more CMCs will extend their marketing budget than suggested by responses to the information request, to attract more claims in the categories they manage or because they enter new categories of claims. This is plausible if CMCs that responded to our information request expected more CMCs to remain in each category of claim.

### Expected benefits

- 109.** Our analysis of lost revenues for CMCs due to capping charges has shown that the cap reduces charges by about £9.6m in total for all FCA-regulated management of FS claims (about £4.6m for the sample of 28 CMCs). This amount results in equal savings for customers of CMCs, i.e. it is a transfer from CMCs to their customers. (The assumptions and limitations are discussed under Key assumptions and Impact of key assumptions above.)

- 110.** Moreover, we will require that CMCs get confirmation from their customers that they understand that they can make their claim without a CMC, prior to entering a contract. This should ensure that consumers will make better-informed decisions about how to progress their claim. In our view, the benefit to customers of requiring their confirmation is not reasonably quantifiable.
- 111.** It is possible that more consumers will choose to progress a claim with the help of a CMC if fees decrease or the reputation of the claims management market as a whole improves (e.g. because high-cost/high fees CMCs will exit). This would result in greater access to justice for consumers. If that were to happen, CMCs' revenue would increase. Given the degree of customer inertia suggested by our bespoke survey this effect is unlikely to be large.

### Sensitivity testing

- 112.** To assess the robustness of our results we have re-run our analyses under alternative assumptions
- £19 instead of £6.10 as value of time in the analysis of value (see appendix 2 for details)
  - no exit at all when calculating the loss of profit/savings for customers on claims where the cap constrains charges; see section Losses to CMCs
  - added all F&I costs whether the firm exits or not (caps by redress band only). This did not affect the ranking of the candidate caps by redress band (details omitted).
  - that CMCs would continue to incur all overheads.

The results under the alternative assumptions tested do not change our conclusion that the cap ensures an appropriate degree of protection from overcharging (noting that we have assessed the effect on competition only under our key assumptions and the sensitivity for overheads).

### Costs and benefits of general adjustments

- 113.** Changes to our rules which simply correct minor errors or make sure that the Handbook is aligned with FSMA will not lead to additional costs and benefits because the original cost benefit analysis will have reflected the intended rule. The familiarisation, gap analysis and implementation costs are a minimal increment to the F&I costs reported above in relation to the proposed cap.
- 114.** An exception is the additional guidance on pre-contract information (see section 5 of the consultation paper for details):
- a. The pre-contract information relating to bankruptcy, IVAs or similar arrangements clarifies that a CMC is obliged to ask not just about existing arrangements, but past ones as well. If the potential customer is or was affected by those arrangements, any redress might, in certain circumstances, be off-set against their outstanding debts.
  - b. Pre-contract information on the implication of making an unregulated claim requires that CMCs tell their customers when they are undertaking 'unregulated' claims management activities for which customers cannot expect certain protections, e.g. the right to refer a complaint about the CMC to the Financial Ombudsman Service.
- 115.** The additional guidance (on a and b) will provide greater clarity to CMCs and make sure that consumers are aware of all relevant aspects of the service they will get

when deciding whether to make a claim and whether to involve a CMC. In our view, the resulting benefits to CMCs and consumers are not reasonably quantifiable.

- 116.** Since CMCs might amend their customer agreements or call scripts to reflect the additional guidance, they will incur some costs. We estimate that each change to the customer agreement will cost FCA-regulated CMCs managing FS claims £18.9k.<sup>18</sup> This is based on costs provided by firms in response to our information request. The two changes (insolvency and regulatory perimeter) will have a total cost of £37.9k. This is likely an upper bound estimate, however, because the changes will take place alongside the proposed written confirmation that consumers are aware they can use alternative avenues for pursuing claims (see para 84). As up to three changes to customer agreements occur at the same time the total costs will be lower than for three individual changes.

**Q13:** Do you agree with our estimate of the costs and benefits of our proposed interventions?

<sup>18</sup> Using the figure of £18.9k prior to rounding.



## Appendix 1

### Data gathering and cleaning

1. This appendix discusses in turn:
  - our approach to gathering and cleaning the data:
    - from our information request to CMCs
    - from our consumer survey
    - from the ombudsman service and FSCS<sup>18</sup>
    - from CMCs' regulatory returns
  - summary statistics for the data used in our analysis

#### Information request to CMCs

2. We asked CMCs for their customers' contact details and information about their business models, costs, revenues and fee structures (excluding information on PPI claims). The data we requested covered the financial year (FY) 2018/19 (the period from 1 April 2018 to 31 March 2019).

#### Data gathering

3. A total of 355 CMCs applied to the FCA for authorisation as a financial service (FS) CMC by May 2019. From these we excluded from the sample firms that were PPI only and lead generator only (ie firms that introduce customers to other CMCs rather than manage claims directly), as the former are expected to exit the market following the PPI deadline and the latter are typically remunerated by way of a referral fee from a solicitor or case handling CMC rather than by payment from the customer. We also removed CMCs that let us know that they would be winding down, which left approximately 205 CMCs. Of those, only 118 made a revenue on FS claims (based on CMR data dating March 2018).
4. In June 2019, prior to the decision to prioritise FS claims<sup>19</sup>, we sent an information request to 145 CMCs managing claims in all regulated sectors (FS, personal injury, housing disrepair etc). For each sector we selected a range of CMCs with different levels of revenue and numbers of employees based on data we obtained from the CMR.
5. In choosing the 145 firms we contacted, we considered three bands of sector revenues: high, mid and low (by 33 percentiles of revenue, i.e. a third of the CMCs with a positive sector revenue fell into each of the three bands). Then, for each sector and band, we chose the 20% of CMCs that had the largest revenue in each of the three revenue bands. For FS, we additionally aimed to include a sufficient number of CMCs managing each category of claims (based on data gathered from CMCs' websites in February 2019). Following a trial of the information request we replaced 5 CMCs who said they were lead-generators only, or would not hold key information, with similar CMCs.
6. The response rate and quality of the data we received from CMCs in response to this first (June 2019) data request was very poor. Therefore, we issued an expanded information request (with expanded instructions to respond) in December 2019,

<sup>18</sup> We did not consider information from the Pension Ombudsman because only one claim in our sample was decided by this body.

<sup>19</sup> As explained in the consultation paper (CP), we have prioritised making rules for the financial services and products CMC sector and will consider how to use our powers to make such rules for the other sectors after that (see paragraphs 1.6 and 1.28 of the CP).

using our compulsory information gathering powers under s.165 FSMA. Since we decided to prioritise making fee rules for FS, only FS CMCs received this request. 53 firms received the revised request (which at the time, based on CMR March 2018 data, reflected approximately 80% of FS CMC revenue). Of these, 20 firms were subsequently removed from the sample for the following reasons:

- The CMC had an anomalous business model or in 2018/2019 had no claims it classified as successful by the CMC (ie closed claims for which redress was obtained, abbreviated as 'successful claims' in the rest of the document) (3 CMCs)
- The CMC failed to respond to the FCA request and subsequent emails (3 CMCs)
- The CMC was winding down their business and leaving claims management (8 CMCs)
- The data provided was not usable due to poor quality (5 CMCs)
- Illness (1 CMC)

This left 33 firms in our sample.

7. It became evident that CMCs struggled to provide information on direct costs per claim, so we decided to accept firms' estimates of such direct costs and issued an additional clarification note (February 2020) with suggestions on how these estimates could be calculated.
8. Prior to receipt of the data, we held bilateral phone calls with 27 CMCs to assist them in completing the request and to understand more about their business models. We provided firms with continual support during data collection, by answering queries by phone and/or email. On receipt of the data, we checked all submissions thoroughly and sent follow up queries to almost all CMCs. In some cases, a third round of follow up queries were required.

### **Impact of the coronavirus situation on data collection and consultation**

9. At the start of the coronavirus pandemic, CMC revenue had fallen by 30% during April 2020. Additionally, some CMCs decreased their activities and/or furloughed their workers during this period. The pandemic also caused some CMCs to delay their final data submissions. We offered CMCs extensions where appropriate and took their circumstances into account. Between 17 March and 3 April 2020, we received emails from 23 of the firms in our sample asking for extra time to provide information to us. Of those 23, 12 mentioned the coronavirus situation. Issues mentioned included having reduced capacity due to home working and setting that up, and having trouble working with accountants. We accommodated the extra time requested. We received submissions from 33 CMCs, which constitute our final sample.

### **Data Cleaning Inconsistencies**

10. In the first instance, we requested that firms reconcile any inconsistencies in their submission in response to our information request. Where inconsistencies remained, we reconciled them by analysing the whole information request to identify the likely cause.
11. VAT was reported inconsistently by firms in our sample. We identified 11 firms which had included 20% VAT in the revenues and/or costs reported in their data

request submission. Where VAT was not excluded by the firm, we removed the VAT from revenue and costs as required, so that the figures matched across the whole information request and were consistently reported excluding VAT.

12. Other instances of inconsistency involved mismatches across different parts of the information request, for example entries where the sum of revenue and/or cost data in the transaction-level data did not match the corresponding revenue and costs information in the section on claims management. Where inconsistency remained after requesting that the firm correct the information request, we examined the data request to determine the best way to deal with the issue.

### **Customer IDs**

13. Some CMCs in our sample provided transaction level datasets where certain customer IDs were used more than once but contained different demographic data. Where firms did not amend these duplications when requested and where a single ID was clearly used for two different customers, we amended the IDs so they were two unique IDs.

### **Claims with unclear closing dates**

14. In our data request, we had requested that CMCs only report revenue which was received during FY 2018/19. However, several CMCs submitted data on work-in-progress claims or claims with closing dates after FY 2018/19, which had resulted in revenue to the firms.
15. The revenue for a portion of these claims was due to interim payments. In these cases, no changes were made (ie revenue continued to be recorded as made in FY 2018/19). Where it was not clear whether the revenues were made in FY 2018/19 or later, we included the revenue from these claims as made in FY 2018/19 (ie considered in our analyses).

### **Claims with missing Claim Outcome**

16. We marked 24 claims with missing data on outcomes which had revenue or redress as successful. 4 of these claims with revenue had non-percentage fee income revenue only.

### **Overheads**

17. Some CMCs did not include overheads broken down by claim category. As some parts of our financial analysis<sup>20</sup> required this level of detail, the missing overheads were imputed by taking the median overheads per claim for each category of claim and scaling that to each firm missing one or more overheads for categories of claim (ie for each CMC which provided overheads by category of claims, we divided the overheads for a given category of claim by the number of claims in that category). We took the median overheads per claim by category of claims across these CMCs and multiplied it by the number of claims managed in each category by the CMCs with missing data. For example, if the median for S&I was £161 per claim and the median for Pensions was £207 per claim and a CMC managed 80 S&I claims and 20 Pension claims, the calculation would be 80\*161 for S&I and 20\*207 for Pensions. We then applied a scaling factor per CMC based on the total overheads they provided and the total overheads we calculated. For example, if we imputed that a CMC had total overheads of £486k and they provided a figure for total overheads of £295k, we applied a scaling factor of 0.61 to each category of claims they managed, to bring the total overheads back to the figure provided by the CMC. This ensured the imputed overheads breakdown for each CMC reconciled back to the

20 Financial analysis refers to the assessment of 1) losses for CMCs because of the proposed cap, 2) savings for consumers because the proposed cap constrains charging and 3) firms' profitability underlying our analysis of exit. This analysis is described in our CBA and appendix 3.

total overheads figure provided by each CMC.

### **Replacement across tables**

**18.** Some CMCs provided incomplete responses to the information request in one or more of the tables. Where firms did not correct this when requested, we replaced it with data from other tables in the information request where this was possible, for example, data on overheads in the table on CMCs' wider business with overheads data provided in the table on the claims management business.

### **Data received and cleaned**

**19.** We received complete data from 28 of the 33 CMCs forming our sample. The data we received is divided into the following two groups:

- Group 1 contains data from 28 firms which submitted complete responses and whose data has been used in the financial analysis.
- Group 2 contains data from Group 1 plus the additional 5 firms which are used for parts of the analysis. Data from these 5 firms have been excluded from the financial analysis and analyses building on it because sufficiently granular cost data was not provided. However, the information provided by these 5 CMCs has been included wherever possible and useful, e.g. when considering information on thresholds used by CMCs when deciding whether to manage a claim.

**Table 1.1: Number of submissions and total revenue by category (Group 1)**

| Category                | Number of Firms | Total Revenue (£) |
|-------------------------|-----------------|-------------------|
| Savings and Investments | 11              | 8,303,911         |
| Pensions                | 16              | 10,947,672        |
| Insurance               | 3               | 26,528            |
| Mortgages               | 6               | 1,281,002         |
| Packaged Bank Accounts  | 11              | 3,321,973         |
| Loans                   | 8               | 1,150,795         |
| Credit Cards            | 0               | -                 |
| Other                   | 2               | 313,249           |

Note: The number of submissions does not sum to 28 because some CMCs manage claims in more than one category.

**Table 1.2: Number of submissions and total revenue by category (Group 2)**

| Category                | Number of Firms | Total Revenue (£) |
|-------------------------|-----------------|-------------------|
| Savings and Investments | 15              | 9,307,859         |
| Pensions                | 19              | 11,781,081        |
| Insurance               | 3               | 26,528            |
| Mortgages               | 8               | 1,782,580         |
| Packaged Bank Accounts  | 12              | 3,494,546         |
| Loans                   | 9               | 1,281,083         |
| Credit Cards            | 0               | -                 |
| Other                   | 4               | 420,408           |

Note: The number of submissions does not sum to 33 because some CMCs manage claims in more than one category.

### **Representativeness of the data**

**20.** Our analysis of cleaned data from regulatory returns shows that our sample of 28 CMCs covers ca. 49% of the revenue of FS CMCs (ca. 55% for the sample of

32 CMCs, omitting 1 CMC which managed claims for businesses; see the section on Regulatory returns below for details). For each category of claims, we also compared the revenues from regulatory returns of all CMCs and revenues from regulatory returns of our sample CMCs and concluded that our sample covers a wide range of revenue categories. We therefore consider our sample to be a satisfactory reflection of FCA-regulated management of FS claims and a suitable basis for the design of fee rules.

## CMC Summary Statistics

### Number and types of claims

21. In response to our information request, 33 claims management companies not in winddown have provided data on a total of 252,995 claims active during the FY 2018/19. The mean number of claims managed by a CMC was 7,667 and the number of claims managed by CMCs in the sample ranged from 9 to 75,263.
22. In total, there were 171,293 claims closed during FY 2018/19. Across all CMCs, there was a claim success rate of 13% (where the denominator includes all closed claims, including cancelled claims).

**Table 1.3: Number (N) of claims and CMCs by category**

| Category     | N firms   | N claims       | N closed claims | N successful claims | Success rate (%) |
|--------------|-----------|----------------|-----------------|---------------------|------------------|
| S&I          | 15        | 31,266         | 24,364          | 3,771               | 15               |
| Pensions     | 19        | 11,446         | 6,026           | 2,121               | 35               |
| PBA          | 12        | 126,905        | 82,940          | 11,117              | 13               |
| Loans        | 9         | 82,240         | 57,069          | 4,600               | 8                |
| Insurance    | 3         | 127            | 122             | 19                  | 16               |
| Mortgages    | 8         | 845            | 620             | 140                 | 23               |
| Other        | 4         | 136            | 124             | 40                  | 32               |
| Missing      | 1         | 30             | 28              | 7                   | 25               |
| <b>TOTAL</b> | <b>33</b> | <b>252,995</b> | <b>171,293</b>  | <b>21,875</b>       | <b>13</b>        |

Note: S&I: Savings and investment; For 30 claims the category was not given (recorded under "Missing").

### Redress

23. The mean redress for successful claims was £5,163 (standard deviation (sd)<sup>21</sup> = £14,788) and the median was £1,042. The range of redress was £-642 to £1,150,847 (1st quartile: £325, 3rd quartile: £2,674). The negative redress was queried with the firm and it was decided that we would keep the value as submitted. This is likely a balance adjustment to a claim across two financial years.

21 The standard deviation (sd) is the measure of variation within a set of values. A small sd means the values are typically close to the mean and a larger sd means values are dispersed over a wide range.

**Table 1.4: Consumer redress by category of claim (£)**

| Category  | Number of successful claims | Mean redress | Standard deviation | Min redress* | Median redress | Max redress |
|-----------|-----------------------------|--------------|--------------------|--------------|----------------|-------------|
| S&I       | 3,771                       | 7,717        | 13,567             | 0            | 3,365          | 195,562     |
| Pensions  | 2,121                       | 27,316       | 20,777             | -642         | 25,102         | 218,277     |
| PBA       | 11,177                      | 1,053        | 1,022              | 0            | 753            | 9,460       |
| Loans     | 4,600                       | 961          | 1,267              | 0            | 536            | 17,523      |
| Insurance | 19                          | 4,971        | 5,906              | 32           | 1,673          | 19,563      |
| Mortgages | 140                         | 51,375       | 31,332             | 427          | 50,000         | 100,000     |
| Other     | 37                          | 64,962       | 185,896            | 0            | 26,675         | 1,150,847   |
| Missing   | 7                           | 1,626        | 2,559              | 0            | 315            | 6,758       |

Note: S&I: Savings and investment. \* Some successful claims had zero redress, usually because the problem did not cause a financial loss to the customer.

### Revenue

**24.** The mean revenue for closed claims that generated any form of revenue was £1,297 (standard deviation = £3,085). Closed claims refers to any claim that reached an outcome in FY 2018/19 (redress, no redress, cancelled etc).

**Table 1.5: Revenue for closed claims that generated revenue, by category (£)**

| Category  | Number of claims | Mean revenue | Standard deviation | Min revenue | Median revenue | Max revenue |
|-----------|------------------|--------------|--------------------|-------------|----------------|-------------|
| S&I       | 3,553            | 2,620        | 4,101              | 1           | 1,278          | 68,447      |
| Pensions  | 2,095            | 5,625        | 4,871              | 9           | 4,832          | 87,311      |
| PBA       | 11,114           | 314          | 308                | 1           | 224            | 2,838       |
| Loans     | 4,676            | 274          | 357                | 1           | 155            | 4,381       |
| Insurance | 19               | 1,379        | 1,492              | 11          | 579            | 4,595       |
| Mortgages | 141              | 12,642       | 7,921              | 119         | 12,500         | 25,000      |
| Other     | 44               | 9,119        | 9,936              | 0           | 5,980          | 50,138      |
| Missing   | 6                | 703          | 1,015              | 28          | 176            | 2,534       |

Note: S&I: Savings and investment

**25.** Although there are a number of potential types of revenue for claims management companies, percentage fee income forms the whole revenue for 99% of all closed claims that generated revenue.

### Revenue as a percentage of redress

**26.** The average closed claim (that generated revenue) has revenue as a percentage of redress of 30% (sd = 5%). Table 1.6 shows summary statistics revenue as a percentage of redress for each category of claim.

**Table 1.6: Revenue as a percentage of redress by category**

| Category         | revenue as % of redress, mean | Standard deviation | revenue as % of redress, median |
|------------------|-------------------------------|--------------------|---------------------------------|
| <b>S&amp;I</b>   | 34                            | 6                  | 35                              |
| <b>Pensions</b>  | 21                            | 7                  | 20                              |
| <b>PBA</b>       | 30                            | 2                  | 30                              |
| <b>Loans</b>     | 29                            | 4                  | 30                              |
| <b>Insurance</b> | 32                            | 6                  | 35                              |
| <b>Mortgages</b> | 24                            | 3                  | 25                              |
| <b>Other</b>     | 25                            | 16                 | 25                              |
| <b>Missing</b>   | 33                            | 7                  | 37                              |

### Direct costs

**27.** The tables relating to direct costs are based on submissions by the 28 CMCs which submitted usable data on direct costs per claim. The mean direct costs for closed claims was £61 (regardless of whether successful or not). For work in progress claims, this was £59.

**Table 1.7: Total direct costs for all closed claims (£)**

| Category         | Number of claims | Mean direct costs | Standard deviation | Min direct costs | Median direct costs | Max direct costs |
|------------------|------------------|-------------------|--------------------|------------------|---------------------|------------------|
| <b>S&amp;I</b>   | 21,302           | 147               | 136                | 0                | 121                 | 5,223            |
| <b>Pensions</b>  | 5,438            | 590               | 904                | 0                | 144                 | 6,143            |
| <b>PBA</b>       | 80,869           | 22                | 21                 | 0                | 11                  | 402              |
| <b>Loans</b>     | 55,593           | 10                | 22                 | 0                | 3                   | 331              |
| <b>Insurance</b> | 122              | 158               | 491                | 3                | 64                  | 2,799            |
| <b>Mortgages</b> | 508              | 1,953             | 2,249              | 14               | 1,076               | 12,512           |
| <b>Other</b>     | 119              | 2,241             | 1,371              | 400              | 3,452               | 5,057            |

**Table 1.8: Total direct costs for work in progress claims**

| Category                       | Number of claims | Mean direct costs | Standard deviation | Min direct costs | Median direct costs | Max direct costs |
|--------------------------------|------------------|-------------------|--------------------|------------------|---------------------|------------------|
| <b>Savings and Investments</b> | 6,623            | 127               | 208                | 17               | 64                  | 2,546            |
| <b>Pensions</b>                | 4,882            | 568               | 561                | 21               | 447                 | 2,939            |
| <b>PBA</b>                     | 43,712           | 12                | 36                 | 0                | 3                   | 340              |
| <b>Loans</b>                   | 25,050           | 16                | 22                 | 0                | 5                   | 107              |
| <b>Insurance</b>               | 2                | 2,799             | 0                  | 2,799            | 2,799               | 2,799            |
| <b>Mortgages</b>               | 98               | 1,505             | 549                | 141              | 1,908               | 2,012            |
| <b>Other</b>                   | 7                | 3,069             | 1,016              | 765              | 3,452               | 3,452            |

### Overheads

**28.** Only overheads at an aggregate level are presented here as a number of firms did not provide data for overheads for some or all categories of claims. These were imputed where possible for the financial analysis (see paragraph 17 above). The mean overheads were £142,008 (sd = £159,305).

**Table 1.9: Total overheads incurred by CMCs (£)**

| Mean overheads | Standard deviation | Min overheads | Median overheads | Max overheads |
|----------------|--------------------|---------------|------------------|---------------|
| 142,008        | 159,305            | 3,627         | 93,703           | 667,129       |

29. A number of sample CMCs had additional revenue, such as from lead generation or management of PPI claims. 15 of the 33 sample CMCs managed PPI claims, which accounted for between 1% and 99% of their total revenue. For 10 firms, PPI claims accounted for 50% or more of their revenue. Only one CMC had lead-generation business (which accounted for 86% of its total revenue). 6 sample CMCs had revenue from other business, which accounted for between 1% and 44% of their total revenue.

### IFF Consumer Survey

30. As part of the information request of June 2019, we gathered customer contact details with a view to conducting a bespoke customer survey. 61 CMCs of the 145 CMCs that we contacted in June 2019 provided customer contact details as part of their response, which were used by IFF to carry out a CMC consumer survey. Further details regarding the survey sample and resulting number of responses are available in the IFF Financial Services Report.<sup>22</sup>

### Financial Ombudsman Service, FSCS and Pension Ombudsman

31. We obtained data on financial services claims from the FSCS, the ombudsman service and the Pension Ombudsman. We decided to use the per-claim data provided by CMCs because it included information on direct costs per claim which was important for our analysis. We also obtained qualitative information from the ombudsman service which we used to inform our proposed rules and our judgement on the correct multiplier to be applied on time spent by CMCs (in the analysis of value of claims management for customers).

### Regulatory returns

32. Starting from 29 June 2019, CMCs are required to submit annual regulatory returns to the FCA. With few exceptions, the first round of regulatory returns covers the period from April 2019 to the CMC's latest reporting date, see details [here](#). The FCA is currently receiving these returns from firms, however, so far, many returns have been delayed due to the coronavirus situation. In addition, the data in many of the returns that have been received is of poor quality. (The FCA is continuing to work with CMCs to submit the required data promptly and correctly.)
33. The regulatory returns data is useful for the cost benefit analysis of the proposed intervention as it includes: revenues, number of claims and successful claims, including data by product type. We use this data to scale up results from our sample of CMCs to all FCA-regulated management of FS claims and to assess how representative the sample data is of the current FCA-regulated claims management.
34. By 26 October 2020, we had received regulatory returns from 492 CMCs. In total 702 firms hold either full authorisation or temporary permissions for claims

<sup>22</sup> <http://recmgmt.is.fsa.gov.uk/livelink/livelink?func=ll&objaction=overview&objid=64191489&viewType=1> [Link to be updated pre-publication]



management. There are around 273 FS CMCs among these firms. We estimate that around 223 of these are not PPI-only CMCs. However, a minority of these firms will not yet have reached the end of their first regulatory reporting period.

### **Data cleaning**

- 35.** The system allows CMCs to submit several regulatory returns for the same reporting period, e.g. to correct discrepancies, and many CMCs have done that. Newly-received regulatory returns were compared against any previously submitted returns and duplicated or superseded returns. We have introduced a series of validation rules to the returns, where possible, to ensure that the submitted figures are internally consistent.
- 36.** Completed returns were only omitted or removed from the dataset if we received a subsequent submission for the same regulatory period from the CMC. If a CMC leaves a partially-completed return in the system for a period of time, then the system automatically closes it off and submits it as an 'incomplete' return. In addition, we removed partially completed returns on submission of a complete return. We have also received a small number of 'test' submissions which have obviously been completed with dummy data. We removed such returns.
- 37.** Revenue in regulatory returns which did not cover a whole year were scaled up to a year. Scaled revenues for each CMC were calculated as follows:

$$\text{revenue} / (\text{return period in days} / \text{one year in days})$$

- 38.** Our analysis considered only (cleaned) data from regulatory returns by CMCs that 1) have not told us that they are winding down or 2) did not only report revenue from managing PPI claims. 110 firms with revenue on FS claims were included in the analysis. 29 additional firms with relevant permissions did not report revenue on managing FS claims. 5 of our sample CMCs had not yet submitted a regulatory return. We estimate that around 223 FS CMCs are not PPI-only CMCs (table 6 in Annex 2 summarises).
- 39.** Tables 1.10 and 1.11 provide number of firms and corresponding revenue. The seemingly implausibly high proportion of CMCs managing mortgage claims in our sample likely reflect the incompleteness of the regulatory returns. The apparent high share of mortgage revenue accounted for in our sample could be due to the same reason and also year on year fluctuations in business for some CMCs. This also applies to revenue on PBA claims and S&I claims. None of the FS CMCs reported revenue on insurance claims or credit card claims in their regulatory returns. Table 1.12 is used to scale up sample results for our analysis of exit in the CBA.

**Table 1.10: Number of CMCs managing claims in each product category from Regulatory Returns**

| Category                                 | FS CMCs (excl. PPI-only) | Sample of 28 CMCs | Sample of 33 CMCs | 28 CMCs as % of FS CMCs (excl. PPI only) | 33 CMCs as % of FS CMCs (excl. PPI only) |
|------------------------------------------|--------------------------|-------------------|-------------------|------------------------------------------|------------------------------------------|
| Pensions                                 | 43                       | 16                | 19                | 37%                                      | 44%                                      |
| Savings and Investments                  | 37                       | 11                | 15                | 30%                                      | 41%                                      |
| Packaged Bank Accounts                   | 35                       | 11                | 12                | 31%                                      | 34%                                      |
| Loans (consumer credit)                  | 18                       | 8                 | 9                 | 44%                                      | 50%                                      |
| Mortgages                                | 6                        | 6                 | 8                 | 100%                                     | 133%                                     |
| Insurance                                | -                        | 3                 | 3                 | n/a                                      | -n/a                                     |
| Credit cards (payment card bank charges) | -                        | -                 | -                 | n/a                                      | n/a                                      |
| Other                                    | 4                        | 2                 | 4                 | 50%                                      | 100%                                     |

**Table 1.11: Revenue of CMCs managing claims in each product category (£k) from Regulatory Returns**

| Category                                 | All FS CMCs (excl. PPI-only) | Sample of 28 CMCs | Sample of 33 CMCs | 28 CMCs as % of FS CMCs (excl. PPI only) | 33 CMCs as % of FS CMCs (excl. PPI only) |
|------------------------------------------|------------------------------|-------------------|-------------------|------------------------------------------|------------------------------------------|
| Pensions                                 | 21,181                       | 10,948            | 11,781            | 52%                                      | 56%                                      |
| Savings and Investments                  | 7,843                        | 8,304             | 9,308             | 106%                                     | 119%                                     |
| Packaged Bank Accounts                   | 2,153                        | 3,322             | 3,495             | 154%                                     | 162%                                     |
| Loans (consumer credit)                  | 5,004                        | 1,151             | 1,281             | 23%                                      | 26%                                      |
| Mortgages                                | 1,374                        | 1,281             | 1,783             | 93%                                      | 130%                                     |
| Insurance                                | -                            | 27                | 27                | -                                        | -                                        |
| Credit Cards (payment card bank charges) | -                            | -                 | -                 | -                                        | -                                        |
| Other                                    | 436                          | 313               | 420               | 72%                                      | 96%                                      |

**40.** The information in table 1.11 sums to the total revenue for the FS CMCs that submitted regulatory returns, shown in table 1.12 below. We scaled up these revenues in light of the number of returns submitted and the number of returns expected, as shown in the note to table 1.12, and we used the resulting share of 48.5% (representing revenues in our sample as a proportion of the revenue of the population) to scale up results from our sample to the population of FS CMCs we regulate.

**Table 1.12: FCA-regulated FS claims management revenue and our sample's share of FS revenues (scaled up from FS revenues in regulatory returns to date) (£m)**

| Category                                                  | All FS CMCs submitting regulatory returns (£m) | Sample of 28 CMCs (24 CMCs submitted) (£m) | Sample of 33 CMCs (28 CMCs submitted) (£m) | Share 28 CMCs | Share 33 CMCs |
|-----------------------------------------------------------|------------------------------------------------|--------------------------------------------|--------------------------------------------|---------------|---------------|
|                                                           | (a)                                            | (b)                                        | (c)                                        | (b/a)         | (c/a)         |
| <b>total for CMCs which submitted returns</b>             | 37.991                                         | 25.345                                     | 28.094                                     | 66.7%         | 73.9%         |
| <b>total for all FS CMCs</b>                              | 61.009*                                        | 29.569**                                   | 33.111 <sup>+</sup>                        | 48.5%         | 54.3%         |
| <b>Total (for all, but 1 CMC, working for businesses)</b> | 61.009*                                        | 29.569**                                   | 33.297 <sup>++</sup>                       | 48.5%         | 54.6%         |

Note: \*£37.991m/139x223; \*\* £25.345m/24x28; + £28.094/28x33; ++ £28.094/27x32; 139 FS CMCs which do not only manage PPI claims have submitted a regulatory return before 26 October 2020, ca. 223 are expected to do so. 5 sample CMCs had not submitted a return by that date, among them the sample CMC managing claims for businesses. This CMC is not included in the sample of 28 CMCs.

## Appendix 2

### Further results of our analyses

#### Further information on the factor 2 for estimating time spent on a claim without a CMC

1. We have assumed that a customer managing a claim without a CMC would spend on average twice as much time as the estimated time spent by a CMC on managing a claim in a category (PBA, pensions etc.). In this section, we explain the basis for this assumption. Based on the FCA's extensive experience with the redress system we considered the steps a consumer would need to take to manage:

- a typical straightforward claim (such as a loan claim or PBA claim) or
- a typical complex claim (such as a savings and investment (S&I) claim or pensions claim)

with and without a CMC until it reaches a decision; see table 2.0 below. Looking at the mid-point of the ranges it can be seen that the total number of hours spent without a CMC is less than twice the time spent using a CMC. We have rounded to a factor of 2 to avoid spurious accuracy.

**Table 2.0: Steps to manage a claim with and without a CMC (hours)**

| Task                                                                                | Straightforward   |                 | Complex        |                 |
|-------------------------------------------------------------------------------------|-------------------|-----------------|----------------|-----------------|
|                                                                                     | no CMC            | With CMC        | no CMC         | With CMC        |
| Identifying issue and gathering evidence for complaint                              | 0.5 - 3           | 0.5 - 2         | 4 - 8          | 2 - 6           |
| Selecting and signing up with CMC                                                   | 0                 | 0.5 - 2.5       | 0              | 0.5 - 3         |
| Submitting complaint to firm                                                        | 0.5 - 1.5         | 0               | 1 - 3          | 0               |
| Responding to requests for additional information*                                  | 0 - 2             | 0 - 1           | 2 - 8          | 1 - 5           |
| Considering firm's response**                                                       | 0.5 - 2           | 0 - 1           | 2 - 6          | 0 - 2           |
| <b>Subtotal (assuming no referral to Financial Ombudsman Service)</b>               | <b>1.5 - 8.5</b>  | <b>1 - 6.5</b>  | <b>9 - 23</b>  | <b>3.5 - 16</b> |
| Submission to Financial Ombudsman Service and introductory call                     | 0.5 - 2           | 0 - 1           | 2 - 4          | 0 - 1           |
| Responding to requests for additional information*                                  | 1 - 2             | 0 - 1           | 2 - 6          | 1 - 3           |
| Considering investigator's opinion**                                                | 0.5 - 2           | 0 - 1           | 2 - 6          | 0.5 - 3         |
| Appealing investigator's opinion and responding to requests for further information | 0.5 - 2           | 0 - 1           | 2 - 6          | 0 - 2           |
| Considering ombudsman's final decision**                                            | 0.5 - 2           | 0 - 1           | 1 - 4          | 0 - 2           |
| <b>Total</b>                                                                        | <b>4.5 - 18.5</b> | <b>1 - 11.5</b> | <b>18 - 49</b> | <b>8.5 - 27</b> |
| <b>Total (mid-point)</b>                                                            | <b>11.5</b>       | <b>6.3</b>      | <b>33.5</b>    | <b>17.8</b>     |

Note: \* including administrative tasks such as chasing or requesting updates, \*\* including offer of redress where one made; source: FCA experience with the redress system.

## Results for the analysis of value using a value of time of £19

2. Tables 2.1 to 2.4 below show the results of the analysis of value presented in tables 2 to 5 of our CBA using the rate for a self-represented litigant of £19 per hour instead of the value of time (VoT) from DfT's tag data book of £6.10.

**Table 2.1: Key results of the analysis by category of claims (VoT £19)**

|                                                         | S&I   | pensions | PBA | loans |
|---------------------------------------------------------|-------|----------|-----|-------|
| <b>time spent (hours) by consumer without a CMC (a)</b> |       |          |     |       |
| average                                                 | 63    | 87       | 10  | 20    |
| lower bound                                             | 32    | 49       | 6   | 10    |
| upper bound                                             | 94    | 124      | 15  | 31    |
| <b>time spent (hours) by consumer with a CMC (b)</b>    |       |          |     |       |
| average                                                 | 5     | 13       | 3   | 10    |
| lower bound                                             | 4     | 11       | 3   | 7     |
| upper bound                                             | 6     | 15       | 3   | 13    |
| <b>monetised time saved (a – b)x£19</b>                 |       |          |     |       |
| average                                                 | 1,106 | 1,401    | 142 | 192   |
| lower bound                                             | 532   | 729      | 68  | 49    |
| upper bound                                             | 1,679 | 2,072    | 223 | 334   |

Note: S&I: savings and investments.

**Table 2.2: Interim step: Weighting the time saved (sample)**

| band | S&I          |                                | pensions     |                          | PBA          | loans                      |              |                          |
|------|--------------|--------------------------------|--------------|--------------------------|--------------|----------------------------|--------------|--------------------------|
|      | nr of claims | weight (s <sub>S&amp;I</sub> ) | nr of claims | weight (s <sub>p</sub> ) | nr of claims | Weight (s <sub>PBA</sub> ) | nr of claims | Weight (s <sub>L</sub> ) |
| 1    | 1,046        | 8%                             | 101          | 1%                       | 8,416        | 63%                        | 3,827        | 29%                      |
| 2    | 2,460        | 36%                            | 444          | 7%                       | 2,963        | 44%                        | 880          | 13%                      |
| 3    | 608          | 51%                            | 547          | 46%                      | -            | 0%                         | 9            | 1%                       |
| 4    | 222          | 25%                            | 625          | 70%                      | -            | 0%                         | -            | 0%                       |
| 5    | 84           | 13%                            | 469          | 73%                      | -            | 0%                         | -            | 0%                       |

Note: This step does not depend on the assumption about VoT.

**Table 2.3: Key results of the analysis by redress band, VoT £19 (for the proposed cap)**

| Band | ratio (c) | Value estimate: time/effort saved and increased confidence (monetised)* |       |        | share of claims c.e.** | share of claims c.e. capped*** |
|------|-----------|-------------------------------------------------------------------------|-------|--------|------------------------|--------------------------------|
|      |           | average                                                                 | lb    | ub     |                        |                                |
| 1    | 0.7       | 400                                                                     | 173   | 636    | 6%                     | 87%                            |
| 2    | 1.1       | 1,206                                                                   | 576   | 1,842  | 25%                    | 83%                            |
| 3    | 1.9       | 3,601                                                                   | 1,808 | 5,394  | 52%                    | 71%                            |
| 4    | 4.3       | 6,994                                                                   | 3,582 | 10,406 | 59%                    | 94%                            |
| 5    | 4.3       | 7,166                                                                   | 3,697 | 10,635 | 88%                    | 78%                            |

Note: lb: lower bound, ub: upper bound, c.e.: charged excessively against the individual value to the consumer. \* The formula at paragraph 30 of our CBA shows how these numbers are derived. \*\* Proportion of claims where the revenue is higher than the estimated value for the given redress band. \*\*\* Proportion of claims with revenue higher than i) the estimated value for the given redress band (i.e. likely charged excessively) and ii) the maximum revenue under the proposed cap (i.e. under our proposal charges on these claims would have been lower).

**Table 2.4: Share of claims charged excessively (against the individual value to the consumer) and share of such claims capped by the candidate cap @ VoT £19 (using the estimates for average value at table 2.3)**

| category | share of claims c.e. | share of claims c.e. capped |
|----------|----------------------|-----------------------------|
| S&I      | 43%                  | 91%                         |
| pensions | 52%                  | 58%                         |
| PBA      | 6%                   | 66%                         |
| loans    | 5%                   | 70%                         |

Note: S&I: savings and investments, c.e.: charged excessively against the individual value to the consumer.

## Net adjusted benefits for the top-ranked caps

3. In this section, we present the alternative specifications of the top ranked caps by redress band.
4. The alternative specifications of the top ranked caps by banded redress were labelled in the order in which they were considered. A significant number of caps (caps B, C etc.) led to smaller net adjusted benefits and were not included in the group of caps that the final choice was made from. This final group consisted of specifications A, J, K, plus the proposed cap (at table 7 of our CBA).

**Table 2.5: Specification of the alternative cap A**

| band | redress obtained |         | max % of redress charged | max total charge (£) |
|------|------------------|---------|--------------------------|----------------------|
|      | lb (£)           | ub (£)  |                          |                      |
| 1    | £1               | £499    | 40%                      | £150                 |
| 2    | £500             | £4,999  | 30%                      | £1,000               |
| 3    | £5,000           | £19,999 | 25%                      | £4,000               |
| 4    | £20,000          | £49,999 | 20%                      | £7,500               |
| 5    | £50,000          | na      | 15%                      | £10,000              |

Note: lb: lower bound, ub: upper bound

**Table 2.6: Specification of the alternative cap J**

| band | redress obtained |         | max % of redress charged | max total charge (£) |
|------|------------------|---------|--------------------------|----------------------|
|      | lb (£)           | ub (£)  |                          |                      |
| 1    | £1               | £1,499  | 35%                      | £450                 |
| 2    | £1,500           | £9,999  | 30%                      | £2,000               |
| 3    | £10,000          | £24,999 | 25%                      | £3,750               |
| 4    | £25,000          | £49,999 | 20%                      | £5,000               |
| 5    | £50,000          | na      | 15%                      | £10,000              |

Note: lb: lower bound, ub: upper bound

**Table 2.7: Specification of the alternative cap K**

| band | redress obtained |         | max % of redress charged | max total charge (£) |
|------|------------------|---------|--------------------------|----------------------|
|      | lb (£)           | ub (£)  |                          |                      |
| 1    | £1               | £1,499  | 35%                      | £450                 |
| 2    | £1,500           | £9,999  | 30%                      | £2,500               |
| 3    | £10,000          | £24,999 | 25%                      | £5,000               |
| 4    | £25,000          | £49,999 | 20%                      | £7,500               |
| 5    | £50,000          | na      | 15%                      | £10,000              |

Note: lb: lower bound, ub: upper bound

**Table 2.8: Net adjusted benefits for the 4 top-ranked caps by redress band**

| effect                                                         | PC*    | A      | K      | J       |
|----------------------------------------------------------------|--------|--------|--------|---------|
| loss of profits, constrained charges (excluded in the NAB) (a) | -9,582 | -9,920 | -9,077 | -10,432 |
| loss of profits on categories no longer managed (b)            | -1,006 | -1,006 | -1,006 | -2,193  |
| F&I costs (c)                                                  | -167   | -167   | -209   | -176    |
| savings on fees (d)                                            | 9,582  | 9,920  | 9,077  | 10,432  |
| Net adjusted benefits (b+c+d)                                  | 8,409  | 8,747  | 7,862  | 8,062   |

Note: \* PC: proposed cap

## Analysis of possible exit for the top-ranked caps

5. In this section, we present the number of CMCs which might exit if one of the alternative caps by redress band (A, J or K) would be implemented. We also show the share of revenue and claims the remaining CMCs and the exiting CMCs would account for. The estimates are extrapolated from our sample of CMCs.
6. In the tables 2.9 to 2.11, 'CMCs exiting' are those exiting because of the candidate cap; 'unprofitable CMCs' are those which are already unprofitable before the cap and likely to exit even in absence of a cap. Categories of claims where the number of claims in our sample was insufficient for a robust analysis are excluded (e.g. claims relating to mortgages or insurance). We have also considered whether CMCs make a short-term margin ((revenue – direct costs)/revenue) and long-term profit margin ((revenue – total costs)/revenue) greater than 10% once the cap applies. We apply a 10% profit margin as a threshold as this also allows for CMCs that will make a small profit margin and may consider that to be insufficient to continue providing services in the relevant sector. Figures are scaled up in the same way as for table 12 in Annex 2 (see note to that table).

**Table 2.9: Specification A: estimated number of CMCs remaining after the cap and their share of claims and revenue (FS claims management\*)**

|                                               | S&I | Pensions | PBA | Loans |
|-----------------------------------------------|-----|----------|-----|-------|
| Number of CMCs remaining                      | 16  | 26       | 10  | 7     |
| Proportion of claims                          | 2%  | 40%      | 34% | 21%   |
| Proportion of total revenue                   | 29% | 57%      | 62% | 49%   |
| Number of CMCs exiting                        | 5   | 13       | 5   | 0     |
| Proportion of claims                          | 57% | 34%      | 1%  | 0%    |
| Proportion of total revenue                   | 60% | 35%      | 1%  | 0%    |
| Number of unprofitable CMCs                   | 38  | 30       | 41  | 22    |
| Proportion of claims                          | 41% | 25%      | 66% | 79%   |
| Proportion of total revenue                   | 11% | 8%       | 37% | 51%   |
| Number of CMCs remaining with ST Margin > 10% | 16  | 22       | 10  | 7     |
| Number of CMCs remaining with LT Margin > 10% | 16  | 17       | 10  | 7     |

\*The table refers to the population of firms and claims (extrapolated from our sample)

**Table 2.10: Specification J: estimated number of CMCs remaining after the cap and their share of claims and revenue (FS claims management\*)**

|                                               | S&I | Pensions | PBA | Loans |
|-----------------------------------------------|-----|----------|-----|-------|
| Number of CMCs remaining                      | 16  | 22       | 15  | 7     |
| Proportion of claims                          | 2%  | 31%      | 34% | 21%   |
| Proportion of total revenue                   | 29% | 48%      | 63% | 49%   |
| Number of CMCs exiting*                       | 5   | 17       | 0   | 0     |
| Proportion of claims                          | 57% | 43%      | 0%  | 0%    |
| Proportion of total revenue                   | 60% | 44%      | 0%  | 0%    |
| Number of unprofitable CMCs                   | 38  | 30       | 41  | 22    |
| Proportion of claims                          | 41% | 25%      | 66% | 79%   |
| Proportion of total revenue                   | 11% | 8%       | 37% | 51%   |
| Number of CMCs remaining with ST Margin > 10% | 16  | 22       | 15  | 7     |
| Number of CMCs remaining with LT Margin > 10% | 16  | 17       | 10  | 7     |

\*The table refers to the population of firms and claims (extrapolated from our sample)



**Table 2.11: Specification K: estimated number of CMCs remaining after the cap and their share of claims and revenue (FS claims management\*)**

|                                                         | S&I | Pensions | PBA | Loans |
|---------------------------------------------------------|-----|----------|-----|-------|
| <b>Number of CMCs remaining</b>                         | 22  | 30       | 15  | 7     |
| <b>Proportion of claims</b>                             | 59% | 65%      | 34% | 21%   |
| <b>Proportion of total revenue</b>                      | 89% | 68%      | 63% | 49%   |
| <b>Number of CMCs exiting</b>                           | 0   | 9        | 0   | 0     |
| <b>Proportion of claims</b>                             | 0%  | 9%       | 0%  | 0%    |
| <b>Proportion of total revenue</b>                      | 0%  | 24%      | 0%  | 0%    |
| <b>Number of unprofitable CMCs</b>                      | 38  | 30       | 41  | 22    |
| <b>Proportion of claims</b>                             | 41% | 25%      | 66% | 79%   |
| <b>Proportion of total revenue</b>                      | 11% | 8%       | 37% | 51%   |
| <b>Number of CMCs remaining with ST Margin &gt; 10%</b> | 22  | 26       | 15  | 7     |
| <b>Number of CMCs remaining with LT Margin &gt; 10%</b> | 16  | 22       | 10  | 7     |

\*The table refers to the population of firms and claims (extrapolated from our sample)

## Appendix 3

### Further details on the profitability analysis

1. In this appendix, we describe the analytical framework developed to examine the impact of the proposed fee cap on the profitability (and viability) of Financial Services (FS) Claims Management Companies (CMCs).
2. This appendix is structured as follows:
  - In section A, we set out the methodology used to assess the profitability in the FS claims management business<sup>23</sup> we regulate, together with additional high-level summary statistics for the sample of claims we used. We show how we assess the following key impacts for the cost-benefit analysis: potential exit from claims management or categories of claims and the loss of revenue and profits.
  - In section B, the findings of the profitability analysis are set out and discussed.

#### A. Methodology

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3. The methodology used for assessing what impact the introduction of a fee rule has on the profitability of FS CMCs comprises the following:
  - i. Calculating profitability
  - ii. Establishing a baseline for the analysis
  - iii. Modelling the fee rule intervention
  - iv. Understanding potential exit from market or product categories and loss of revenue (and profit)

##### i. Calculating profitability

4. To calculate profitability, we compare the total revenue to direct costs and total costs incurred in managing claims management business over the financial year 2018/19.
5. Total revenue is the fee income which the firm receives from managing a successful claim. Given the no-win-no-fee (NWNF) business model, this is typically paid as a percentage of the total consumer redress. As some firms undertake multiple services or activities - which include claims management (CM) - we asked firms to separate their total costs into direct and indirect costs for each service/activity. Direct costs are expenses which are directly related to their CM business - such as CM staff salaries and advertising and marketing costs - while indirect costs (or overheads) are more general business expenses - such as the cost of office space - which are also relevant to the wider business.
6. In our data request, we asked all the 33 claims management firms<sup>24</sup> in the sample to report all the costs incurred and revenue received from managing individual financial services claims during the financial year 2018/19<sup>25</sup>. In total, 28 firms were able to allocate revenue and costs at an individual claim level, which provided a sample of approximately 244,000 individual claims on which to base the financial

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23 Where we refer to claims management business or services, we mean regulated claims management activities.

24 Appendix 1 provides a detailed discussion of the data collection, data cleaning and sampling.

25 The financial year 2018/19 referred to the period 1 April 2018 to 31 March 2019.

analysis<sup>26</sup>. The sampling of CMCs, the representativeness of the sample and summary statistics of the data received are discussed in appendix 1.

7. The cost allocation inevitably depends on the quality of the direct cost data recorded by the CMCs and assumptions they made when allocating direct costs.
8. We have omitted a very small proportion of claims managed on behalf of businesses from the dataset. These claims are very different, so that their inclusion would likely have led to a cap that is not well suited for the vast majority of claims.
9. We apportioned indirect costs to individual claims, by using the average indirect cost for each category of claims<sup>27</sup>. We have used this only to illustrate the main impacts of the NWNF charging model in the charts below.
10. This allowed us to construct two measures of profit, where short-term profits (STP) deduct only direct costs from revenue (equation 1) and long-term profits (LTP) deduct all costs from revenue (equation 2):

$$\text{STP} = \text{Total Revenue} - \text{Direct Costs} \quad 1)$$

$$\text{LTP} = \text{Total Revenue} - \text{Total (Direct+Indirect) Costs} \quad 2)$$

11. In the profitability analysis, long-term profits are calculated for each CMC in the sample whereas short-term profits are calculated for each one of the categories of claims each CMC manages; it is therefore a more granular measure.
12. A further measure of profitability is the profit margin. Equation 3 refers to the ST profit margin and equation 4 refers to the LT profit margin:

$$\text{ST Margin} = (\text{Total Revenue} - \text{Total Direct Cost}) / (\text{Total Revenue}) = \text{STP} / (\text{Total Revenue}) \quad 3)$$

$$\text{LT Margin} = (\text{Total Revenue} - \text{Total Cost}) / (\text{Total Revenue}) = \text{LTP} / (\text{Total Revenue}) \quad 4)$$

13. These measures compare the total revenue received to the costs of managing claims, and give a relative indication of profitability across different firms and product categories, and allow us to consider which firms and which product categories are generating the greatest profit margins. This is helpful information when considering the likelihood that a CMC may exit altogether or from a particular category of claim.

26 Firms were asked to categorise claims by product category, and the analysis focuses on the following categories: savings and investments, pensions, packaged bank accounts, loans, mortgages and other. Other is used as a catch-all category to cover those categories of claims where there are too few claims to analyse on a standalone basis – such as insurance claims – but whose inclusion was important to assess the profitability of firms managing these types of claims.

27 Firms found it challenging to allocate overhead costs to categories of claims. We worked with firms on the best way to accomplish this. We had detailed discussions with a number of firms and provided a detailed guidance note to all firms. More details on our engagement with firms over data challenges is discussed in appendix 1.

### ***Why a conventional reasonable profit analysis was not feasible in the case of claims management firms.***

- 14.** In price regulation the conventional, or most established, method of assessing profitability assesses whether the level of profit a company earns is reasonable or not by comparing the return on capital employed (ROCE) to its weighted average cost of capital (WACC).

- 15.** The ROCE and WACC are reported as equation 5 and 6 below:

$$\begin{aligned} \text{ROCE} &= \frac{\text{Operating Profit (or EBIT)}}{\text{Capital Employed}} \\ &= \frac{\text{Earnings Before Interest and Tax}}{\text{Equity+LT Liabilities}} \end{aligned} \quad 5)$$

$$\text{WACC} = (w_e \times C_e) + (w_d \times C_d) \times (1-t) \quad 6)$$

- 16.** The ROCE measures the operating profit (or EBIT) as a share of the capital employed – which comprises shareholder equity and long-term liabilities or debt. The ratio reflects how economically the capital is being used. The WACC is the weighted average of the share of equity ( $w_e$ ) multiplied by the cost of equity ( $C_e$ ), plus the share of debt ( $w_d$ ) multiplied by the cost of debt ( $C_d$ ), with an adjustment for tax ( $1-t$ ).
- 17.** However, we do not consider that a ROCE or WACC approach are suitable for use in the case of claims management firms for the following reasons.
- 18.** First, claims management is characterised by a NWNF business model where many claims are taken on a speculative basis, on the assumption that the revenue generated from a small proportion of successful claims will be sufficient to offset the losses which accrue from the majority of claims, and still generate a profit. The result of using such a business model is that profitability can vary greatly even across firms managing similar types of claims. Additionally, even within individual firms which are found to be loss-making overall, the overall margin earned on successful claims are often very high. We observed many firms who are loss-making overall, yet manage to extract a high margin on their successful claims.
- 19.** Second, the large variations in profitability both between firms and even within the different categories of claims a single firm might service, mean that this method of assessing profitability – which assumes that firms operating in the same sector will share similar financial fundamentals, with shared trends across firms being observed in the data – is not appropriate in this context.
- 20.** Third, in the context of price regulation, the WACC represents the opportunity cost of capital that an investor incurs as a result of investing in a project, and is used as a minimum acceptable rate of return for new investments. In such a context, decisions about new projects are made on the basis of the degree to which the return on capital exceeds the cost of capital, where the difference between the ROCE and WACC is used as the standard measure of excess return, or economic profit. This is used in price regulation which typically addresses market power of a natural monopolist, a market failure that is different to those affecting claims management (see the CBA in Annex 2 for details).
- 21.** Fourth, to calculate both the ROCE and WACC, we would need to produce an economically meaningful measure of capital, with clearly identifiable sources of debt and equity. This approach has been developed for use with large well established public companies, who generally share a similar capital structure. This is not typically the case for CMCs, where many firms are very small and have no identifiable sources of capital. The model used to estimate the cost of equity (

in equation 6) - Capital Asset Pricing Model - is again designed for large public companies, not small illiquid limited companies or single person sole traders as in the cases of claims management. Estimating the cost of equity for illiquid firms tends to produce downward biased estimates of the cost of capital.

22. Fifth, together with these obvious conceptual challenges, there are also a number of practical problems with applying this method analytically. The big challenge is the lack of data. The paucity and quality of the data we received from the majority of CMCs would render any analysis using this approach extremely dubious. Estimating the cost of equity requires historic data which is regularly sampled over multiple intervals over a number of years. Furthermore, the majority of firms we surveyed were not able to provide the required accounting data – including variables such as the values of equity, debt and liabilities - making many of these calculations in equation 5 and 6 impossible to compute.
23. We have adopted an approach to modelling profitability which is simpler than ROCE because this analysis could be supported by the data submissions we received from firms. Lastly, and importantly, the approach we have adopted, ie the analysis of long-term profits and short-term profits described above, provides the information on profitability we need to assess the effects of the proposed cap.

## ii. Establishing a baseline for the analysis

24. As explained in the CBA, we compare two states of the world:

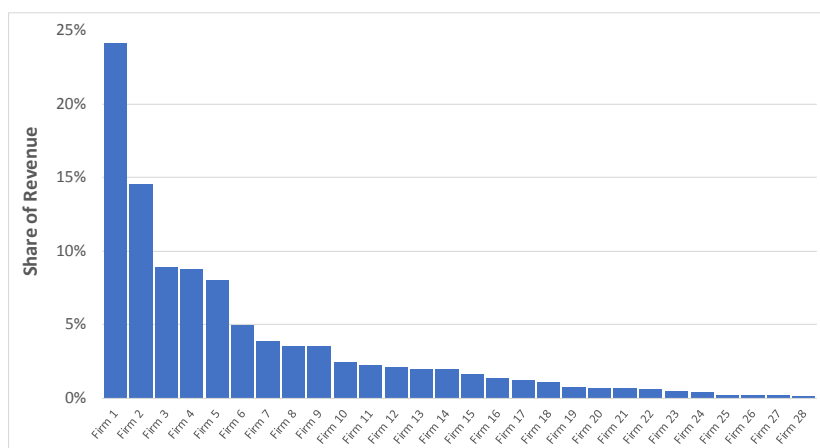
- the world in the absence of the proposed intervention (the baseline)
- the world in which the proposed intervention occurs.

25. Comparing profitability between the two states allows us to estimate the impact of introducing a fee cap on claims management.

### *What the data shows*

26. The data shows that CMCs differ significantly in their size, with a small subsample of CMCs making most of the revenue. Revenue data from regulatory returns show that this is also true for FS CMCs more generally (see appendix 1 for details on the regulatory returns data).
27. Figure 1 illustrates that while the 2 largest firms make almost 40% of total revenue, the 10 smallest firms make less than 4% of total revenue.

**Figure 1: Size of our sample of CMCs illustrated by share of sample total revenue (%)**



28. Table 1 provides summary statistics of the profitability analysis based on the sample of 28 firms. The following 4 product categories of claims:

- savings and investments
- pensions
- packaged bank accounts
- loans

jointly account for over 99.6% of the total number of claims in the sample.

**Table 1: Summary Statistics\***

|                                      | <b>Savings &amp; Investment</b> | <b>Pension</b> | <b>PBA</b> | <b>Loans</b> | <b>Total</b> |
|--------------------------------------|---------------------------------|----------------|------------|--------------|--------------|
| <b># Firms</b>                       | 11                              | 16             | 11         | 8            | 28           |
| <b># Claims</b>                      | 27,925                          | 10,321         | 124,581    | 80,643       | 244,329      |
| <b># Successful</b>                  | 2,927                           | 1,929          | 10,692     | 4,185        | 19,896       |
| <b>Success rate (%)</b>              | 10%                             | 19%            | 9%         | 5%           | 8%           |
| <b>Upheld rate (%)</b>               | 14%                             | 35%            | 13%        | 8%           | 12%          |
| <b>Total Revenue (£mn)</b>           | 8.3                             | 10.9           | 3.3        | 1.2          | 25.3         |
| <b>ST Profits (£mn)</b>              | 4.3                             | 5.0            | 1.0        | 0.2          | 10.6         |
| <b>LT Profits (£mn)</b>              | 2.9                             | 3.6            | 0.3        | -0.1         | 6.5          |
| <b>1 firm concentration</b>          | 60%                             | 34%            | 61%        | 36%          | 24%          |
| <b>Margin: All claims (%)</b>        | 35%                             | 33%            | 9%         | -6%          | 26%          |
| <b>Margin: Successful claims (%)</b> | 88%                             | 75%            | 86%        | 68%          | 80%          |

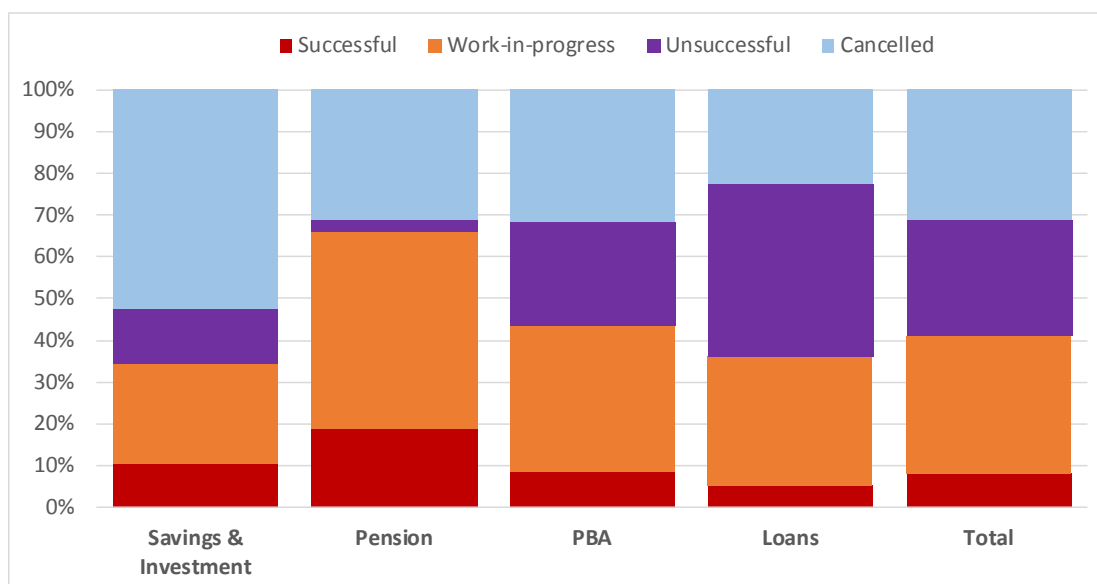
\* In total, 28 of the 33 firms in the sample were able to allocate revenue and costs at an individual claim level. The number of firms in the Total column is not equal to the sum of the individual product categories, because some firms manage claims in more than one claim category. Margins for all claims and successful claims refer to the LT average margin calculated as equation 4.

29. CMC firms operate on a NWNF business model where their remuneration is taken as a share of the redress which the consumer receives on successful claims. The revenue generated from a small proportion of successful claims needs to offset the losses which accrue from the majority of claims that are unsuccessful.
30. In Table 1 we observe that the success rate (the number of successful<sup>28</sup> claims as a proportion of all live and closed claims) varies among the categories of claims, with 19% of the pension claims managed in financial year 2018/19 being successful, compared with only 5% for loans. An alternative way of reporting the likelihood of success is the upheld rate which measures the proportion of claims which are successful as a share of all the claims which have reached an outcome (ie they are closed) during the year. By this measure 35% of pension claims were upheld and 8% of loan claims were upheld.
31. CMCs also differ significantly in the amount of revenue they make on individual categories of claims. Where profitability is assessed over all claims, we see that overall individual CMCs in the sample make an average margin of 26%, but this varies greatly across the different categories of claims where savings and investment make an average margin of 35%, but loans are loss-making with an average margin of -6%. By contrast the average LT profit margin on successful claims is between 68% and 88%.
32. 11 of the 28 firms in the sample made a loss in FY 2018/9 – with 5 firms failing to even cover their direct costs. We only have 1 year of granular data and so are unable to consider how profitability of categories of claims for CMCs varies over time.

28 The term 'successful' reflects a classification provided by CMCs. The success rate is the share of successful claims as a proportion of all claims. The 'upheld' rate measures the share of successful claims as proportion of all claims which are completed - not classified as work in progress - at the end of the financial year.

33. A caveat to results in the later section 'Key effects of NWNF model' is that we only observed the cost that firms have incurred in FY 2018/19 rather than through the full duration of the claim. Therefore, where claims are opened before the start of the financial year or managed beyond the end of the financial year, these estimates will not reflect the full cost of managing the claim<sup>29</sup>. To illustrate, 82% of claims closed in FY2018/9 were opened in FY2018/9 and 18% were opened before FY2018/9. However, the revenue and cost data covering FY2018/9 accurately reflect the profit or loss made by CMCs on categories of claims or claims management (excl. PPI) in the given year (it includes all costs for all types of claims, successful, work-in-progress etc).
34. Our working assumption is that the data for FY2018/9, in particular on profits made, is broadly representative for other financial years. To understand how significant work-in-progress is, Figure 2 provides the breakdown of claims managed in FY 2018/19 based on their outcome status at the year end.

**Figure 2: Breakdown of claims by claim outcome**



35. Figure 2 shows that over 33% of the claims managed during FY 2018/19 remained work-in-progress at the end of it. This is particularly so for pensions, where 47% of claims remained work in progress. Other important observations regarding outcome states are the proportion of claims which are:
- **unsuccessful** - 3% of pension claims and 13% of savings and investment claims compared with 41% of loan claims and 25% of package bank account claims
  - **cancelled**<sup>30</sup> - 52% of savings and investment claims, 31% of pension claims, 31% of package bank account claims and 23% of loan claims.
36. Nevertheless, though a large number of cases in FY 2018/19 are ongoing, the same

29 The average duration (or length of time) over which a claim in our sample is managed is less than 1 year. Successful claims which tend to be most costly to manage are found to have a lower claim duration on average. Over 90% of successful loans, PBA and savings and investment claims reach an outcome in less than 1 year. The exception is successful pension claims, where the average duration is 1.2 years. These findings suggest that the cost data submitted by firms, which refer to the 12 months covered by the FY 2018/9, may be a reasonable approximation for the total costs a CMC accrues over the full life of the claim.

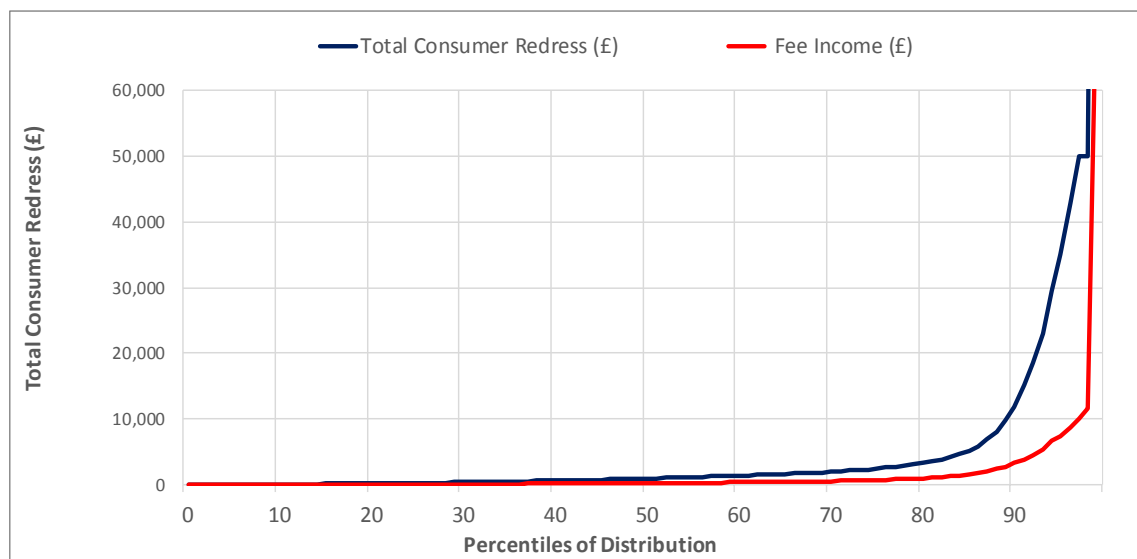
30 Cancelled refers to claims which a firm decided to start managing but then were discontinued before reaching a successful or unsuccessful outcome. Claims were cancelled by either the customer or the firm.

was true in the year before, where costs were incurred that generated revenue recognised in the year we are looking at. We did not have any prior that the previous year's cost and revenue flows would be sufficiently different from this one to bias our analysis one way or another and our discussions with firms confirmed this.

### iii. Modelling the fee rule intervention

- 37.** The fee rule is based on the total amount of redress which a consumer receives, and works by capping the value of the share of redress that the CMC receives from managing the claim to a different extent depending on the redress achieved. There are 5 redress bands, where each redress band has a lower and upper limit and a share of redress and value threshold which are used to calibrate the cap. Next, we explain how the rule is calibrated and modelled.
- 38.** Figure 3 shows the distribution of total redress for all successful individual claims in the sample. Consumer redress ranges from £0 to £220,000 but to improve readability, we illustrate only the range up to £60,000, by percentiles of the distribution.

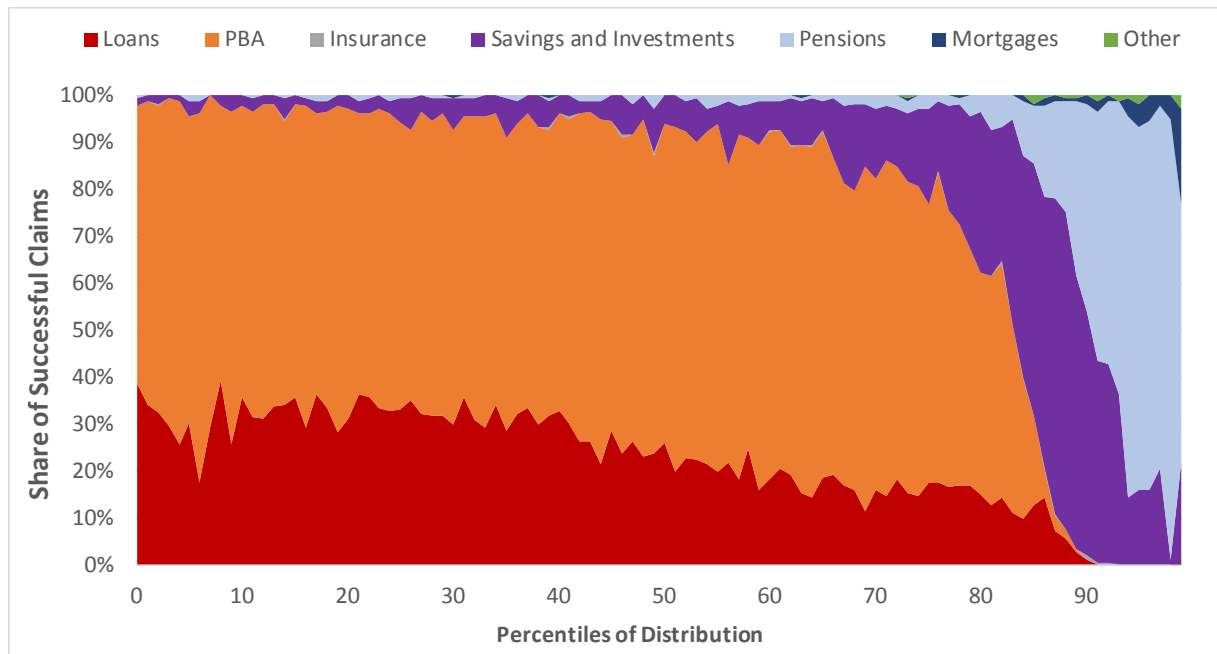
**Figure 3: Distribution of the total redress (£)\***



\* Individual claims are ordered by the value of total consumer redress, where the distribution is reported as percentiles.



**Figure 4: Distribution of value of total redress (£) by product type**



\* Individual claims are ordered by the value of total consumer redress, where the distribution is reported as percentiles.

39. Figure 4 shows a breakdown of the claim type within each percentile by number of successful claims ordered by their total consumer redress. The lowest value claims mainly regard loans and PBA and the highest value claims mainly regard mortgages, savings and investments and pensions.

40. We observe that at the:

- 50th percentile, the value of total redress is approximately £1,000 and the fee income is approximately £300 (see Figure 3), where 87% of claims are loans or PBA (see Figure 4)
- 90th percentile, the value of total redress is approximately £10,000 and the fee income is approximately £2,900 (see Figure 3), where 96% of claims are savings and investments or pensions (see Figure 4)

41. Under the proposed cap, the CMC's fee income from a successful claim is capped where it is higher than permitted by the rule. In each redress band, the total revenue or fee income which the CMC received is capped as a:

- **share of redress (%)**, such that the CMC cannot earn more than a fixed proportion of the total consumer redress
- **fixed value amounts (£)**, such that the CMC cannot earn more than a particular fixed amount on each claim.

42. The rule will cap the claim at the minimum of the share of redress, or value allowed within the band.

43. The proposed cap is summarised in Table 2.

**Table 2: Proposed redress band fee rule**

| Band | Lower (£) | Upper (£) | ShareOfRedress | Value (£) |
|------|-----------|-----------|----------------|-----------|
| 1    | £0        | £1,499    | 30%            | £420      |
| 2    | £1,500    | £9,999    | 28%            | £2,500    |
| 3    | £10,000   | £24,999   | 25%            | £5,000    |
| 4    | £25,000   | £49,999   | 20%            | £7,500    |
| 5    | £50,000   | N/A       | 15%            | £10,000   |

44. For instance, a claim with a total consumer redress of £5,500 which generates fee income of £1,650 is in band 2: with the proposed fee cap, fee income will be capped at £1,540 – the minimum of a share of redress of 28% of £5,500 (ie £1,540) or a value of £2,500 – generating a potential saving for the consumer of £110.
45. Where the fee cap bites, the revenue (or fee income) which the CMC earns from managing successful claims will be reduced – shown in equation 7.

$$\text{Total Revenue}^{\text{Capped}} = \text{Total Revenue} \times (1 - \% \Delta \text{ Fee Rule}) \quad 7)$$

46. In turn, the effect of capping the revenue is that profitability is reduced, as shown at equations 8 and 9:

$$\text{STP}^{\text{Capped}} = \text{Total Revenue}^{\text{Capped}} - \text{Direct Costs} \quad 8)$$

$$\text{LTP}^{\text{Capped}} = \text{Total Revenue}^{\text{Capped}} - \text{Total (Direct+Indirect) Costs} \quad 9)$$

47. The loss of profits is twofold. Effect 1: CMCs which continue to manage claims will lose revenue equal to the difference between the revenue earned on each claim before and after the fee rule was introduced. Since we make the simplifying assumption that firms do not react and reduce their costs as a result of the introduction of the fee rule, this loss of revenue equates to a loss of profit. In reality, some firms may respond with cost reductions to compensate. Effect 2: CMCs will lose the profit they made before the cap on categories of claims they are likely to exit. For the purposes of modelling this effect we assume that such exit is immediate (see paragraph 71 of the CBA at Annex 2 for a discussion).
48. The loss of profits from all those successful claims that are impacted by the fee cap (effect 1) is reported as equation 10. The loss of profits due to exit from categories of claims (effect 2) is reported as equation 11.

$$\text{Loss of Profits (effect 1)} = \text{Total Revenue}^{\text{Capped}} - \text{Total Revenue}_{\text{pre-cap}} \quad 10)$$

$$\text{Loss of Profits (effect 2)} = \text{Total Revenue}_{\text{pre-cap}} - \text{Total Direct Costs}_{\text{pre-cap}} \quad 11)$$

#### iv. Potential exit from market or product categories and the loss of revenue (and profit)

49. In this section, we explain the approach used to estimate the required CBA effects resulting from the introduction of a fee rule. The profitability of firms both before and after the introduction of the fee rule will be an important determinant of whether they continue to remain in business, and if they remain in business which types of claims they will continue to manage. A pricing rule that makes a firm loss making is a signal that a firm may exit the market in the long run.
50. We assume that CMCs will likely exit categories of claims if they cannot cover the direct cost incurred on managing these claims ( $\text{STP} < 0$ ) or exit claims management

completely if their total revenue does not cover their total costs from claims management ( $LTP < 0$ ).

51. The total loss of profits from all claims impacted by the fee cap is classified as effect 1 (loss of profits because the cap constrains charges, realised as a cost saving by the consumer), or effect 2 (loss of profits because of exit, not leading to cost savings for the consumer), depending on whether the firm is assumed to continue managing those categories of claims.
52. To avoid including losses that would have occurred absent our rules (or savings that would not have been made), we only considered losses on claims in categories that will continue to be managed by CMCs when the cap applies, ie we do not consider profits or losses of categories that are not (short term) profitable before the introduction of the cap. Since our aim is to assess effects for a typical year and since those categories of claims that are already loss-making before the cap will eventually cease to be managed by CMCs, we consider this abstraction to be the best reflection of the likely effect of a cap in a quantification of these losses (see the sections on key assumptions and losses for CMCs in the CBA for details). Making this assumption means that we do not overstate the impact of the fee rule, by subjecting claims to the rule where there is a significant likelihood that CMCs would have ceased managing those types of claims even if the fee rule had not been introduced. This assumption implies that data from 2 of the 28 CMCs in the sample are not used because they make losses on all the categories of claims they manage absent any fee rules.
53. As a sensitivity test, we also report the impact of applying this fee rule to all claims regardless of whether the CMCs managing them would have likely exited absent our rules. I.e. we report the loss of profits because the cap constrains charging for all claims in our dataset (effect 1 in the lower half of table 3). This loss of profits corresponds to savings for consumers. Additionally, we consider the loss of profits on categories of claims that become loss-making and exit because of the cap (effect 2) when calculating the total loss of profit for CMCs under the sensitivity. In that way, the sensitivity is a worst-case scenario for the impact of the cap on CMCs profitability that overestimates the loss of profit (because CMCs will likely exit before revenues are reduced by the cap).

The following CBA outputs are estimated as part of the financial analysis:

- a. Loss of profits for CMCs and the potential benefit for consumers (effect 1)
- b. Loss of profits to CMCs which potentially exit certain categories of claims (effect 2)
- c. Potential for partial or complete market exit from claims management

#### ***a. Loss of profits for CMCs and the potential benefit for consumers***

54. This loss of profits is equal to the difference between the revenue earned on all successful claims managed by the CMC before and after the fee rule is introduced. The loss of profits on claims managed by CMCs which do not exit the given category of claims or claim management (effect 1) to the firm represents a corresponding benefit for the consumer. Our assumption regarding exit implies that these savings for consumers will only be realised where the firm was to remain profitable –at the product-category level - following the introduction of the fee rule.
55. As explained above (paragraph 51), if the category of claims which the firm manages is:

- profitable after the fee rule is introduced (based on  $STP > 0$ ), then it is assumed that the firm will continue to manage these types of claims in the future, and the loss of profits translates to a realised consumer benefit (effect 1).
- loss-making after the fee rule is introduced (based on  $STP < 0$ ), then it is assumed that the firm will cease managing these types of claims in the future, and the loss of profits will not translate to a realised consumer benefit (effect 2, discussed at b. below).

### ***b. Loss of profits to CMCs which potentially exit categories of claims***

- 56.** Where a firm manages claims across multiple categories of claims, its claims management business may remain profitable following the introduction of a fee rule, but certain categories of claims may become unprofitable because of the cap. In this case, we assume that a firm will likely stop managing these categories of claims which are now loss-making (based on  $STP$ ), but continue to manage other categories.
- 57.** When assessing whether a CMC will likely exit claims management in the longer term, we assume that CMCs which no longer manage a given category of claims will no longer incur overheads for this category of claims, ie that CMCs incur overheads specific to categories of claims and will avoid incurring these overheads if they stop managing a category of claims. This is consistent with the fact that most CMCs managing several categories of claims have provided us with overheads by category of claim (as we asked in our information request). The results are not sensitive to this assumption.
- 58.** We estimate the impact of the fee rule on the potential exit from categories of claims, ie we identify all those firms where each of the categories of claims they managed were profitable before the fee rule was introduced (where  $STP$  in equation 1 is positive) but unprofitable after the fee rule is introduced (where  $STP$  in equation 8 is negative). When firms exit product categories they would both lose revenue and save total costs, hence they lose the profits they previously made on the categories of claim they exit. This would be a cost of the intervention.
- 59.** The loss of profits (effect 2) here does not translate in consumer benefits because we do not attempt to quantify what happens to claims in categories exited by the firm. In reality, where a firm exits because of the introduction of the fee rule, the consumer could simply use another, more efficient CMC that would find the claim profitable. Alternatively, the consumer could claim direct without using a CMC (see our CBA at Annex 2, paragraphs 76 to 79, for a more detailed discussion of this).

### ***c. Potential for partial or complete market exit from claim management***

- 60.** As well as identifying exit from categories of claims due to the cap (on the basis of  $STP < 0$ ), we also identify firms whose claims management business as a whole was profitable before, but become loss-making after the introduction of the fee rule and are at risk of exiting claims management completely. Exit from categories and claims management, and the conditions under which exit occurs, are discussed in our CBA at Annex 2 (see in particular tables 10, 11 and 12). See also the CBA for a discussion of the competition effect of CMCs leaving FS claim management completely.

### ***Caveat***

- 61.** An important caveat with this framework, is that the approach we have taken to modelling market exit is quite a conservative one. We have assumed that if the firm goes from being profitable before the introduction of the fee rule, to being loss-

making afterwards, the firm will likely exit immediately.

62. In reality, the decision of a loss-making firm to exit the market may be less immediate than this framework suggests. For instance, where a loss-making firm holds a significant stock of claims that are work-in-progress, which may be thought of as a source of future cashflow, it may take more time to assess whether this will bring it back to profitability (see the sections on key assumptions and losses for CMCs for a detailed discussion). Any decision to exit Claims Management may not be immediate but rather a protracted outcome, resulting in a slower withdrawal of firms out of the market rather than a sudden contraction of supply. Should a loss-making firm with a large stock of claims which are work-in-progress exit Claims Management, there is also the likelihood that another firm would purchase the loan book and take over managing these claims.
63. Further, as discussed above, where a firm exits the market because of the introduction of the fee rule, the consumer could simply use another, more efficient CMC that would find the claim profitable. Alternatively, the consumer could claim direct without using a CMC. But we have assumed that if the firm exits the market the consumer will not claim (see our CBA at Annex 2, paragraphs 76 to 79, for a more detailed discussion on this).

## B. Findings

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64. In this section we:

- i. Illustrate findings from our profitability analysis at claim level by category, to aid understanding of FS claims management
- ii. report the impact of the proposed fee cap on our sample of CMCs

### i. Key effects of the NWNF model (contribution of claims to profits)

65. In the CBA we have used results on the profitability by CMC and by category of claim for individual CMCs (and not used profitability by individual claim). However, in this section, we share the findings from our profitability analysis at claim level by category to provide useful context for understanding FS claims management.
66. As noted above, an important feature of the NWNF model in claims management is that most of the revenue and profit are generated by a small proportion of successful claims. This means that the distribution of profit is highly skewed.
67. The NWNF model requires that, over the financial year, the fee income earned by the CMC on successful claims is sufficient to offset the losses on unsuccessful claims and the cost incurred from managing claims which are work in progress. To reflect any costs incurred from managing claims in an earlier period, our working assumption is that the revenue and costs associated with managing these claims in the past will be similar to the costs from managing work in progress in the current period. The analysis of margins for individual claims will not reflect the full cost and will overstate the profitability of those individual claims which were opened before the start of the financial year.
68. We show profitability at the claim level for 2 different categories of claims: savings and investments and packaged bank accounts. The reason for choosing these 2 categories is that they represent examples of complex and simple products respectively.
69. We consider the profitability of the NWNF business model by looking at the following variables:

- Individual revenue and cost at claims level
  - Cumulative revenue and cost
  - ST profit Margin (%)
  - Fee income (£)
  - Share of redress charged as fee (%)
- 70.** For each of these variables we report the distribution of individual claims, where each distribution is ordered on the basis of the value of each of the given variables from lowest to highest, and expressed as percentiles of the distribution. For each of the product categories this is summarised as a set of 5 figures, shown as a. to e., where Figure:
- a.** shows the distribution of total revenue, total direct costs and total costs (which include direct costs and overheads) for all individual claims in the sample. It shows that successful CMC claims represent a small proportion, but the fee income to CMC can be significant, particularly compared to the cost of managing the claim.
  - b.** shows the distribution of the cumulative total revenue, total direct costs and total costs (which include both direct costs and overheads). An important insight is that given the NWNF model, firms work at a loss until redress is awarded on successful claims, and given the speculative nature of the business there may be considerable uncertainty over the frequency, size and timing of successful claims, which means cashflows are potentially volatile and sporadic, and require careful management.
  - c.** shows the distribution of the short-term margin earned on those claims which were successful – equation 3. This figure gives a sense of the mark-up that the firm has earned from managing the claim within FY-2018/19. While a proportion of the successful claims are loss making – revenue is insufficient to cover costs – there are also a significant share of claims where charges appear high – short-term margins greater than 50% - or very high – short-term profit margins greater than 90%. Short term profit margins show the differences in the contribution to profits of individual successful claims in the context of the NWNF model.
  - d.** show the distribution of fee income for successful claims - ordered from lowest to highest - along with the cumulative revenue, associated with this ordering. This shows how fee income varies across successful claims.
  - e.** show the distribution for the effective share of redress<sup>31</sup> for successful claims - ordered from lowest to highest - along with the cumulative revenue, associated with this ordering. The share of redress earned across CMCs takes the form of the step function, indicating the various charging-levels used by firms.

### ***Savings and investment***

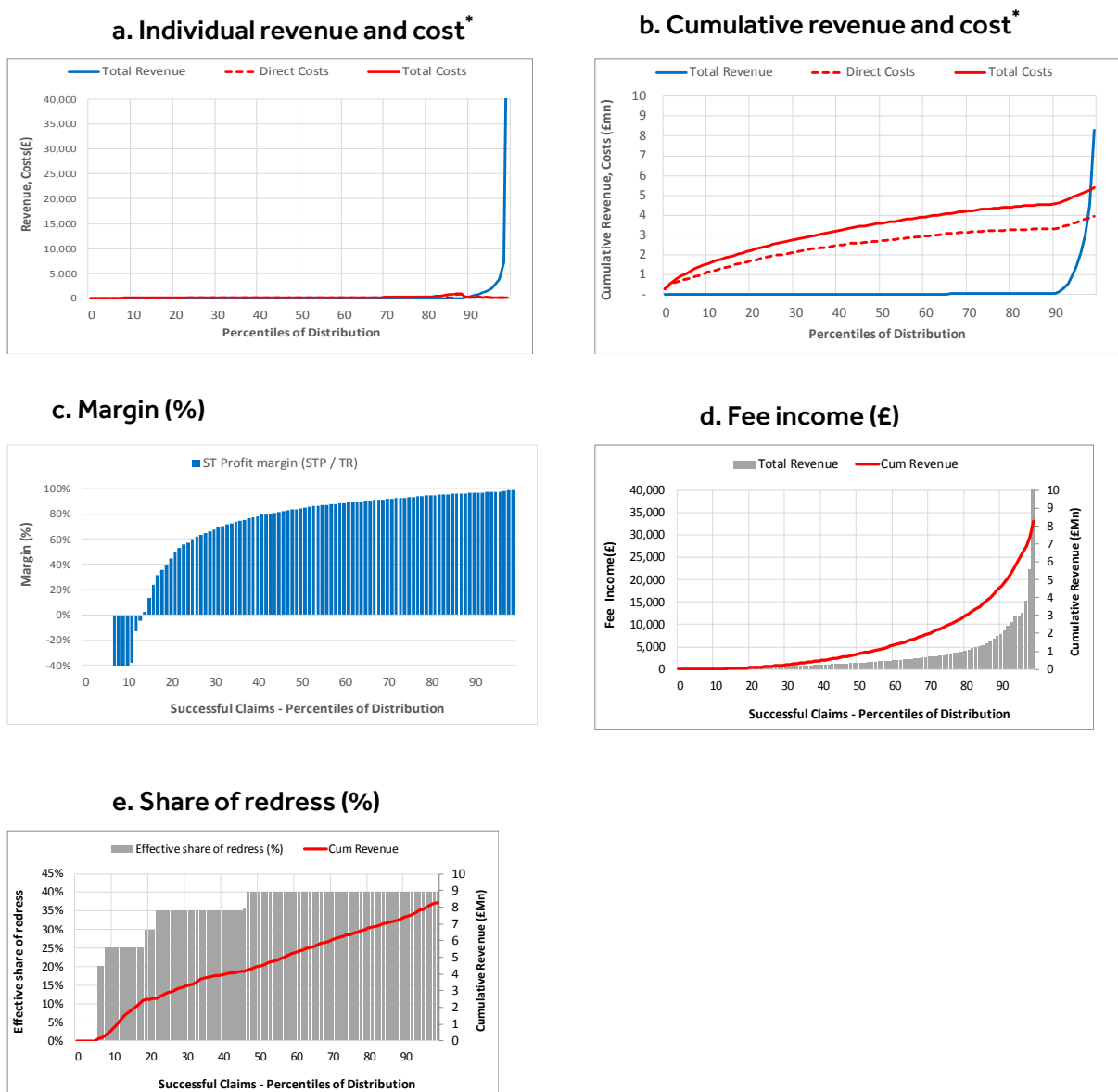
**71.** Figure 5 summarise the findings of the profitability analysis for the savings and investments category. We observed, with respect to the distribution of:

- individual costs and revenue, that approximately 10% of claims were successful, with these claims typically generating average revenue of £1,500 with the top percentile generating over £7,500. Fees for a small number of claims are over £25,000.

<sup>31</sup> The share of redress is imputed from the individual claims data in the dataset by comparing fee income (or total revenue) to total consumer redress.

- The cost of managing a claim seems to be unrelated to revenue. On average, the total cost of managing a claim – direct plus overheads – is approximately £150, with the most expensive percentile costing approximately £900.
- short-term profit margin, that 14% of successful claims are loss-making, 50% of successful claims earn a margin of more than 85% and over 10% of successful claims a margin of more than 95%.
- fee income (together with cumulative revenue), that the top 10% of successful claims generates almost half of all fee income or revenue. This indicates the revenue is concentrated in a small number of successful claims
- share of redress (together with cumulative revenue), that the share of redress charged by firms range from a low of 20% to a high of 40%. The gradient of the cumulative revenue shows that the claims which generate the highest share of revenue are those on the lowest share of redress.

**Figure 5: Distributional analysis – Savings and Investments**



# Figure a and b report the distribution of revenue and costs for all claims (successful, unsuccessful and work in progress) and Figure c, d and e report the distribution for successful claims only.

\* The distribution is ordered from lowest to highest value on the basis of total revenue and then total cost.

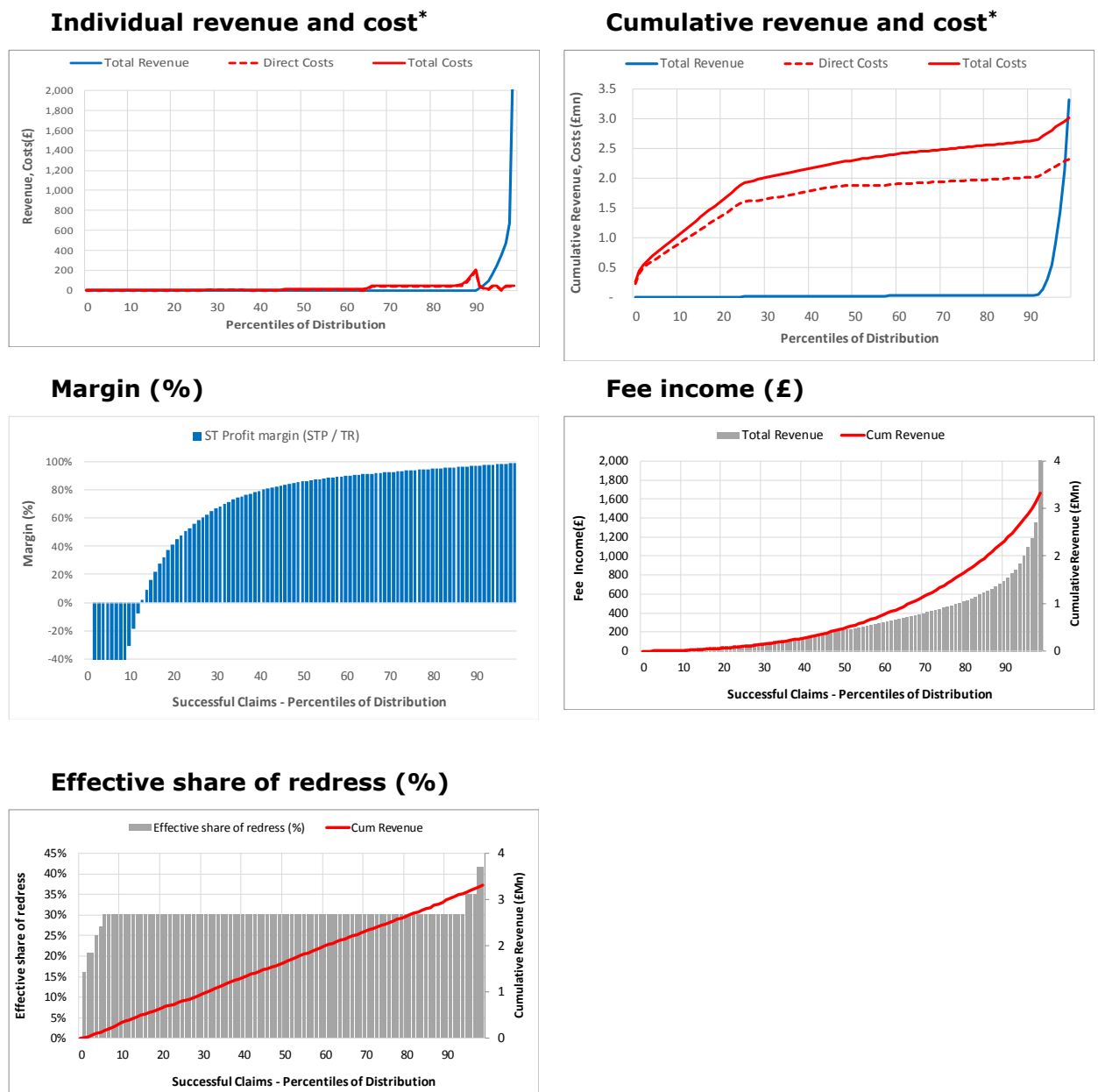
### ***Packaged Bank Accounts***

**72.** Figure 6 summarises the findings of the profitability analysis for the packaged bank accounts category. We observed, that with respect to the distribution of:

- individual costs and revenue, that approximately 9% of claims were successful. These claims typically generate average revenue of £220 with the top percentile generating over £1,300, and fees for a small number of claims are over £2,000.
- The cost of managing a claim seems to be unrelated to revenue. On average, the total cost for managing a claim – direct plus overheads - is £13, with the most expensive percentile costing over £200 (and for a small number of claims over £250).
- short-term profit margin, that 13% of successful claims are loss-making, 50% of successful claims earn a margin more than 85% and over 10% of successful claims a margin of more than 95%.
- fee income (together with cumulative revenue), that revenue is concentrated, with the top 10% of successful claims generating 30% of all fee income or revenue.
- share of redress (together with cumulative revenue), that the share of redress is quite uniform with 90% of successful claims being subject to a charge of 30%



**Figure 6: Distributional analysis – Packaged bank accounts<sup>#</sup>**



<sup>#</sup> Figure a and b report the distribution of revenue and costs for all claims (successful, unsuccessful and work in progress) and Figure c, d and e report the distribution for successful claims only.

\* The distribution is ordered from lowest to highest value on the basis of total revenue and then total cost.

## ii. Modelling the fee rule intervention

**73.** In this section, we report the impact of simulating the proposed fee rule. The results are shown in Table 3 which is organised into 2 sections, where section:

- A. shows the impact on the profitability and financial viability of claims management. We report the proportion of successful claims impacted by the fee rule (shown as Impact), the percentage change in total revenue (shown as dTR), the percentage share of lost revenue across all categories (shown as %Share of TR) and the average profit margin before and after the fee rule (FR) is in place (shown as Pre-FR and Post-FR).
- B. shows the impact in terms of loss of profits. The 3 columns show the total loss of profits to the firms, along with the share of the loss of profits because the cap constrains charges (effect 1) realised as a cost saving to the consumer, and loss of profits which is not realised as a cost saving to consumers because of exit (effect 2).

**74.** The top panel reports the results of the proposed (base case) fee cap scenario, where the loss-making categories of claims at the end of FY 2018/9 are not subject to the fee rule, and the bottom panel shows an alternative sensitivity case scenario where we drop this assumption of exit and apply the cap to all claims irrespective of whether the category of claims was loss making prior to the intervention or after the intervention. Comparing the results of the 2 scenarios shows how sensitive the findings are to the assumption that only those categories of claims which are all together profitable<sup>32</sup> for an individual firm in the short-term before the fee rule is introduced will be subject to the cap.

**Table 3: Impact of the proposed fee rule scenario\***

|                            | Section A. |      |            |                     |         | Section B.                 |                                                     |                                      |
|----------------------------|------------|------|------------|---------------------|---------|----------------------------|-----------------------------------------------------|--------------------------------------|
|                            | Impact     | dTR  | %Share dTR | Average Margin (%)* |         | Total loss of profits (£k) | Loss of profits because cap constrains charges (£k) | Loss of profits because of exit (£k) |
|                            |            |      |            | Pre-FR              | Post-FR |                            |                                                     |                                      |
| <b>1. Base case</b>        |            |      |            |                     |         |                            |                                                     |                                      |
| All Claims                 | 35%        | -30% | 100%       | 37%                 | 25%     | 5,132                      | 4,644                                               | 487                                  |
| <b>Products</b>            |            |      |            |                     |         |                            |                                                     |                                      |
| 1. Savings&Investment      | 80%        | -40% | 46%        | 56%                 | 35%     | 2,865                      | 2,758                                               | 107                                  |
| 2. Pensions                | 35%        | -22% | 32%        | 49%                 | 40%     | 1,894                      | 1,737                                               | 157                                  |
| 3. PBA                     | 29%        | -5%  | 2%         | 48%                 | 45%     | 130                        | 130                                                 | -                                    |
| 4. Loans                   | 5%         | -1%  | 0%         | 51%                 | 51%     | 7                          | 7                                                   | -                                    |
| 5. Mortgages               | 0%         | -99% | 16%        | 18%                 | 75%     | 210                        | -                                                   | 210                                  |
| 6. Other                   | 31%        | -93% | 4%         | 10%                 | 40%     | 25                         | 12                                                  | 13                                   |
| <b>2. Sensitivity case</b> |            |      |            |                     |         |                            |                                                     |                                      |
| All Claims                 | 38%        | -24% | 100%       | 26%                 | 2%      | 6,548                      | 6,061                                               | 487                                  |
| <b>Products</b>            |            |      |            |                     |         |                            |                                                     |                                      |
| 1. Savings&Investment      | 85%        | -36% | 49%        | 52%                 | 25%     | 3,098                      | 2,991                                               | 107                                  |
| 2. Pensions                | 38%        | -20% | 36%        | 45%                 | 32%     | 2,338                      | 2,181                                               | 157                                  |
| 3. PBA                     | 30%        | -5%  | 3%         | 30%                 | 26%     | 162                        | 162                                                 | -                                    |
| 4. Loans                   | 26%        | -6%  | 1%         | 16%                 | 11%     | 66                         | 66                                                  | -                                    |
| 5. Mortgages               | 78%        | -42% | 9%         | 11%                 | -53%    | 747                        | 537                                                 | 210                                  |
| 6. Other                   | 64%        | -37% | 2%         | 8%                  | -45%    | 138                        | 125                                                 | 13                                   |

\* The average margins reported pre- and post-fee rule: for all claims, this refers to the long-term average margin, and, for each product-category this refers to the short-term average margin. Margins post the introduction of the fee rule are based on capped revenues. For the base case, these consider revenues on categories of claims that remain profitable under the cap. For the sensitivity, all categories of claims are considered regardless of whether they are profitable.

The average margin pre-FR of 26% for the sensitivity represents the average long-term margin for all individual claims in the sample before the fee rule is introduced, and is equivalent to that reported in Table 1. The average margin pre-FR of 37% for the base case shows what impact excluding loss-making categories of claims before the fee rule is applied has on profitability.

<sup>32</sup> By all together profitable, we mean that all claims in a particular product category collectively make a profit, even though there will be individual claims within this category which are loss-making.

### ***Loss of profits for CMCs and the potential savings for consumers***

75. With respect to the base case fee cap scenario, the overall impact is that 35% of all successful claims are impacted by the fee rule, and the revenue (or fee income) is reduced by 30%. Before the rule was introduced, the average margin earned from claims management was 37% and this is reduced to 25% afterwards. The total loss of profits is a cost to the firms of £5.1 million. The loss of profit for CMCs which no longer manage claims in particular product categories because they become loss-making as a result of the cap is a cost of £0.487 million.
76. Therefore, the loss of profits for the CMCs because the cap constrains charges, which translates to a realised benefit to consumers in terms of savings in fees, is £4.6 million.<sup>33</sup>
77. For context, at a product-category level, the impact of the fee rule is greatest amongst savings and investment, with 80% of successful claims being impacted by the rule and total revenue reduced by 40% - ie 46% of the total loss of revenue. Jointly, savings and investments, pensions and mortgages account for 94% of the loss of revenue. In contrast, low value PBA and loan claims jointly account for less than 2% of the total loss of revenue.
78. Regarding section B in Table 3, the majority of the benefits which consumers are expected to realise come from savings and investments and pensions. These two categories account for 97% of the £4.6 million consumer benefits. The loss of profits for CMCs' managing mortgage claims is £0.2 million, where these losses are due to exit (an unrealised consumer benefit).
79. As a sensitivity test, we simulate the same fee rule assuming that there would be no exit prior to the cap (and so more claims are affected by the cap), but that there is exit after the cap when categories of claims are loss making – panel 2 in Table 3. As a result, the total loss of profits is £6.5 million. The increase in the loss of profits of approximately £1.4 million is the result of applying the cap to those successful claims which are part of loss-making categories of claims that were excluded. We treat the £1.4m as a realised consumer benefit, because in the sensitivity these claims are successfully completed and charged for by the CMC, so they are subject to the cap and the consumer benefits from the capped, lower, fee.

### ***Potential for partial and complete market exit from claim management***

80. We are also interested in whether claims management overall and management of individual categories of claims are likely to remain financially viable for individual firms after the introduction of the fee rule: this is discussed in the CBA at Annex 2 (see, in particular, tables 10, 11 and 12 of the CBA).

33 These estimates are based on the sample of claims. They are scaled-up and reported as market estimates in the CBA.

## Annex 3

# Compatibility statement

### Compliance with legal requirements

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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 the Financial Services and Markets Act 2000 (FSMA).

When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under section 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA. The FCA is also required by section 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

This Annex also sets out the FCA's 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.

In addition, this Annex explains how we have considered the recommendations made by the Treasury under section 1JA FSMA about aspects of the economic policy of the Government to which we should have regard in connection with our general duties.

Under section 137FD of FSMA we must make our proposed rules with a view to securing an appropriate degree of protection against excessive charges for claims management services.

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

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The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers.

Chapter 4 of this consultation sets out how our proposed fee cap will secure an appropriate degree of protection against excessive CMC charges. Chapter 5 sets out how our proposed enhanced disclosure requirements will help consumers make better-informed decisions about how to bring claims for redress when they believe they have suffered harm at the hands of a financial service or product provider. Chapter 6 sets out minor amendments which will improve our regulation of CMCs generally, in the interests of consumers.

We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because the enhanced disclosure measures aim to address the market failures of information asymmetry and behavioural bias and the cap aims to reduce harm caused by excessive charging.

In preparing the proposals set out in this consultation, 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**

Our statutory duty to make rules to protect consumers from excessive fees requires us to take action. We considered the likely impact on FCA resources of our proposed fee cap and enhanced disclosure requirements and we are satisfied that supervision of the rules will not require significant additional resources. Our miscellaneous amendments are intended to improve the efficient functioning of the FCA-regulated CMC market and our supervision of it.

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

As set out in the cost benefit analysis we have estimated the costs and benefits of our proposals and we are satisfied that the net benefit justifies the costs.

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

Our proposals are not explicitly designed to further this principle but they do not impede it. We have designed our intervention in a way that we believe will allow FCA-regulated claims management activity to remain viable, and in a way that will allow consumers to purchase assistance to claim redress if they desire. Our miscellaneous amendments are intended to improve the efficient functioning of the FCA-regulated CMC market and our supervision of it.

### **The general principle that consumers should take responsibility for their decisions**

Our disclosure requirements are intended to improve consumers' ability to take responsibility for their decisions. Our proposed fee cap protects consumers where there is evidence that market failures prevent consumers from making fully informed decisions.

## **The responsibilities of senior management**

Our proposals do not specifically relate to the responsibilities of senior management, but senior managers of CMCs will need to take reasonable steps to ensure their business complies with the regulatory system.

## **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**

The sample of CMCs we looked at included small and large firms and firms managing a range of claim types. We considered the types of business carried on in the sample and do not expect our proposals to adversely affect particular types of CMC or CMCs carried on by particular persons. We do not expect our proposals to impact on mutual societies.

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

We consider the information published in this consultation paper regarding FCA-regulated CMCs to be appropriate and necessary to transparently communicate the basis for our proposals.

## **The principle that we should exercise our functions as transparently as possible**

This consultation provides a transparent account of the proposals we seek to implement and the basis upon which we have developed them. In addition to this we plan to establish a data room to allow interested parties to inspect the data on which our proposals are based.

## **Financial crime**

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 s. 1B(5)(b) FSMA). We do not think our proposals will affect the extent to which this is possible.

## **Chancellor's recommendations**

We have had regard to the Chancellor's [recommendations](#) for the FCA from November 2019. The proposals are designed to help financial services work well for consumers, in particular by ensuring consumers can have help at a reasonable cost when they seek redress. 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.

## **Expected effect on mutual societies**

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We do not expect the proposals in this paper to have a significantly different impact

on mutual societies. Mutual societies do not generally conduct claims management activities. Some mutual societies are respondent firms to the claims managed by CMCs. They will not be adversely affected by these proposals. If mutual societies use the services of CMCs to make claims about financial products and services they will benefit from the protection from excessive charges that we propose.

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

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In preparing the proposals as set out in this consultation, we have complied with the FCA's duty to promote effective competition in the interests of consumers. This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives. In designing these proposals, we carefully considered competition impacts and balanced them against our consumer protection requirements.

We recognise the risk that a price cap could cause firms to exit the market and potentially reduce competition. We conducted a competition analysis and have set our proposed price cap at a level which we expect to allow for firms to operate viably in numbers sufficient to support effective competition in the interests of consumers.

The proposed price cap is not intended to indicate a fair price for CMC services in all cases. Rather, it is the level we think will provide an appropriate degree of protection against excessive charges. We are confident that the level of the cap will allow CMCs to charge fees that reflect the value they provide. By setting the cap above the cost to firms of managing claims, and at a level which allows a viable market to exist, we expect firms to be able to compete under the cap.

Currently CMCs charge a wide range of fees. CMCs which are expected to remain profitable (and active in the market) after the implementation of our proposed fee cap, currently tend to charge the lowest fees on claims. These firms exert a competitive constraint on other firms. By allowing CMCs that charge at lower rates to continue doing so, while eliminating excessive charges, our proposed intervention has the potential to increase competitive pressure from CMCs charging lower rates.

The enhanced disclosure proposals set out in Chapter 5 are designed to better empower consumers to make informed choices to help promote competition under the fee cap.

As described in Chapter 4, we assessed various options for meeting our statutory duty and we rejected those that would have an unacceptable impact on market viability and thus competition. (See paragraph 4.32.) We consider that our proposed intervention is the option that is most compatible with promoting competition while securing an appropriate degree of protection against excessive charges.

## Equality and diversity

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Our consideration of the equality and diversity implications of our proposals under the Equality Act 2010 is set out in Annex 4.

## Annex 4

# Equality Impact Assessment

We are required under the Equality Act 2010 to consider whether our proposals could have a potentially discriminatory impact on groups with protected characteristics (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation). We are also required to have due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations between persons who share a relevant protected characteristic and persons who do not share it, when carrying out our functions.

We have conducted an initial equality impact assessment (EIA) of our proposals to ensure that the equality and diversity implications are considered. This annex sets out the results, explaining the potential impact of our proposals on protected groups where we have identified them and, where relevant, the steps we have taken or will take to minimise them.

The main outcomes of our assessment are as follows:

Statistics from our Financial Lives Survey 2017 suggested that certain groups with protected characteristics were either more likely to use a CMC to process a claim, or were less likely to know that they could make a claim without using a CMC.

Since the FCA started regulating CMCs, data shows a substantial number of consumers using CMCs to make claims in respect of pensions. These consumers might be of, or approaching, older age.

Consumers with disabilities such as learning difficulties or not being able to see might feel they have to depend more heavily on CMCs to make a claim.

These consumers will likely benefit from our proposals as the fee they are charged will be capped so that they will not pay excessively.

For other groups with protected characteristics we have not identified any concerns that arise in our proposals but welcome any comments on the effect of our proposals for these consumers.

It is possible that if CMCs cease to manage claims, some of these customers might not make claims at all and might, therefore, miss out on receiving redress due to them. This would mean that harm they have suffered would not be put right. However, our proposals are intentionally designed to avoid making FCA-regulated claims management activity unviable. We believe our proposals will ensure that anyone wanting to use a CMC to make a claim will continue to be able to do so.



We welcome any views, evidence or information that respondents might have on the quality and diversity impacts mentioned above and any equality and diversity issues they believe arise from the proposals in the rest of this paper.

**Q14:** Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

## Annex 5

### Abbreviations used in this paper

|                |                                                       |
|----------------|-------------------------------------------------------|
| <b>CBA</b>     | Cost benefit analysis                                 |
| <b>CMC</b>     | Claims management company                             |
| <b>COMP</b>    | Compensation                                          |
| <b>CONRED</b>  | Consumer Redress Schemes Sourcebook                   |
| <b>DISP</b>    | Dispute Resolution: Complaints                        |
| <b>FGCA</b>    | Financial Guidance and Claims Act 2018                |
| <b>F&amp;I</b> | Familiarisation and implementation                    |
| <b>FS</b>      | Financial services                                    |
| <b>FSMA</b>    | Financial Services and Markets Act 2000               |
| <b>FSCS</b>    | Financial Services Compensation Scheme                |
| <b>FY</b>      | Financial year                                        |
| <b>HCSTC</b>   | High-cost short-term credit                           |
| <b>IMD</b>     | Index of multiple deprivation (appears in Annex only) |
| <b>NAB</b>     | Net adjusted benefits                                 |
| <b>PBA</b>     | Packaged bank accounts                                |
| <b>PPI</b>     | Payment protection insurance                          |
| <b>S&amp;I</b> | Savings and investment                                |
| <b>SRA</b>     | Solicitors Regulation Authority                       |
| <b>VoT</b>     | Value of time                                         |



We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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# Appendix 1

## Draft handbook text

## **CLAIMS MANAGEMENT (FEES RULES) 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 137FD (FCA general rules: charges for claims management services);
  - (3) section 137T (General supplementary powers); and
  - (4) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

### **Commencement**

- C. This instrument comes into force on [3 months after making – date to be inserted].

### **Amendments to the Handbook**

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Claims Management: Conduct of Business sourcebook (CMCOB) is amended in accordance with Annex B to this instrument.

### **Citation**

- F. This instrument may be cited as the Claims Management (Fees Rules) Instrument 2021.

By order of the Board

[Date]

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

*FS claims management agreement* an agreement for:

- (1) *advice, investigation or representation in relation to a financial services or financial product claim; or*
- (2) *seeking out, referrals and identification of claims or potential claims in relation to a financial services or financial product claim,*

or any combination of these activities, except to the extent the activity is in relation to payment protection insurance *claims*.

*regulated claims management agreement*

an agreement, the entering into or performing of which by either party is a *regulated claims management activity* (see section 137FD(7)(a) of the Act).

Amend the following definition as shown:

*PPI* *claims management fee cap* the provisions in sections 29 and 31 of the Financial Guidance and Claims Act 2018 (see *CMCOB 5.1*).

## Annex B

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

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

- 1.2.1 R (1) *CMCOB applies to a firm (including to a Gibraltar-based firm or a TP firm) with respect to carrying on regulated claims management activities and ancillary activities, unless otherwise stated in, or in relation to, a rule.*
- (2) In (1) “Gibraltar-based firm” has the same meaning as in the Gibraltar Order.

...

#### Disclosure to other firms by lead generators

- 2.2.10 R Where a lead generator passes customers, or details of a customer or a claim, to a third party, the lead generator must disclose to the third party any charges imposed or to be imposed on the customer concerned in relation to the customer’s claim.
- 2.2.11 G Where more than one lead generator is involved, lead generators should disclose charges imposed or to be imposed by the preceding lead generators. Firms receiving claims from lead generators should take reasonable steps to ascertain the entirety of the charges payable or paid in relation to a claim.

...

## 4.2 Pre-contract information and advice

### Summary document

...

- 4.2.5 R (1) The firm must explain the basis on which it would calculate its fee, and provide an illustration or estimate of that fee.
- (2) ~~Where the fee would be payable by reference to the amount recovered for the customer, the firm must provide an illustration of what its fee would be by reference to each of the following amounts recovered for the customer:~~
- ~~(a) £1,000;~~
- ~~(b) £3,000; and~~
- ~~(c) £10,000.~~
- (2A) Where the amount of the fee, or any part of it, would be payable by reference to the amount recovered for the customer, the firm must provide its fee illustration or estimate with reference to at least 3 of the redress bands in the table in CMCOB 5.2.6R.
- (2B) In its fee illustration or estimate, the firm must:

- (a) choose the 3 redress bands it reasonably considers most likely to be representative of the *customer's claim*; and
- (b) state which fee illustration of the ones provided best reflects the amount the *customer* is likely to pay in the event of a successful *claim*.
- (3) For the purposes of ~~(2)~~ (2A) and (2B), the “amount recovered for the *customer*” means the amount paid or payable by the *person* against or about whom the *claim* would be made, ignoring any set-off or netting against any sum owed or payable by the *customer* to that *person*.
- (4) Where the *firm's* fee is not ascertainable as in ~~(2)~~(2A) and (2B), but is instead dependent on factors which cannot be known in advance (for example, where the *firm* charges an hourly rate), the *firm* must explain its fee structure, and provide an estimate calculated by reference to:
  - (a) the facts and circumstances of the *claim*, to the extent that the *firm* has knowledge of them; and
  - (b) (if the *firm* charges on an hourly basis) the typical number of hours the *firm* would expect to spend on a *claim* of that type.
- (5) The illustration or estimate must be accompanied:
  - (a) where ~~(2)~~ applies the amount of the fee, or any part of it, would be payable by reference to the amount recovered for the *customer*, by a statement that the fee illustration is not to be taken as an estimate of the amount likely to be recovered for the *customer*;
  - (b) where ~~(4)~~ applies that is not the case, an explanation of how the estimate has been calculated; and
  - (c) a statement to the effect that the fee that the *customer* will have to pay may be more than or less than the illustration or estimate.

...

- 4.3.2      G      (1) For the purposes of CMC OB 4.3.1R(1)(a) a *firm* will have complied with its obligations if it has:
- (a) provided relevant examples of potential alternative methods of pursuing the *claim*; and
  - (b) obtained a “standalone” signed statement from the *customer*, dealing only with this issue, stating that the *customer* is aware of the alternative methods, and the *customer's* reasons for not wishing to pursue these methods, and has asked the *customer* whether any such methods are available to them.
- (2) ~~A *customer* should be treated as having~~ Other methods of pursuing a *claim* for the purposes of CMC OB 4.3.1R(1) include if, for example:
- (a) if the *claim* is for personal injury and the *customer* has legal expenses cover under a contract of insurance relating to their car or

home and that cover includes legal advice, assistance and representation; ~~or~~

- (b) if the *customer* is entitled to legal advice, assistance and representation by virtue of their membership of a trade union; or
- (c) direct *claims* by *customers* themselves to a *firm*, statutory ombudsman scheme, statutory compensation scheme or alternative dispute resolution scheme (see *CMCOB* 3.2.8G(2) and 4.2.2R(2)(g) and (h)).

...

## **5 Fee caps for regulated claims management activities**

### **5.1 Fee cap for payment protection insurance claims**

- 5.1.1 G (1) Under section 29(3) of the Financial Guidance and Claims Act 2018, the fee cap applicable to *regulated claims management activity* in connection with a PPI claim is 20% of the amount recovered. The cap applies by reference to a sum comprising all amounts charged for such services in connection with the *claim* (whether or not charged under a single agreement), exclusive of VAT.
- (2) Section 31 of that Act (PPI claims: interim restriction on charges imposed by authorised persons after transfer of regulation to FCA) prohibits a *firm* from:
- (a) charging an amount which exceeds the *PPI claims management fee cap* ~~in connection with a PPI claim~~; and
  - (b) entering into an agreement which provides for the payment by a *customer* of charges which would breach or are capable of breaching the *PPI claims management fee cap* ~~in connection with a PPI claim~~.
- (3) Any payment in excess of the *PPI claims management fee cap* is recoverable by the *customer*. The *FCA* would expect the *firm* to reimburse the *customer* promptly, irrespective of whether the *customer* has asserted that the *firm* has breached the fee cap.
- (4) Any agreement which provides for the payment by a *customer* of charges which would breach or are capable of breaching the *PPI claims management fee cap* are not enforceable to the extent that they provide for such a payment.
- (5) A *firm* that breaches the *PPI claims management fee cap* is subject to the *FCA*'s disciplinary powers in the same way as if the *firm* had breached a *rule*.

Insert the following new section, *CMCOB* 5.2, after *CMCOB* 5.1 (Fee cap for payment protection insurance claims). The following text is all new and is not underlined.



## 5.2 Fee restrictions for financial services and financial product claims other than payment protection insurance claims

Application and purpose

Application

5.2.1 R This section applies to *firms* in relation to:

- (1) *FS claims management agreements* entered into by a *customer*; and
- (2) charges imposed on a *customer* under such an agreement, or a **connected agreement**.

5.2.2 G (1) This section applies to financial services or financial product *claims* other than PPI *claims* (for PPI *claims* see *CMCOB* 5.1).

(2) This section comes into force on [3 months after making – insert date], and applies to charges imposed after that date, whether the agreement under which the charge is imposed is entered into before or after that date.

(3) The terms in bold in this section (other than in headings or in titles) are defined in *CMCOB* 5.2.18R.

Statutory context and purpose

5.2.3 G (1) Section 137FD of the *Act* (FCA general rules: charges for claims management services) places a duty on the *FCA* to make *rules* in relation to all *regulated claims management agreements*, and all *regulated claims management activities*, which concern *claims* in relation to financial products or services.

(2) The *rules* must be made with a view to securing an appropriate degree of protection against excessive charges for the provision of a service which is, or which is provided in connection with, a *regulated claims management activity*.

(3) In accordance with that duty, the purpose of this section is:

- (a) to specify charges, including by reference to charges that exceed or are capable of exceeding, a specified amount; and
- (b) to secure an appropriate degree of protection against excessive charges.

Fee cap for financial services and financial product claims within scope of complaints rules, or ombudsman or compensation scheme, where customer is awarded redress

FS claims management fee cap

5.2.4 R The **FS claims management fee cap** applies to charges payable by *customers* who are awarded financial redress for their *claim*, provided the *claim*:

- (1) is **within the scope of complaints handling or resolution rules**; or

- (2) if made, would fall within the scope of a statutory ombudsman scheme or statutory compensation scheme.

5.2.5 G The statutory schemes include the *Financial Ombudsman Service*, the *Pensions Ombudsman*, and the *compensation scheme* (see *CMCOB 3.2.8G*).

5.2.6 R The **FS claims management fee cap** for a *claim* is the lower of:

- (1) the maximum percentage rate of charge, or
- (2) the maximum total charge

in the table below applicable to the redress awarded for that *claim*.

| <b><i>Band</i></b> | <b><i>Redress awarded for a claim (£)</i></b> | <b><i>The maximum percentage rate of charge</i></b> | <b><i>The maximum total charge (£)</i></b> |
|--------------------|-----------------------------------------------|-----------------------------------------------------|--------------------------------------------|
| <i>1</i>           | <i>1-1,499</i>                                | <i>30%</i>                                          | <i>420</i>                                 |
| <i>2</i>           | <i>1,500-9,999</i>                            | <i>28%</i>                                          | <i>2,500</i>                               |
| <i>3</i>           | <i>10,000-24,999</i>                          | <i>25%</i>                                          | <i>5,000</i>                               |
| <i>4</i>           | <i>25,000-49,999</i>                          | <i>20%</i>                                          | <i>7,500</i>                               |
| <i>5</i>           | <i>50,000 or above</i>                        | <i>10%</i>                                          | <i>10,000</i>                              |

5.2.7 R The **FS claims management fee cap** for a *claim*:

- (1) includes expenses and any other charge provided for in the *FS claims management agreement* or **connected agreement**; but
- (2) excludes VAT.

FS claims management fee cap: prohibition on entering into agreements

5.2.8 R A *firm* must not enter into an *FS claims management agreement* that provides for the payment of one or more charges that, alone or in combination with any other charge under a **connected agreement**, exceed or are capable of exceeding the **FS claims management fee cap**.

FS claims management fee cap: prohibition on imposition of charges

- 5.2.9 R
- (1) A *firm* must not impose one or more charges on a *customer* under an *FS claims management agreement* for a *claim* that, alone or in combination with any other charge in relation that *claim*, under that agreement or a **connected agreement**, exceed or are capable of exceeding the **FS claims management fee cap**.
  - (2) The prohibition in (1) applies whether the *FS claims management agreement* or **connected agreement** is entered into before or after this section comes into force.

5.2.10 G A charge is imposed for the purposes of *CMCOB 5.2.8R* and *5.2.9R* regardless of how payment of a *firm's* charge is made, including where a *firm*:

- (1) deducts payment from redress received by it on behalf of the *customer*; or
- (2) arranges for or instructs another *person* to impose a charge on its behalf.

- 5.2.11 G (1) The **FS claims management fee cap** applies to charges paid or payable by a *customer* who is awarded financial redress. Such charges must not exceed the lower of the maximum percentage rate of charge or the maximum total charge.
- (2) For example, a *customer* who is awarded financial redress falling in band 1 must not be charged more than the lower of (i) 30% (plus VAT) of the redress (the maximum percentage rate of charge in band 1); or (ii) £420 (plus VAT) (the maximum total charge in band 1).
- (3) Therefore a *customer* who is awarded redress of £1,000 must not be charged more than £300 (plus VAT). This is the lower figure out of (i) 30% of the redress awarded (30% of £1,000 = £300); and (ii) £420.
- (4) However, a *customer* who is awarded redress of £1,450 must not be charged more than £420 (plus VAT). This is the lower figure out of (i) 30% of the redress awarded (30% of £1,450 = £435); and (ii) £420.
- (5) The fee cap applies where a *customer* is awarded financial redress, irrespective of whether charges are imposed on a ‘no-win-no-fee’ basis, hourly basis, or other basis.
- 5.2.12 R In calculating whether charges for a *claim* exceed the **FS claims management fee cap**, a *firm* must include charges imposed in relation to the *claim* before this section comes into force.
- 5.2.13 G (1) A *firm* does not need to repay to *customers* charges imposed before [insert coming into force date]. However, when calculating the maximum charge which may be imposed after [insert coming into force date], a *firm* must include charges imposed before that date. If charges imposed before that date exceed the fee cap for a *claim*, a *firm* may not impose further charges.
- (2) A *firm* must include all charges imposed in relation to a *claim* under the *FS claims management agreement* or **connected agreement** when assessing whether the fee cap has been exceeded. This includes charges imposed for *claims management services* that are not regulated by the *FCA*, such as services provided by legal professionals. While this section does not impose obligations on *persons* providing *claims management services* that are not regulated by the *FCA*, any charges imposed in relation to those services must be included by *firms* to which this section applies.

#### Consequences of breaching FS claims management fee cap

- 5.2.14 R (1) An *FS claims management agreement* is unenforceable against the *customer* to the extent it provides for a charge that breaches or is capable of breaching the **FS claims management fee cap**, whether the agreement is entered into before or after this section comes into force.
- (2) If a *firm* imposes a charge in breach of the **FS claims management fee cap**, the *firm* must:
- (a) reimburse the amount of overpayment promptly, irrespective of whether the *customer* has asserted the *firm* has breached the fee cap; and

- (b) pay interest to the *customer*, at a rate of 8% per annum simple interest, from the date of overpayment by the *customer*.

5.2.15 G *Firms* are reminded of the need to take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards (see SYSC 3.2.6R).

Charges for financial products and services claims not within scope of complaints rules, or ombudsman or compensation schemes, or where customer is not awarded redress

- 5.2.16 R (1) This rule applies to charges in relation to a *claim*:
- (a) for which the *customer* is not awarded financial redress; or
  - (b) where the *claim*:
    - (i) is not **within the scope of complaints handling or resolution rules**; or
    - (ii) if made, would not fall within the scope of a statutory ombudsman scheme or statutory compensation scheme.
- (2) A *firm* must not enter into an *FS claims management agreement* that provides for the payment of one or more charges in relation to a *claim* that, alone or in combination with any other charge in relation to the *claim* under a **connected agreement** exceed, or are capable of exceeding, an amount that is reasonable in the circumstances, in light of the work to be undertaken by the *firm*.
- (3) A *firm* must not impose one or more charges on a *customer* in relation to a *claim* under an *FS claims management agreement* or **connected agreement** that exceed, or are capable of exceeding, an amount that is reasonable in the circumstances, in light of the work undertaken or to be undertaken by the *firm*.
- (4) The prohibition in (3) applies whether the *FS claims management agreement* is entered into before or after this section comes into force.
- (5) For the purposes of (2) and (3), a *firm* must take into account charges imposed under **connected agreements** whether imposed before or after this section comes into force.
- 5.2.17 G (1) The **FS claims management fee cap** applies to charges payable or paid by a *customer* who is awarded financial redress for a *claim*, in circumstances where the *claim*, if made, is **within the scope of complaints handling or resolution rules**, a statutory ombudsman or a statutory compensation scheme.
- (2) In practice, the fee cap is applicable to most cases where a *customer* is charged for a financial services or financial product *claim*. That is because such claims usually fall **within the scope of complaints handling or resolution rules**, or a statutory ombudsman or compensation scheme. Further, most *firms* which carry out *regulated claims management activities* do not charge *customers* who are not awarded financial redress.

- (3) The purpose of *CMCOB* 5.2.16R is to ensure that charges not subject to the fee cap are nevertheless reasonable.
- (4) A *firm* is expected to be able to demonstrate what services it has provided, how charges are calculated, and why the charges are reasonable. In assessing whether charges are reasonable, *firms* are expected to take into account, where possible, the applicable level of the **FS claims management fee cap** if the fee cap had applied.
- (5) *Firms* are also expected to take into account charges imposed under a **connected agreement** (irrespective of when that agreement was entered into and of when the charge was imposed), including charges imposed for *claims management services* that are not regulated by the *FCA*, such as services provided by legal professionals.

#### Interpretation

- 5.2.18 R
- (1) The terms in bold in this section (other than in headings or in titles) have the meaning below.
  - (2) An agreement (agreement A) is a “**connected agreement**” in relation to an *FS claims management agreement* (agreement B) if:
    - (a) (i) agreement A enables a charge to be imposed on a *customer* in connection with a *claim*, and
    - (ii) agreement B provides for *regulated claims management activities* in relation to that *claim*; or
    - (b) agreement A provides for services in connection with the *regulated claims management activities* provided for in agreement B; or
    - (c) agreement A varies, supplements, novates or replaces agreement B (or vice versa).
  - (3) “**FS claims management fee cap**” has the meaning in *CMCOB* 5.2.6R.
  - (4) A *claim* is “**within the scope of complaints handling or resolution rules**” where:
    - (a) if received by the *respondent*, it would constitute a *complaint* subject to the *complaints handling rules* or *complaints resolution rules*; or
    - (b) if received by the *MiFID investment firm* or *third country investment firm*, it would constitute a *MiFID complaint* subject to the provisions in *DISP* 1.1A.12-1.1A.19 or *DISP* 1.1A.20-1.1A.22.
- 5.2.19 G Firms are reminded that “*complaint*” in the *complaints handling rules* means any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a *person* about the provision of, or failure to provide, a financial service, *claims management service* or a *redress determination*, which alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience.

## CLAIMS MANAGEMENT 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 or under the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
  - (2) section 137B (FCA general rules: clients’ money, right to rescind etc);
  - (3) section 137R (Financial promotion rules);
  - (4) section 137T (General supplementary powers);
  - (5) section 138D (Actions for damages);
  - (6) section 139A (The FCA’s power to give guidance);
  - (7) section 226 (Compulsory jurisdiction); and
  - (8) paragraph 13 (FCA’s rules) of Schedule 17.
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on *[date]*.

### Amendments to the FCA Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

| (1)                                                       | (2)     |
|-----------------------------------------------------------|---------|
| Claims Management: Conduct of Business sourcebook (CMCOB) | Annex A |
| Consumer Redress Schemes sourcebook (CONRED)              | Annex B |

### Amendments to material outside the Handbook

- E. The Perimeter Guidance manual (PERG) is amended in accordance with Annex C to this instrument.

### Citation

- F. This instrument may be cited as the Claims Management Instrument 2021.

By order of the Board  
*[date]*

## Annex A

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

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 2 Conduct of business

### 2.1 General principles

...

2.1.14 R (1) *A firm must not charge a fee to a customer in relation to a claim in respect of a payment protection contract prior to the later of:*

(a) *the customer withdrawing or deciding not to pursue the claim; ~~and~~ or*

(b) *the settlement of the claim.*

...

...

## 4 Pre-contractual requirements

...

### 4.2 Pre-contract information and advice

...

4.2.8 R ...

(13) *the nature and frequency of updates that the firm will give the customer on the progress of the claim; ~~and~~*

(14) *the Financial Ombudsman Scheme or any other Ombudsman scheme to which the firm is subject; ~~and~~*

(15) *any relevant statutory compensation scheme to which the firm is subject.*

...

4.2.14 G *When providing information concerning any statutory ombudsman or the statutory compensation scheme as required by CMCOB 4.2.8R(14) or CMCOB 4.2.8R(15) or otherwise in CMCOB 4.2.8R, a firm's communications with a customer should:*

- (a) comply with the *fair, clear and not misleading rule* and the *client's best interests rule*; and
- (b) specify whether the scheme or schemes to which the *firm* is subject covers all the activities and/or services which the *firm* proposes to undertake for the *customer*, and specify which activities (if any) are not within the jurisdiction of the scheme or schemes.

#### 4.3 Pre-contract requirements

4.3.1 R ...

- (6) ask the *customer* if they, whether in *Great Britain* or in another jurisdiction:
  - (a) have ever been declared bankrupt;
  - (b) are subject to a bankruptcy petition;
  - (c) are subject to, or have ever been subject to, an individual voluntary arrangement;
  - (d) have proposed an individual voluntary arrangement which is yet to be approved or rejected by creditors;
  - (e) are currently subject to, or ever been subject to, a debt relief order; or
  - (f) are or have ever been subject to any other ~~similar~~ process or arrangement which is similar to those listed in (a) to (e) including but not limited to sequestration; and

if so, explain that any damages, compensation or settlement monies might, in certain circumstances be off-set against the *customer's* outstanding debts; and that the *customer* will, where necessary, need to pay the *firm's* fees from funds that are not subject to the processes or arrangements listed above at (a) to (f).

...

#### 7 Prudential requirements and professional indemnity insurance

##### 7.1 Purpose

7.1.1 G ...

- (3) The chapter also includes requirements for *firms* to have professional indemnity insurance if they carry on *advice, investigation or representation in relation to a ~~criminal~~ personal injury claim*.



...

### 7.3 Calculation of prudential resources

Eligible prudential resources

...

7.3.2R Table: Items which are eligible to contribute to the prudential resources of a firm

|     | Item              | Additional explanation                                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                    |
|-----|-------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ... |                   |                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                    |
| 3   | Reserves (Note 1) | These are, subject to Note 1, the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners</i> ' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i> . |                                                                                                                                                                                                                                    |
|     |                   | For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its reserves, where appropriate:                                                                                                                                                                                                                                 |                                                                                                                                                                                                                                    |
|     |                   | (1)                                                                                                                                                                                                                                                                                                                                                                      | a <i>firm</i> must deduct any <del>realised</del> <u>unrealised</u> gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category; |
|     |                   | ...                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                    |
| ... |                   |                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                    |

...

## Annex B

### Amendments to the Consumer Redress Schemes sourcebook (CONRED)

In this Annex, underlining indicates new text and striking through indicates deleted text.

#### 1 General

...

#### 1.4 Scope of a consumer redress scheme

The ~~financial~~ services that a consumer redress scheme can apply to

- 1.4.1 G In accordance with section 404E(2) of the *Act*, a *consumer redress scheme* can secure redress for consumers of services provided by:

(1) ...

...

- (3) *authorised persons* in communicating, or approving the communications by others of, invitations or inducements; ~~to engage in investment activity;~~

(a) to engage in investment activity; or

(b) to enter into or offer to enter into an agreement the making or performance of which by either party constitutes a *controlled claims management activity*.

...

...

- 1.4.4 G Where the ~~financial~~ services to which a scheme applies are those provided by *authorised persons* in carrying on *regulated activities*, the limitation to '*regulated activities*' means that a *consumer redress scheme* cannot apply to services that were provided before the activity in question first became regulated by the *FSA* or *FCA* (e.g. the start date of a scheme applying to general insurance mediation could not be earlier than 14 January 2005, which was the commencement of regulation of general insurance mediation).

- 1.4.5 G That said, it would be possible for the Treasury by order to widen the type of ~~financial~~ services that a *consumer redress scheme* can cover in order to encompass pre-regulation activities (see section 404G of the *Act*).

Consumers that can be covered by a consumer redress scheme

- 1.4.6 G (1) For the purposes of a scheme, a consumer can be any person:
- (a) who has used, or may have contemplated using, any of the ~~financial~~ services listed in section 404E(2) of the *Act* (see *CONRED* 1.4.1G); ~~or;~~
  - (b) who has relevant rights or interests in relation to any of those services; or
  - (c) in respect of whom a person carries on the regulated activity of seeking out, referrals and identification of claims or potential claims whether that activity, as carried on by that person, is a regulated activity or is, by reason of an exclusion provided for under the Regulated Activities Order or the Act, not a regulated activity.
- (2) As such, the section 404 power is not limited to retail customers only.

...

- 1.4.10 G The fact that a consumer “who may have contemplated using” a relevant ~~financial~~ service can be covered by a *consumer redress scheme* is unlikely to catch many cases in practice. One example of a case where it might be used is where there has been widespread discrimination: the section 404 power could be used to ensure redress for consumers who were unlawfully denied access to a ~~financial~~ service contrary to any relevant equality legislation. All the restrictions and evidence requirements explained in *CONRED* 1 would apply equally to any scheme developed in this sort of area.

...

## 1.6 Role of the Financial Ombudsman Service and the Financial Services Compensation Scheme

...

Failures by firms that span the period before and after an activity became regulated by the FCA

- 1.6.22 G In this situation, the *Act* would require the *Financial Ombudsman Service* to decide *complaints* within the scope of a scheme by applying the scheme (unless the relevant firm and consumer otherwise agreed – see section 404B of the *Act*) and *complaints* outside the scope of a scheme on the basis of its usual approach (see section 228 of the *Act*). However, as explained in *CONRED* 1.4.5G, it would be possible for the Treasury by order to widen the type of ~~financial~~ services that *consumer redress schemes* can cover in order to encompass the pre-regulation activities (see section 404G of the *Act*).

## Annex C

### Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text.

#### 8 Financial promotion and related activities

...

#### 8.4 Invitation or inducement

...

- 8.4.4 G The *FCA* considers that it is appropriate to apply an objective test to decide whether a communication is an invitation or an inducement. In the *FCA's* view, the essential elements of an invitation or an inducement under section 21 are that it must both have the purpose or intent of leading a person to *engage in investment activity* or to *engage in claims management activity*, and be promotional in nature. So it must seek, on its face, to persuade or incite the recipient to *engage in investment activity* or to *engage in claims management activity*. The objective test may be summarised as follows. Would a reasonable observer, taking account of all the circumstances at the time the communication was made:
- (1) consider that the communicator intended the communication to persuade or incite the recipient to *engage in investment activity* or to *engage in claims management activity*, or that that was its purpose; and
  - (2) regard the communication as seeking to persuade or incite the recipient to *engage in investment activity* or to engage in claims management activity.



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