Association of British Insurers

ABI RESPONSE TO THE CALL FOR EVIDENCE ON THE REGULATION OF CLAIMS MANAGEMENT COMPANIES (CMCS)

About the ABI

The Association of British Insurers is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12bn in taxes and manage investments of £1.8trillion.

Executive Summary

The ABI welcomes the review of the regulation of Claims Management Companies (CMC). Unscrupulous behaviour from CMCs, looking to circumvent the current regulatory regime, has served to fuel the UK's compensation culture, encouraging fraudulent and frivolous claims that push up the cost of insurance for honest customers.

We acknowledge and welcome the improvements that have been made by the Government and the Claims Management Regulatory Unit (CMRU) in recent years. However, the fact that in 2014, 22% of regulated CMCs either lost their accreditation or received a formal warning demonstrates the need for a much more robust regulatory regime, as does continued public anger over unsolicited marketing communications and evidence of CMC involvement in fraud.

A demonstration of how consumers lose out as a result of rogue CMCs comes from the recent example of Rock Law Ltd, which received a record fine from the CMRU on 16th October 2015 The investigation by the CMRU found this firm "had consistently infringed rules".

In his foreword to the CMRU's Annual Report 2014/15, the Head of the CMRU, Kevin Rousell, writes, "some CMCs – and some solicitors – have a lot to do in terms of making sure leads are legally obtained and claims are properly substantiated before being submitted." All consumers lose out as a result of the costs incurred by businesses dealing with this kind of poor CMC practice.

The ABI recognises that this review cannot be expected to solve every problem in this area. One objective of this review should be to identify aspects of CMC activity that will merit further attention, both within Government and by a better-equipped regulator.

In particular, we hope this review will re-emphasise the need for sustained action within the CMC sector to implement the 15 proposals made by Which?'s 'Nuisance Calls and Texts Taskforce', and for the Government to review progress against its own action plan in 2016. The ABI would also like to see an in-depth review of the effectiveness of the application of the ban on referral fees. More broadly, this review will need to set out key themes that a better-equipped regulator can explore in more depth.

Yet, even in a relatively short timeframe, this review offers a chance to make significant changes that will address many of the worst CMC behaviours. To tackle the problem, reform should be introduced covering the following areas:

- Transparency regarding all aspects of CMC involvement in claims
- Regulatory architecture and governance of the CMC regulator
- Scope of the current regulations
- Compliance and enforcement of rules
- Improvements to conduct rules
- A clear process for those affected by CMC activity to highlight bad practice

1. Introduction

1.1. The ABI welcomes this review as there is an urgent need to improve the regulation of CMCs. It is hoped that the outcome of the review will be recommendations for reforms to address the problems in this sector, and an identification of key themes that a stronger regulator can continue to explore after this review has been completed.

1.2. The insurance industry fully supports genuine claimants receiving compensation in a timely and proportionate manner. We have campaigned for changes to the civil litigation system that support this objective.

1.3. Consumers have a right to be represented by whoever they see fit. CMCs can meet a legitimate demand from some consumers for support in making a claim and facilitate access to justice for some vulnerable consumers who would otherwise face difficulties navigating the civil justice system. We recognise that a claim generated because a CMC has brought an issue to a consumer's attention can be just as valid as a claim brought directly by a consumer.

1.4. However, the behaviour and practices of many CMCs have damaged the reputation of the sector as a whole and undermined confidence in the system. These practices encourage frivolous and exaggerated claims that push up the costs of insurance for honest customers. There are occasions when CMCs are involved unnecessarily in processing relatively simple claims, which leads to consumers giving up a significant percentage of their damages when it would have been as easy to submit the claim themselves.

1.5. Many consumers, including those with legitimate grounds to make a claim, do not receive good value for money from their CMC when making a claim. Evidence from Citizens Advice in 2014 found that 47% of customers who had used a CMC would not have done so if they had known about the free alternatives available and 27% did not feel the fees structure was clearly explained.[1] Even more worryingly, Citizens Advice found examples of claimants ending up in debt as a result of the fees charged, even when their claim was successful. In addition, many CMC business models allow firms to generate quick profits while in turn generating increased costs for other industries (and their customers) and for the Financial Ombudsman's Service (FOS).

1.6. Given evidence of direct links between some CMCs and fraud (*set out in more detail in Paragraph 2.6*), it is imperative that this review engages with the Insurance Fraud Taskforce, and that these complementary pieces of work are co-ordinated closely.

1.7. It is important that this review does more than offer a handful of 'quick wins'. There is a clear need for a regulatory structure that does more than punish CMCs for poor conduct after the event – it must create a culture of good practice and regulatory compliance within all CMCs.

[1] Claims firms cash in up to £5 billion of PPI compensation', Citizens Advice, 5 March 2014 - https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/claims-firms-cash-in-on-up-to-5-billion-of-ppi-compensation/

2. The nature of the problem

2.1. Effectiveness of existing CMC regulation

2.1.1. The ABI is supportive of work already undertaken within Government and by the Claims Management Regulatory Unit (CMRU) to tackle malpractice and drive up standards amongst CMCs. The decision to make the Legal Ombudsman responsible for handling complaints made against CMCs and the strengthened conduct requirements and additional powers to impose fines demonstrated an increased commitment by Government to tackling this problem. We also note the increased resources devoted to the CMRU and its improved governance structure (with independent directors).

2.1.2. This review represents an opportunity to assess the early effect of these changes on the CMC market. However, concern remains that even after these changes, the current regulatory regime is only able to go part of the way to tackling the malpractice associated with certain CMCs operating in the market.

2.1.3. In addition, there is a need to address the more deep-rooted problem of the UK's compensation culture, particularly in relation to the volume of low value personal injury claims and the costs that can be generated by these claims. There continues to be incentives within the low value claims compensation system that drive CMC activity, as it makes such claims especially financially lucrative.

2.1.4. CMCs appear to be adept at switching from one sector to another – recent examples are firms who, having previously focussed on motor claims, now specialise in Noise Induced Hearing Loss (NIHL) claims and firms that now specialise in mis-sold pre-packaged bank accounts. Such trends are likely to continue as some CMCs will chase any opportunities they perceive to be lucrative. There is also evidence of CMCs pursuing other, unregulated, activities that is directly responsible for inflating claims costs for some consumers (for example, the involvement of some CMCs in providing replacement cars through credit-hire agreements, *referred to further in Paragraph 3.3.5*).

2.1.5. The industry is also increasingly concerned about the role of CMCs in property claims. The ABI recently published consumer guidance[2] on this issue, in conjunction with the Citizens Advice Review. *We address this point further in Paragraphs 2.2.5 and 2.2.6*.

2.1.6. The challenges posed by CMCs go beyond issues relating to low value claims. The Motor Insurance Bureau (MIB) has observed larger-value personal injury claims being handled directly by CMCs (and not referred on to a solicitor), and are concerned that the CMCs involved do not have the expertise required to deal with such claims. In addition the MIB has identified a contract in use by a CMC which would allow the CMC to deduct 25% of all damages awarded to a seriously injured claimant, including, potentially, awards for future loss of earnings and/or the claimant's long term care needs.[3]

[2] 'Home Insurance and the Role of Claims Management Companies: Top Tips from the ABI', March 2015 - https://www.abi.org.uk/~/media/Files/Documents/Consumer%20Guides/Home%20insurance%20and%20claims%20management%20companies.pdf

[3] The MIB will be submitting a separate response to the call for evidence giving further insight into these issues.

2.2. Scale of the problem

2.2.1. Despite the recent introduction of increased powers for the CMRU, the value of the CMC sector has grown in the past year (between November 2013 and November 2014), with a turnover of £772m (up from £698m in 2012-13), of which £310m is in the personal injury space (up from £238m). As shown in the CMRU's annual report, there is a significant regional variation in the number of CMCs. For example, 516 are based in the North West and only 39 in the North East. We do not believe the CMRU's existing reporting fully explains the reasons for such trends, further highlighting the need for transparency and more effective reporting outlined below (*Paragraph 2.4*).

2.2.2. In 2014, the CMRU cancelled the authorisation of 105 CMCs and issued warnings to 296 CMCs. Out of a total of 1752 businesses, 401 (23%) were subject to some form of CMRU regulatory intervention.

2.2.3. These numbers demonstrate conclusively that a very significant part of the CMC market has been accredited without being either aware of or having the intention to meet even the existing conduct requirements the CMRU requires of them.

2.2.4. Although we recognise that the CMRU's work is intelligence-led and targets those firms already suspected of poor practice, it is not unreasonable to assume from these numbers that if all 1752 CMCs had been audited, further examples of poor practice would have been uncovered. (*We make proposals for how the CMRU's auditing and accreditation could be further improved in paragraphs 3.5 and 3.6*).

2.2.5. The problems observed with CMC activity are not just related to personal injury claims. For example, insurers are concerned that the CMRU has not fully appreciated the extent of problems with CMCs that pursue property claims. This is understood to be a particular problem in Northern Ireland, where the Compensation Act 2006 does not apply.

2.2.6. To demonstrate the issues with property claims, we have provided two case studies relating to drainage claims below. In both of these cases, the Ombudsman opted not to mention the actions of the CMC in their judgement, despite the insurers' view that the CMCs pursued a course of action that was not in their customers' interests –

- A CMC concluded that a sewerage treatment plant should be installed at a cost of over £120,000. The CMC rejected the insurer's offer to provide alternative services free of charge that would have looked at alternative options more economic to the customer, which the insurer believes to be because the CMC had a financial relationship with panel contractors. The Ombudsman service supported the insurers' decision to reject the claim.

- A CMC alleged that work more extensive than the work the insurer believed was required should be undertaken. The insurers offered arbitration, the cost of which should be funded by the loser; the insurer or the CMC (not the customer). The CMC rejected this offer. The Ombudsman Service agreed that arbitration was the best solution. The arbiter concluded that the insurer's position was correct, so the Ombudsman determined in favour

of the insurer. However, the Ombudsman said that the insurer should fund the arbitration at a cost of £1,000, leaving the CMC free of any responsibility.

2.2.7. As well as highlighting the kind of poor practice that are too prevalent in the CMC sector, these examples demonstrate specific concerns about the effect CMCs have on claims. If consumers were provided with more transparency about the financial relationships and incentives driving CMC activity and were informed what action the CMC took on their behalf during the course of a claim, they would have had a better outcome and – potentially – neither claim would ever have needed to be referred to the Ombudsman.

2.3. Fees cap

2.3.1. The cap on fees that was announced, alongside this review, in the Chancellor's Summer Budget is especially welcome. While this measure alone will not be sufficient to effectively prevent poor practice by CMCs, we strongly support the principle of this cap.

2.3.2. However, we are very concerned by suggestions that this cap may only apply to firms handling PPI claims. The cap must apply to all CMC activity – firstly, because the cap would be an equally effective disincentive to pursuing or exaggerating claims in whichever sector the CMC operates and secondly, because having a different regime for different CMCs risks undermining the important principle that all CMCs should be subject to the same degree of regulation.

2.3.3. If the fees cap was only applied to PPI claims, many CMCs would simply divert their attention to other areas that would then be more lucrative – simply shifting the costs of dealing with claims from one industry to another, and not truly addressing the problem.

2.3.4. The ABI looks forward to engaging with the planned consultation on the detailed implementation of the fees cap when it is published later this year. We encourage this review to recommend a fees regime that applies across the CMC sector.

2.4. Transparency

2.4.1. Improved transparency would allow a more effective assessment of the effect of CMC activity on claimants and on the economy. This would allow consumers who use CMCs to have more confidence in the track-record of the firms they are using, and to be fully aware of the commercial relationships CMCs have with other organisations in the claims process.

2.4.2. As stated above (*paragraph 1.3*), consumers have the right to be represented by whoever they see fit. However, there is no reason why this should not be disclosed when a claim is submitted. For low value motor, Employer's Liability and Public Liability claims, the Claims Notification Form (CNF) already allows for claimants to declare when a CMC has processed or referred their claim – however, because it is not mandatory, this part of the CNF is typically not filled in.

Proposals to improve transparency

2.4.3. Completion of a statement listing any activity by a CMC in the processing or referral of a claim must be mandatory and the CMC must be named. This would provide transparency for all involved, allowing for more accurate assessments of the effect of CMC activity and would be of great assistance in identifying unregulated or fraudulent CMC activity.

2.4.4. In addition to this, as a requirement of authorisation, CMCs should be obliged to declare to the regulator the source of the claims they submit and also to provide data on the volume of claims or complaints they submit that are not upheld (this is especially important when firms charge up-front fees, but also valuable as a measure to assess the effect of CMC activity on the wider economy).

2.4.5. In line with the requirement on the Financial Ombudsman Service (FOS) to provide data about the firms it regulates, there should also be a requirement for the FOS to provide data about the validity of complaints it receives that have been submitted with the involvement of CMCs. In particular, the FOS should publish data on the number of complaints submitted with CMC involvement that are deemed frivolous or vexatious, as well as publishing data on uphold rates. The ABI understands there is already an option for the FOS to refer any concerns it has about CMC activity to either the CMRU or the Competition and Markets Authority, but we see no reason why such data should not also be made public.

2.4.6. There are improvements that could be made to the information the CMRU (or a new regulator) provides on the success of CMC regulation. The CMRU's assessment of the state of the sector tends to focus on the number of active CMCs and the numbers who have been subject to sanction or had their accreditation revoked.

2.4.7. The focus of the CMRU's reporting should instead be on the volume of claims (including rejected claims and those where the FOS deems insufficient or inaccurate information has been provided). This will better demonstrate the effect CMCs have on the wider economy – and will provide more robust data in the event of a consolidation of the CMC market and on the extent of CMC activity in the wider economy.

2.4.8. At present, while the CMRU publishes regular updates on investigations and enforcement activity, these rarely contain detailed information about why these actions have been pursued. Data on the reasons why CMCs receive warnings or lose their authorisation could then be cross referenced against data from the regulated sectors in which CMCs operate, ultimately leading to a better understanding of the CMC market and more effective regulation.

2.5. Nuisance Communications

2.5.1. Speculatively contacting consumers encouraging them to make a claim is inappropriate, especially given the significant consumer distress and anger unsolicited communications are known to cause.

2.5.2. It is indisputable that CMCs are still actively commissioning or conducting cold-calling and that this is disturbing the public. According to ICO data[4], in the month of September 2015 alone, 1963 people reported concerns about nuisance communications in relation to personal injury claims and 2767 people reported nuisance communications about PPI claims. No other form of communication prompted as many people to report concerns. Overall this year, there have been 23,396 concerns reported to the ICO about personal injury cold calls and 23,992 concerns reported about PPI cold calls. An undercover investigation by the Sunday Times[5] highlighted the issue of customers being pressured through cold calling into making unjustified claims.

2.5.3. The ABI recently conducted research on the public's experience of unsolicited communications from CMCs[6], and found that –

- 83% of those asked have been contacted by a CMC encouraging them to claim for compensation, including for personal injury following a road traffic accident and mis-sold PPI.
- 49% had been contacted within the last week.
- 92% of those who were contacted said that the contact had no relevance to any event or product that they held.
- 83% feel it is unacceptable to be contacted by CMCs without an individual's prior consent.

2.6. Fraud

2.6.1. The evidence outlined above that CMCs often target consumers on a speculative basis gives rise to concerns that such contact may encourage people to submit claims (sometimes without the customer's consent) when they have no reason to, and that some CMCs may be encouraging fraud.

2.6.2. The Insurance Fraud Bureau (IFB) has identified clear links between a number of CMCs and organised fraud -

- Nearly 50% of IFB live operations feature a CMC.
- 56 CMCs are under investigation by the IFB as part of 'crash for cash' scams.
- IFB has received more than 400 intelligence reports where a CMC is at the heart of the problem.
- In July 2015, an organised criminal gang which attempted to defraud the UK Insurance industry for circa £5.6m was found guilty of "conspiracy to defraud". The gang operated a CMC – 'Herald Claims Limited' – and orchestrated 'cash for crash' incidents which were then submitted as

[4] ICO – 'Concerns reported by type, 2015' - https://ico.org.uk/media/action-weve-taken/monitoring/1431832/concerns-reported-by-type-2015.csv
[5] Sunday Times, 'Cold callers push clients into false accident claims', 5 July 2015 - http://www.thesundaytimes.co.uk/sto/news/uk_news/National/article1577228.ece
[6] 'ABI calls for clampdown on rogue claims management companies as people continue to be bombarded by nuisance calls and texts', 8 September 2015 - https://www.abi.org.uk/News/News-releases/2015/09/ABI-clampdown-rogue-claims-management-companies-as-people-continue-bombarded-by-nuisance-calls-texts

claims. The gang had previously traded as 'Euro Claims Management' and 'FS Claims Management'[7].

- South Yorkshire Police suspected a bus crash they were investigating to be fake. During interview, the driver of the bus admitted to staging the collision with Mohammed Gulzar, owner of an authorised CMC - City Claims 4 U (the authorisation was suspended on 27 March 2012. The IFB worked with insurers and South Yorkshire Police and identified over 30 further incidents staged by this CMC. On 24 January 23014, Mr Gulzar and 4 colleagues were found guilty of fraud related offences and were sentenced to 10 years imprisonment.[8]
- An investigation into an authorised CMC - Concept Accident Management Ltd (also known as Advance Claims) revealed it was being used as a front for creating and pursuing staged motor claims (its authorisation was surrendered on 7 October 2013). West Yorkshire Police worked with insurers and the IFB to compile a comprehensive evidence package, not only linking the illegal activity to the 4 directors of the business, but also a significant number of others, all of whom were arrested as part of the investigation. 48 were charged with conspiracy to defraud with 35 pleading guilty and the remaining suspects being convicted during 2014. The 4 directors of the CMC received over 6 year's imprisonment.[9]

[7] IFB, '£5.6 million Crash for Cash criminal gang found guilty', 16 July 2015 - https://www.insurancefraudbureau.org/media-centre/news/2015/56-million-crash-for-cash-criminal-gang-found-guilty/

[8] This case study was provided by the IFB – the case also received media coverage here: BBC, 'Sheffield 'crash-for-cash' ringleaders jailed', 24 January 2014 - http://www.bbc.co.uk/news/uk-england-south-yorkshire-25886347

[9] This case study was provided by the IFB – the case also received media coverage here: Huddersfield Daily Examiner, '44 sentenced for huge Huddersfield crash for cash scam: full list of those convicted, 5 April 2014 - http://www.examiner.co.uk/news/west-yorkshire-news/crash-cash-fraud-gang-jailed-6922814

3. Required solutions

As outlined previously, it is clear that while progress has been made in tackling some of the adverse behaviours of CMC, given the innovative nature of the market, CMCs quickly find new ways around the regulations. As such, further reforms are required to help crack down on poor behaviours and practices that lead to the overall detriment of consumers.

To tackle the problem, reform should be introduced covering the following areas:

- Regulatory architecture and governance of the CMC regulator
- Scope of the current regulations
- Compliance and enforcement of rules
- Improvements to conduct rules
- A clear process for those affected by CMC activity to highlight bad practice

3.1. Regulatory architecture and governance

3.1.1. When the Claims Management Regulator was established in 2007, a decision was taken to make it part of the Ministry of Justice in order that it be established as soon as possible. This was the appropriate decision at the time, as action was clearly needed. However, it remains unusual for a regulator to sit formally within a Government department rather than as an independent body. It is clear the concerns that prompted the creation of the CMRU in 2007 have not been wholly addressed, and also that new issues have emerged since. This is therefore an appropriate time to consider whether regulatory activity should be undertaken by an independent regulator.

3.1.2. The existing regulatory structure is unlikely to ever address concerns about CMCs in full. Indeed, the Claims Management Regulator Kevin Rousell has stated publicly that this issue is “not a priority” for the Ministry of Justice.

3.1.3. Given that ultimate responsibility for nuisance calls and direct marketing regulation rests elsewhere, the review should consider whether a reformed Claims Management Regulator should also devote resources to this issue, or whether more onus should be placed on Ofcom and the ICO to take action. The review should also consider whether, if CMCs were subject to stronger authorisation and governance requirements, there would be less need for targeted policing of their marketing activities. Due to the ongoing complexity of regulating nuisance communications, consolidating the other aspects of regulating CMC activity into a single, well-established regulator can only be beneficial.

3.1.4. Effective regulation of CMCs would benefit from the expertise of an established regulator, which will be in a position to utilise prior experience of addressing comparable poor behaviour in other sectors. An established regulator would also need to devote less time to operational and organisational matters when first taking on responsibility for CMCs. Therefore, this would be preferable to creating a new independent body.

3.1.5. We are concerned that dividing responsibility between the CMRU and the FCA (dual-regulation) would create too many potential loopholes, with the possibility for different regulatory priorities to be developed between different regulators. It should be possible to seek the expertise of several regulators or public bodies while maintaining the formal responsibility for regulation within a single organisation.

3.1.6. When the CMRU was initially established, we understand that it was the original intention that the Legal Services Board (LSB) would assume responsibility for regulating CMCs. However, in practice the LSB has not assumed the role of an active regulator and none of the front-line regulators it authorises would be appropriate organisations to regulate CMCs. Effective CMC regulation will be primarily driven by understanding the financial incentives and market trends that drive CMC activity – issues which are typically not guiding principles for legal regulation. As such, transferring responsibility to one of these bodies would therefore be a backward step.

3.1.7. However, it is clear that a close working relationship will be needed between the regulator of CMCs and these legal regulators, especially the SRA, reflecting that CMCs often refer cases on to legal professionals.

3.2. Transferring responsibility for CMC regulation to the Financial Conduct Authority

3.2.1. The ABI's preferred option would therefore be to transfer responsibility for CMC regulation in full to the Financial Conduct Authority (FCA). Section 5 of the Compensation Act 2006 allows the Secretary of State to designate a person as the Regulator. Therefore, transferring responsibility from the Ministry of Justice to another existing regulatory body should not require primary legislation. As both the existing CMR and the FCA are funded by the firms subject to regulation, such a move should be cost-neutral to the Exchequer.

3.2.2. Financial incentives are the primary reason CMCs exist – they do not typically operate where consumer grievances can be addressed without financial compensation. Therefore, the sectors most affected by CMCs are those the FCA already regulates, including consumer finance, banking and insurance. The FCA therefore would be able to understand the CMC market in a way no other regulator could. The ABI anticipates that the FCA would want to consider how insurers interact with CMCs in this context – something missing in the existing CMC regulatory regime.

3.2.3. Such a move would demonstrate the intention to place regulation of this sector on a secure and long term footing. Those using CMCs to make claims would benefit from the FCA's focus on delivering good outcomes for consumers, while those CMCs who do comply with regulation and treat customers well will benefit from the FCA's focus on ensuring there is effective competition in the markets they regulate. This would allow CMC regulation to benefit from the FCA's broader expertise and allow the MOJ to focus on its core objectives.

3.2.4. In addition, the FCA's specific focus on fraud within its statutory objective of reducing the risk of financial crime should allow a better joined-up approach to

this issue. In practice, the CMRU and FCA already work closely together – formally merging the CMRU into the FCA would be a logical step and reduces the likelihood of new loopholes appearing through which those CMCs that intend to commit fraud can slip.

3.2.5. The FCA's experience of consumer credit regulation offers a workable model for how CMC regulation should be addressed. The FCA assumed responsibility for regulating the 50,000 firms that offer consumer credit, loans and debt services after this was transferred from the Office of Fair Trading (including the transition of 105 permanent staff). The FCA was able to take action quickly – within the first five months of assuming responsibility for this sector, the number of loans and the amount borrowed fell by 35%[10]. This indicates that regulating the 1,752 authorised CMCs should not cause the FCA significant operational difficulties. In October 2015, the FCA launched a consultation on its proposals for regulation of consumer credit, prompted by a CMA investigation into the sector[11]. The questions raised in this consultation demonstrate how similar the questions for regulators in this sector are – with the FCA looking at measures to improve disclosure on fees and charges, transparency about links with commercial partners, transparency regarding lead generation. The FCA had already announced a review of consumer credit firms' use of cold calling and on the effectiveness of a cap on fees.

3.2.6. We therefore recommend transferring the existing CMRU leadership team and staff to the FCA. The CMRU team will be able to combine its expert understanding of how CMCs operate with the FCA's wider understanding of how markets operate. This will allow the existing risk-based, firm-by-firm auditing to continue, while also conducting more focussed work on the impact CMCs have on the wider economy. This will mean that CMC regulation will not merely ensure that regulated firms meet a minimum level of compliance, but that the CMC market as a whole operates in a way that promotes good outcomes for consumers.

3.2.7. The FCA's greater scale allows for a stronger internal distinction between audits and accreditation, and an entirely distinct part of the regulator responsible for taking formal enforcement action. Though we have no reason to think this is a problem with the current staff of the CMRU, it is a clear risk for all regulators that decisions may be taken not to pursue enforcement action on cases which highlight their own earlier failures to assess or audit firms appropriately.

3.2.8. As was the case when the FCA took on the regulation of consumer credit, there will be two concurrent tasks – firstly, ensuring that CMCs are properly accredited under the new regime (a task the ABI believes would need to happen even if the FCA did not take on regulation, given that much more is asked of CMCs than was the case when the CMRU was originally created in 2007) and secondly, a deeper investigation of the CMC market that establishes what the different business models of CMCs look like in the marketplace and whether the range of products and services offered are all socially useful.

[10] FCA, 'FCA confirms price cap rules for payday lenders', 11 November 2014 - https://www.fca.org.uk/news/fca-confirms-price-cap-rules-for-payday-lenders

[11] FCA, 'CP15/33: Consumer credit: proposals in response to the CMA's recommendations on high-cost short-term credit', October 2015 - https://fca.org.uk/your-fca/documents/consultation-papers/cp15-33

3.2.9. The ABI recognises that the transition of responsibility for CMC regulation to the FCA will need to be carefully managed. The FCA's usual approach to SMEs may need to be revised for CMCs given that there is still a need to pro-actively make many CMCs aware of their compliance requirements and target firms on a case-by-case rather than an industry-wide basis.

3.2.10. We also accept that some of the smaller sectors in which there is CMC activity do not directly relate to the FCA's core expertise of financial services (for example, employment claims). However, the FCA already has well established working relationships with other regulators and public bodies, and will be able to use this to understand issues in this sector as they arise. The FCA's remit is already broad and the clear advantages it offers to CMC regulation outweigh this small potential disadvantage. Furthermore, while the details of the claims themselves may vary, we expect that the business models will be very similar, and therefore, the regulatory models needed for each different CMC sector are unlikely to vary significantly.

3.2.11. Further to the above point, one of the ABI's major concerns about the existing regulatory regime is that – while it has made progress in extending the scope of firm-by-firm auditing – it has not proven able to fully understand the market dynamics of this sector (*see 'Scope of Regulation' section below*). The FCA's expertise in assessing how markets operate will allow questions about the different kinds of CMC activity to be better understood, enabling an assessment of where standard regulatory practices should apply to all CMCs, and also where specialist CMCs require different approaches.

3.2.12. The existing CMRU has only a limited capacity to assess how the CMC landscape is likely to develop – for example, how the falling number of PPI claims is likely to affect CMC activity in other sectors. The FCA's econometric modelling and ability to place the activities of one sector within a wider economic and societal context will allow a better understanding of how CMCs are likely to develop, in turn ensuring that the auditing and risk-assessing of firms is better targeted. Such modelling would also benefit from the increased transparency about CMC activity referred to above (*paragraph 2.4*).

3.2.13. The FCA is uniquely placed to effectively regulate this challenging sector. Not using this review to completing the job of putting the right regulatory architecture in place that was started in 2007 would be a lost opportunity. However, if this review opts against taking this step, at the very least, the following features of the FCA's regulation must be adopted by the CMRU (or other responsible regulatory body) –

- A commitment to giving consumers a fair deal (promoting the highest standards of consumer care rather than simply sanctioning poor behaviour)
- A commitment to maintaining the integrity of the market (and ensuring that CMC activity does not distort other interrelated markets)
- A legislative responsibility to prevent fraud and financial crime

- Robust internal mechanisms to separate accreditation, auditing and compliance functions entirely from enforcement functions

- Sophisticated econometric modelling and forensic data analysis to understand the factors driving market trends

- Formal and well-defined working relationships with other regulators and public bodies

- A well-established public profile that allows change to be driven across the sectors regulated

3.3. Scope of regulation

3.3.1. To ensure a holistic and joined up approach to combating some of the issues posed by CMCs, this review must consider the wider claims environment, as well as those organisations currently defined as CMCs by the CMRU. The 2006 Act defines claims management services as "advice or other services in relation to the making of a claim".

3.3.2. Given this, it would be consistent with the original principles under which the CMRU was established to extend its remit to include firms that do not currently fall directly within the current definition of a CMC, but that clearly exist to serve clients who are making a claim. Medical Reporting Organisations (MROs) are one example of this (*and address these in more detail below – paragraph 3.4*).

3.3.3. The review should seek to understand how the sector as a whole is regulated and be mindful that, where different parts of managing a claim are subject to widely varying degrees of regulation, this prompts 'regulatory arbitrage', with firms able to choose the regulatory regime that will be least burdensome. In the worst cases, this can allow firms to operate 'under the radar', leading to undetected malpractice and, often, fraud.

3.3.4. There is evidence that unregulated CMC activity is a growing problem. The CMRU currently receives an average of 50 reports a month of businesses allegedly engaged in unregistered CMC activity – a 25% increase on 2013.

3.3.5. There is also evidence that lines between different types of firms in the wider sector have become blurred – for example, the CMRU's most recent annual report notes that the main source of income for some firms authorised to conduct CMC activity has become ancillary services related to PI claims (such as vehicle recovery, storage, repair and credit-hire). An ongoing task for the CMC regulator should be to ensure that it considers new forms of company that can reasonably be considered to be providing "advice or other services in relation to the making of a claim", even if such companies choose not to identify themselves as a CMC.

3.3.6. We do not expect this review to make final conclusions on the complex-issue of credit-hire, but it would be appropriate for the review to come to an initial view on whether this activity should be considered as falling under the broad definition of "claims management" and be regulated accordingly.

3.4. Medical Reporting Organisations (MROs)

3.4.1. In particular, the ABI recommends that Medical Reporting Organisations (MROs) are brought directly under the scope of Claims Management regulation as we have already recommended in our response to the MoJ Call for Evidence on the MedCo framework review[12]. The current exclusion of MROs from regulation is an oversight that is not in the interests of consumers, and that – in the context of the recent launch of MedCo – this is an issue where urgent action needs to be taken and where this review can solve the problem.

3.4.2. MedCo is the new system to facilitate the sourcing of medical reports in soft tissue injury claims brought under the Ministry of Justice's Pre-Action Protocol for Low Value Personal Injury Claims in Road Traffic Accidents. This system went live on 6th April 2015. Medical Experts, MROs and Commissioners of Medical Reports must register via the MedCo website in order to be able to provide or commission medico-legal reports in relation to RTA soft tissue injury claims.

3.4.3. Since the launch of MedCo earlier this year, a substantial amount of work has been contributed by the insurance industry and wider stakeholders, but due to patterns of behaviour by certain operators in the market, MedCo has in effect been obliged to operate as a quasi-regulator. As such, now is the right time to consider whether a regulatory framework should be applied to MROs in light of the behaviours witnessed in the market since MedCo became operational.

3.4.4. The establishment and operation of MedCo has highlighted exactly the kind of behaviour from MROs and the wider medico-legal reporting sector for soft tissue injury claims that led to the Government deciding to introduce MedCo in the first place. The dysfunctional behaviour witnessed has almost exclusively emanated from MROs in their attempts to undermine the system of random allocation for their own commercial gain.

3.4.5. MedCo was not designed to be, does not have the powers associated with, and does not have the mandate to be a regulator of MROs. The introduction of MedCo, and the behaviours of MROs that have followed, has highlighted the need for regulation of this sector. The other main sectors involved in soft tissue injury claims – insurers, solicitors, claims management companies, medical experts - are all subject to regulation (by the Financial Conduct Authority, Solicitors Regulation Authority, Claims Management Regulator and General Medical Council respectively).

3.4.6. MROs are not subject to any regulatory disciplines. Effective regulation has the potential to address some of the behaviours by MROs that have been witnessed to date and to assist MedCo in ensuring that only those firms which have been subject to regulatory disciplines are registered.

3.4.7. Given the similarities that exist between claims management companies and MROs in terms of their position in the insurance claims supply chain, this review

[12] 'ABI calls for the regulation of Medical Reporting Organisations to ensure that MedCo provides a fair and transparent service', 7 September 2015 - https://www.abi.org.uk/News/News-releases/2015/09/ABI-calls-regulation-Medical-Reporting-Organisations-ensure-MedCo-provides-fair-transparent-service

offers an ideal opportunity to align the regulatory regimes these firms face, reducing the risk of regulatory arbitrage. As with CMCs, it is important that the regulator focusses on the financial incentives driving behaviour (regulating MROs as a business – while also ensuring that where questions about the medical competence of individuals in these firms are raised, these are referred on to the appropriate regulator.)

3.5. Compliance and Enforcement

3.5.1. In addition to advising on the implementation of the fees cap announced in the Chancellor's Summer Budget, this review should prioritise ensuring customers have transparency about what they have been charged for and why. To help achieve this, CMCs should be:

- obliged to disclose what fees will be charged in full at the pre-contractual stage (and also clearly signpost free alternatives) and;
- should also provide customers with an itemised statement setting out the work they have done for the fees collected/portion of redress taken.

3.5.2. We recognise some work has already been taken forward in this area, but believe this review should consider stronger incentives to ensure this happens.

3.5.3. It is also important that existing bans on personal injury referral fees are diligently enforced, with a joined-up approach between the regulators responsible for enforcing these bans. It is important to include firms who might pay such fees as well as those who might receive them – removing the temptation of fees being offered is the best way to end this practice.

3.5.4. This review may not be able to make detailed recommendations on how a stronger regulatory toolkit would work in practice, but we recommend that it identifies a framework through which the following requirements can be developed –

- An **accreditation scheme** (introduced on a grandfathered basis) that requires every CMC, not just new entrants, to affirm their compliance with the new standards (a model for this could be the re-accreditation the FCA required of firms after it assumed responsibility for consumer credit from the OFT)
- An **approved persons regime** to create meaningful sanctions that prevent those found guilty of serious breaches from working within a CMC in future – going beyond existing rules for directors to ensure anyone responsible for submitting a claim to a third party is personally accountable under conduct rules. Ownership structures should be transparent, to ensure that CMCs which are sanctioned by the regulator cannot re-appear with a new trading name.
- **More proscriptive conduct rules** – the CMRU has expressed a preference for a principles-based rather than rules-based regime. However, the high number of breaches identified every year indicates that

more onus should be placed on CMCs to show they are compliant, rather than on the CMRU to prove they are not (*see paragraph 3.6 for more details*.)

- More targeted audit for **firms charging up-front fees or taking high commissions**. It is reasonable to assume that firms who take a larger share of the compensation or damages paid to a claimant may have a greater incentive to exaggerate the details of a claim, and as a result, that such firms will require more attention from the regulator. Where up-front fees are paid, there is a risk that claims will be submitted regardless of whether they are justified. This review may also consider whether such firms should pay **higher regulatory fees** to account for the greater demands they place on the regulator.

3.6. Proposals for improvements to conduct rules

3.6.1. While we acknowledged the CMRU's preference for a principles-based rather than rules-based regime, existing conduct rules need to be more proscriptive. The continued high number of firms who lose their authorisation demonstrates that the existing guidance offered to firms is not effective. The CMCs themselves will benefit from clearer guidance on what good behaviour looks like.

3.6.2. The following issues need to be addressed in the Conduct Rules CMCs sign up to –

- There should be detailed rules in place requiring firms to get proper authorisation from prospective claimants, investigate the accuracy of information provided by these claimants and ensure they complete questionnaires accurately.

- The lack of detailed training and competence requirements are a key driver behind some of the poor practice by CMCs. A specified training and competence regime must apply to all authorised CMCs, covering requirements around qualifications, ethics and on-going training.

- The ABI is concerned about the scope for consumer detriment arising out of CMCs failure to act in the best interests of their clients. More guidance and stricter enforcement is required with regard to CMCs obligations under Client Specific Rule 1 (g) to "advise a client to pursue a case only if it is in the best interest of the client to do so". Furthermore, this rule should specify directly that it applies in all circumstances, for example, when firms are soliciting for business.

- Standards for the provision of customer information about how fees are calculated must match those the FCA expect for financial service providers providing finance and credit.

- Where CMCs rely on referrals and other financial arrangements with others (such as solicitors) these must be openly declared, including the percentage of fees paid or damages claimed that will be affected. If, for

example, a CMC has a formal agreement to refer cases to a particular solicitor, they must say so, both when initially agreeing a contract with a claimant and at the point the claim is referred on. When more than one organisation charges a percentage of the damages, consumers must be fully aware of the total percentage of these charges they will be obliged to pay.

- Stronger rules to protect consumers who decide not to pursue their claim from being charged 'exit fees'. Consumers who use CMCs should have the same right to withdraw their claim as a consumer who has pursued a claim directly.

3.6.3. On the question of cold calling, it is not sufficient merely to refer CMCs to the Direct Marketing Association's code (the rules of which, in turn, refer firms back to the Data Protection Act 1998 and the Privacy and Electronic Communications Act 2003). There are significant differences between calls or texts that are intended to market a general product or service, and calls or texts that actively encourage someone to claim for compensation or damages. The CMRU (or other responsible regulatory body) should review the rules on marketing published in 2013 to ensure these are specifically tailored to the communications CMCs are likely to undertake.

3.6.4. The CMRU must specify appropriate steps that each CMC should take to ensure they only contact those who have expressly given permission to be contacted about a claim (not just those who have given historical consent to receiving general marketing information) – especially important in the case of personal injury, which will often be a sensitive subject. It must also be noted that, where these calls encourage exaggerated or unwarranted claims, those receiving the calls are at risk of being encouraged not just to buy a product they do not want or need, but in some cases to commit fraud. As mentioned above (*paragraph 3.1.3*), this review should consider whether the CMRU needs to to maintain its specific unit looking at cold calling and nuisance calls, or whether Ofcom and the ICO taking full responsibility for regulating CMC marketing activities would be more effective.

3.6.5. During 2016, the Government should formally review progress against the Department for Culture, Media and Sport's 2014 Action Plan on nuisance calls[13] and also ensure that the recommendations set out by Which?'s 'Nuisance Calls and Texts Taskforce'[14] are implemented.

3.7. Highlighting bad practice

3.7.1. The ABI acknowledges and welcomes the efforts made by the CMRU to engage on a regular basis both with those it regulates and with the sectors affected by CMC activity.

3.7.2. However, concerns have been raised by some compensators that they have not received explanations of what action was taken regarding evidence they passed

[13] DCMS, 'Action Plan On Nuisance Calls', March 2014 - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/299140/Action_Plan.pdf
[14] Which?, 'Nuisance Calls and Texts Taskforce Recommendations', December 2014 - http://www.which.co.uk/documents/pdf/nuisance-calls-task-force-recommendations-388317.pdf

to the CMRU of suspected CMC malpractice. It is important that anyone who raises issues is reassured that their concerns were appropriately considered.

3.7.3. The ABI recommends that this review considers whether the process of evidence of suspected malpractice submitted to the regulator could be improved. Such a process should also incorporate a well-understood function to allow third-parties, consumers and employees of CMCs to submit information that can be considered by the regulator.

3.7.4. Where regulatory action is taken against a CMC, this should automatically trigger the appropriate regulator to investigate whether action should also be taken against those (for example, solicitors) with whom the CMC might have formal agreements. All financial relationships between regulated professions and CMCs should be declared to the respective regulator (for example, the SRA) and audited accordingly.

3.7.5. Where claims that have been handled by a CMC are brought forward, it is important that the Ombudsman always considers the impact the conduct of the CMC has had on how the claim was handed – even in cases where the complaint has been made against another party (such as the insurer).

Annex: How could regulation of MROs be achieved?

1. In the ABI's recent submission to the Ministry of Justice's call for evidence on the operation of MedCo, we set out how regulation of MROs could be achieved. We repeat these comments below.

2. The Compensation Act 2006 (the Act) provides:

> *A person may not provide regulated claims management services unless –*
> *He is an authorised person...*
>
> *4.2.b. defines claims management services as "advice or other services in relation to the making of a claim"*
>
> *4.2.e. Services are regulated if they are –*
> *(i) of a kind prescribed by order of the Secretary of State or*
> *(ii) provided in cases or circumstances of a kind prescribed by Order of the Secretary of State*

3. The regulated services are set out in the Compensation (Regulated Claims Management Services) Order 2006:

> *4.—(1) For the purposes of Part 2 of the Act, services of a kind specified in paragraph (2) are prescribed if rendered in relation to the making of a claim of a kind described in paragraph (3), or in relation to a cause of action that may give rise to such a claim.*
>
> *(2) The kinds of service are the following—*
>
> *(a) advertising for, or otherwise seeking out (for example, by canvassing or direct marketing), persons who may have a cause of action;*
>
> *(b) advising a claimant or potential claimant in relation to his claim or cause of action;*
>
> *(c) subject to paragraph (4), referring details of a claim or claimant, or a cause of action or potential claimant, to another person, including a person having the right to conduct litigation;*
>
> *(d) investigating, or commissioning the investigation of, the circumstances, merits or foundation of a claim, with a view to the use of the results in pursuing the claim;*
>
> *(e) representation of a claimant (whether in writing or orally, and regardless of the tribunal, body or person to or before which or whom the representation is made).*

4. It would appear that for the Order to be applicable to MROs it should include an additional item in 4.(2) along the lines of:

> *"Commissioning the obtaining of evidence in claims for soft tissue injuries."*

5. This amendment would not apply to law firms or insurers, who are exempt from these provisions by virtue of The Compensation (Exemptions) Order 2007. The medical

experts themselves would also be exempt by virtue of section 4.3 of the Act. The process for amending the Order is clearly set out in the Act at section 15(3):

> *(3) An order under section 4(2)(e)*
>
> *Compensation Act 2006*
>
> *(a) may not be made unless the Secretary of State has consulted—*
>
> *(i) the Office of Fair Trading, and*
>
> *(ii) such other persons as he thinks appropriate, and*
>
> *(b) may not be made unless a draft has been laid before and approved by resolution of each House of Parliament.*

6. In summary, there is a short process of statutory consultation, which need not be a full public consultation, followed by the affirmative resolution procedure in Parliament i.e. the draft Order is tabled for debate in both Houses.