EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (CLAIMS MANAGEMENT ACTIVITY) ORDER 2018

2018 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury ("the Treasury") and is laid before Parliament by Command of Her Majesty.

1.2 The memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Financial Services and Markets Act 2000 (Claims Management Activity) Order 2018 ("the Order"), supplementing provision made in the Financial Guidance and Claims Act 2018 ("the 2018 Act"), transfers the regulation of claims management activities from the Claims Management Regulation Unit ("CMRU") in the Ministry of Justice to the Financial Conduct Authority ("the FCA"). The Order sets out the types of claims management activities that will be regulated by the FCA and the restrictions on the promotion of those activities. It also specifies those activities which will be excluded from regulation by the FCA.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Article 1(2) provides that the Order comes into force the day after the day on which it is made to enable the FCA and the Financial Ombudsman Service ("the FOS") to make rules, give guidance, impose requirements or claim legal professional privilege (or confidentiality of communications). The Order comes into force for all other purposes on 1 April 2019. The purpose of article 1(2) is to allow the FCA and the FOS to make rules and guidance ahead of the transfer so that these rules and guidance apply from the date of transfer.

Matters relevant to Standing Orders No.83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales and Scotland.

4.2 The territorial application of this instrument is England and Wales and Scotland.

4.3 This instrument does not apply to Northern Ireland.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Claims Management Activity) Order 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 The Order implements the transfer of regulation of claims management activity from the CMRU to the FCA as provided for in the 2018 Act, which received Royal Assent on 10 May 2018. Part 2 of the 2018 Act establishes that claims management services are to be regulated within the scope of the Financial Services and Markets Act 2000 ("FSMA").

6.2 Section 27 of the 2018 Act amended FSMA by making claims management activity a regulated activity for the purposes of section 22 of FSMA, which can only be carried on by authorised persons and a controlled activity under section 21 of FSMA, which restricts the promotion of controlled activities as there defined by persons who are not authorised persons under FSMA or are subject to an exclusion as provided by order made by the Treasury.

6.3 The effect of these amendments is that as a regulated activity, claims management activity cannot be performed without permission from the FCA or by way of application of a specific exemption provided for in secondary legislation.

6.4 The Order is the first use of the powers in section 419A and 419B of FSMA which were inserted by section 27(11) of the 2018 Act. Section 419A gives the Treasury the power to specify by order the types of claims management services to be subject to regulation. Section 419B enables the Treasury to set out, by order, the circumstances in which a person is to be treated as carrying on a claims management activity or a controlled claims management activity (for the purposes of restrictions on financial promotion) in Great Britain. The Order is made in exercise of both of those powers.

7. Policy background

What is being done and why

7.1 Claims management companies ("CMCs") are businesses which provide advice or other services in relation to the making of compensation claims. CMCs in England and Wales are currently regulated by the CMRU, which was established within the Ministry of Justice in April 2007. According to the CMRU, there are currently 1,238 authorised CMCs in operation. Regulation by the CMRU was intended to be an interim measure.

7.2 As explained at paragraph 14 of the Explanatory Notes to the 2018 Act, evidence of malpractice in the sector had led to distrust by consumers in CMCs, with 76% of the public having reported that they are not confident that CMCs tell the truth to their customers. At Summer Budget 2015, the Government commissioned an independent review, led by Carol Brady,[1] to examine claims management regulation and make recommendations to improve conduct in the sector. The independent review found that the current regulator lacked sufficient powers and resources to regulate the market and recommended a number of actions which would strengthen the regulatory regime. It also concluded that the FCA would be well-placed to deliver a step change in regulation of the sector. Following this review, the government announced at Budget 2016 its intention to establish a tougher regulatory regime for CMCs by

[1] https://www.gov.uk/government/publications/claims-management-regulation-review-final-report

transferring supervisory responsibility from the CMRU to the FCA. The FCA's broader suite of supervision and enforcement powers will more effectively facilitate tougher regulation. Reauthorising CMCs will ensure they are willing and able to comply with the new regime, while the Senior Managers and Certification Regime will ensure CMC managers can be held personally accountable for the actions of their businesses.

7.3 Whilst the types of claims and activities to be regulated by the FCA replicate the existing regulatory regime operated by the CMRU, there are two significant changes in the new regulatory regime. First, regulation will be extended to claims management activity in Scotland for the first time, as provided for by the 2018 Act. The objective of this extension is to ensure that consumers seeking claims management services in Scotland receive the same protection as their counterparts in England and Wales, as the FCA's regulatory framework for CMCs will be applicable across England, Scotland and Wales.

7.4 Secondly, the previous regime set out activity for six different sectors (personal injury, financial products and services, employment issues, industrial and criminal injuries and housing disrepair) with one permission enabling claims management activity across all six sectors. The new regulatory regime introduced by this Order creates seven different permissions across different sectors in respect of different types of activity. The seven different permissions are as follows:

- Seeking out, referring and identifying claims;
- Advising, investigating and representing in relation to personal injury claims;
- Advising, investigating and representing in relation to financial services and product claims;
- Advising, investigating and representing in relation to employment claims;
- Advising, investigating and representing in relation to criminal injury claims;
- Advising, investigating and representing in relation to industrial injury disablement benefit claims; and
- Advising, investigating and representing in relation to housing disrepair claims.

7.5 This approach is intended to strengthen the regulation of CMCs. Each sector requires specialist knowledge and this change will make it possible for the FCA to take into account the different types of work required across each sector and the different activities. Ensuring that CMCs have the appropriate skills, knowledge and expertise for the claims they are managing is intended to improve the protection of consumers. This approach is also intended to minimise the regulatory burden on firms by ensuring that they do not need to be assessed for competency or suitability in a sector which does not relate to the services that they provide.

7.6 The Order maintains the same exclusions from regulation as the previous regime. In relation to legal practitioners carrying on claims management activity, these practitioners will only fall within the exclusion if the activity is being carried on as part of their ordinary legal practice, to which they are already subject to regulation by their professional regulator. The policy intention behind this is to ensure that legal practitioners are not subject to dual regulation by the FCA and their professional regulator for carrying on claims management activity which is part of their ordinary legal practice. However, where a legal practitioner is not acting in the ordinary

course of their legal practice, but is carrying on claims management activity separately, this exclusion from regulation by the FCA will not apply.

7.7 Claims management activity conducted by an independent trade union will also continue to benefit from an exclusion from regulation by the FCA, as they do currently under the existing regime. The existing Code of Practice[2] published by the Lord Chancellor which is applicable to claims management activity undertaken by trade unions will be replaced by a new Code of Practice to be published by the Treasury. The Treasury will also replace the Ministry of Justice on the Monitoring Board established to monitor the operation of the Code of Practice.

7.8 The Government recognises that the transfer will be a significant change for CMCs. The Order therefore provides for a temporary permission regime which will enable CMCs providing claims management services to be given temporary permission by the FCA pending consideration by the FCA of their application for full permission. This is intended to reduce any administrative burden on CMCs arising out of the transfer and to facilitate a smooth transfer between regulators.

7.9 The transfer of regulation from CMRU to the FCA will also transfer complaints-handling responsibility from the Legal Ombudsman to the Financial Ombudsman Service. This will allow the Financial Ombudsman Service to investigate and determine consumer complaints about the service provided by CMCs.

7.10 The Government engaged with the Northern Ireland Executive ("NIE") when developing the policy which led to the 2018 Act and this Order. The position of NIE officials was that extending claims management regulation would be disproportionate, as there is very little CMC activity in Northern Ireland. NIE confirmed recently that the CMC landscape in Northern Ireland remains the same. As such, the territorial scope of the 2018 Act includes Scotland, but not Northern Ireland.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 The Treasury does not have plans to consolidate FSMA at this time.

10. Consultation outcome

10.1 The Government consulted on its proposed approach to the scope of regulation, FCA consultation requirements and the temporary permission regime from 23 April 2018 to 1 June 2018. The consultation attached part of this Order in draft and invited views on whether the draft achieved the Government's policy intentions.

10.2 There were 51 responses to the consultation, from a range of CMCs, firms in the financial services industry and professional and trade bodies. The responses were largely supportive of the Government's proposals on the scope of regulation and the FCA's consultation requirements, particularly in relation to the proposal to introduce multiple permissions and the temporary permissions regime.

10.3 A number of other views were received as follows:

[2] https://www.gov.uk/government/publications/trade-unions-claims-management-services-code-of-practice

- A number of respondents suggested extending regulation to include additional sectors, notably cavity wall insulation, flight delays and timeshares. In order to avoid delaying the transfer of the existing regime to the FCA, the Government will maintain the current scope and will consider whether claims management regulation should be extended to these sectors.
- There were also suggestions from a number of stakeholders in the insurance industry that credit hire and medical reporting organisations should be in scope of this Order. The Government has made clear that these are separate to claims management regulation and the Ministry of Justice is considering them in the broader context of the market.
- One firm that responded is dual regulated by the CMRU for its claims management activity and by the Institute and Faculty of Actuaries ("IFoA") for its other activities. The firm currently benefits from an exemption under FSMA for their financial services activities because it is regulated by the IFoA and this activity is incidental to its other work. As FSMA prevents firms from being regulated for some activities and exempt in respect of others at the same time, this very small number of firms will no longer be able to benefit from their exemption for FCA regulated activities, and will need to be authorised by the FCA in respect of all regulated activities that they carry out. The transfer effected by this Order will not however preclude such firms from being dual regulated by the FCA and the IFoA.
- Several responses challenged the proposed exemptions for legal professionals or expressed concern about the robustness of the Solicitors Regulation Authority ("SRA") regime, citing practices of using the presence of a legal professional in the firm to seek SRA authorisation, rather than CMRU authorisation. The SRA and the FCA propose to develop a memorandum of understanding on how they will work together in relation to the regulation of claims management. The 2018 Act also allows the regulators of legal professionals to make rules capping the fees charged by such firms.
- There were also a number of comments in relation to cold calling and fee restrictions in relation to personal injury. The Government has already made cold calling and fee capping provisions in the 2018 Act.

10.4 The Government's response to the consultation was published on 27 July 2018 and can be found here: https://www.gov.uk/government/consultations/claims-management-regulation-consultation-on-secondary-regulations

11. Guidance

11.1 It is not considered necessary for HMT to issue guidance in respect of the transfer of regulation. However, the FCA provides guidance for CMCs on applying for authorisation and the temporary permissions regime, which can be found here: https://www.fca.org.uk/firms/claims-management-companies. The FCA will provide further guidance in response to their consultations on rules, fees, and the Senior Managers and Certification Regime.

12. Impact

12.1 The direct annual impact on business is estimated as a net loss of £1.9m. There is no, or no significant impact on charities or voluntary bodies.

12.2 The measures effecting the transfer of claims management company regulation to the Financial Conduct Authority will have a minimal effect on the public sector, as it is intended that all costs arising as a result of the transfer will be borne by the CMC industry.

12.3 An Impact Assessment has not been prepared for this instrument because in line with Better Regulation guidance, Treasury considers that the net impact on businesses will be less than £5 million a year. Due to this limited impact, a de-minimis impact assessment has been carried out. The assessment is submitted with this memorandum and published alongside the Order on the legislation.gov.uk website.

13. Regulating small business

13.1 The Order applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise the impact of the requirements on small businesses (employing up to 50 people).

13.3 It would not be appropriate to exempt small businesses from FCA regulation. The vast majority of CMCs are small, and many are defined as micro-businesses. However, in aggregate they serve a very large number of consumers. CMCs of all sizes have the potential to cause significant consumer harm. It is important therefore that this policy applies to all CMCs, regardless of their size, if regulation of this industry is to be strengthened. In addition, the FCA has conducted a Costs Benefit Analysis of their proposed rules and is required by FSMA to ensure that the obligations imposed by the transfer and the reauthorisation process in their rules are proportionate.

14. Monitoring & review

14.1 A statutory review clause is included in article 113 of the Order, which specifies that the Treasury must carry out a review of the regulatory provision contained in the Order and publish a report setting out the conclusions of the review. The first report must be published on or before the expiration of a period of five years beginning with the date on which this Order comes into force.

15. Contact

15.1 Caroline Heisig at the Treasury. Telephone: 0207 270 5502 or email: caroline.heisig@HMTreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Hannah Malik and Becky Morrison at the Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen MP, Economic Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.