Protecting consumers from excessive charges in financial service claims

Consultation response

February 2024

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Financial service claims consultation response

Executive Summary

This document outlines our response to our consultation on protecting consumers from excessive charges in financial service claims. In our consultation we set out our proposed rules to protect consumers from excessive charges when they are represented by solicitors in claims relating to financial services and products.

It followed on from our discussion paper which sought to gather information and evidence to inform our proposals to meet the statutory duty placed on us in the Financial Guidance and Claims Act 2018 (FGCA). The duty requires us to make rules which prevent excessive fees being charged by law firms for all claims management agreements and claims management activities relating to financial products or services.

Our proposals included:

- Four key objectives to underpin our approach.
- Replication of the Financial Conduct Authority's (FCA) framework, of maximum charges in our rules
- Replication of the exemptions from the banding framework already implemented by the FCA
- A possible additional exemption to those implemented by the FCA for exceptional cases that meet specific criteria.
- New information transparency requirements for solicitors representing consumers in relation to financial service claims.

We have also published a summary of the consultation responses we received. This document should be read alongside that report.

Having carefully considered each consultation response and undertake further engagement, we have decided that we will take forward proposals to:

- implement our proposed framework of maximum charges
- confirm the circumstances where solicitors and law firms can make charges outside of that framework (and instead make only reasonable charges) – including where:
  - a case is progressed initially to a statutory redress scheme but subsequently prevented from further progression through that or another statutory redress scheme
  - redress is pursued on a client's behalf through litigation
- require solicitors and law firms to provide information to actual and prospective clients, including that, where the claim can be made to a statutory redress scheme, that they proceed without representation
- confirm that these requirements do not apply retrospectively.

We have also decided to include an additional exemption from the banding framework for claims with exceptional circumstances. However, given the risk of eroding the consumer protections provided by the banding framework, solicitors and firms will only be able to rely

on this exemption with our approval. This will also provide additional case profile and cost data to inform future reviews of our position.

This document explains the rationale for our decisions and our next steps.

We have made a small number of minor changes to the wording of the final rules. The final SRA Regulatory Arrangements (Claims Management Fees) Rules 2024 are published alongside this response document.

Background

Section 33 of the FGCA places a duty on us to make rules to prohibit individuals we regulate from imposing excessive charges in claims relating to financial services or products. The FGCA was part of the government response to concerns about the charges levied by law firms and claims management companies (CMCs) to represent consumers in relation to claims for mis-sold payment protection insurance.

In 2021 we published a discussion paper and undertook a stakeholder engagement programme to build and assess evidence to inform the development of rules to meet our obligations under the FGCA. CMCs may also offer these services, and their regulator, the FCA implemented equivalent rules on 1 March 2022. We paused our work in 2022 while courts considered a judicial review application against the FCA's rules. This was refused permission and so we continued our work.

Who did we hear from?

Between 31 March 2023 and 19 July 2023 we consulted on our proposed approach and draft rules.

We received 29 written responses from law firms, financial service statutory redress schemes, consumer groups, lenders and representative bodies. We also delivered an engagement programme that included:

- public focus groups and a survey with more than 1,000 members of the public across England and Wales
- meetings with consumer groups
- a survey and roundtable meetings with solicitors, firms and their employees operating in the financial service claims sector
- meetings with banks and financial service representative bodies
- discussion events with financial service statutory redress schemes

We are grateful to all the individuals and organisations who responded to the consultation and have engaged with us about the proposals. We have carefully considered all of the feedback we received in developing our final positions.

Our final positions

In this section we outline our final positions. We set out a high-level summary of the responses we received, our next steps and our rationale. Our summary of responses document sets out a more detailed analysis on the responses we received to each proposal.

Our assessment of financial service claims management activity provided by law firms and solicitors

What did we propose?

In our consultation paper, we set out our analysis of financial service claims management activity provided by law firms and solicitors. This was based on information provided by law firms, statutory redress schemes and consumers in response to our discussion paper.

Our analysis showed two operating models for law firms working in this sector:

- Model A: Where solicitors and law firms predominantly represent consumers in relation to larger volumes of claims progressed through statutory financial service redress schemes and with operational similarities to many CMCs.
- Model B: Where solicitors and law firms predominately represent consumers, or groups of consumers, for claims with complex or novel features and that in some cases are ineligible for direction to, or continuation through, statutory redress schemes.

Respondents' views

The majority of respondents agreed with our analysis. Some respondents, particularly consumer representative groups, were cautious about us taking a different approach to Model B firms if this meant consumers using these firms would not benefit from the same fee restrictions as consumers using Model A firms. Other respondents called for clarity as to what type of case would qualify as 'complex' or 'novel' and pointed out that even though a type of claim may be novel to begin with, such claims can quickly become routine and templated.

Some law firms raised concerns about our proposals. There were arguments that there are significant differences between law firms and CMCs and that some cases, even if high volume, may be incredibly complex. These firms felt that it was too simplistic to draw out two specific categories.

Our response

We have reviewed our analysis and carefully reflected on the views provided in response to the consultation and related engagement. We consider our analysis to be accurate based on the evidence we have but are mindful of the comments from law firms about bulk claims work sometimes being complex, and that this work is not always limited to model B firms. Our remaining proposals set out how our approach will recognise work undertaken by both models of law firm and the needs of consumers with claims of differing complexity.

Our objectives

What did we propose?

In our consultation paper we set out four objectives that we proposed should underpin the development of our rules, and future monitoring and evaluation of their impacts. They were:

- Objective 1 - protect consumers from excessive fees during financial service claims, and satisfy the FGCA's requirements in doing so

- Objective 2 - replicate the FCA's approach to restricting fees for CMCs in our rules for solicitors, as far as that is appropriate
- Objective 3 - balance our rules with our duties under the Legal Services Act 2007, including promoting access to justice for members of the public who wish to have professional representation for a financial service claim
- Objective 4 - ensure consumers are empowered to choose, and are well-informed about those choices, for pursuing financial service redress

Respondents' views

The majority of respondents and stakeholders agreed with our proposed objectives, particularly members of the public and consumer groups, believing that they would improve clarity and consistency for consumers.

Some law firms did not agree with our proposed objectives. Some pointed to the different standards, duties and expectations imposed on SRA-regulated firms compared to CMCs and of the consumer right to have fees assessed by the courts. Liverpool Law Society pointed out that the FGCA does not require standardisation of approach from the SRA and FCA. Other law firms were concerned that fee restrictions may make the bringing of some types of claim unviable for law firms, impacting on access to justice. This included investigating new types of claims. In addition, one law firm pointed out that many financial service institutions instruct solicitors, making it more necessary for consumers to be represented. One law firm felt the proposals were anti-competitive.

Our response

Having carefully considered all of the feedback received, we consider that these objectives remain appropriate for our work.

We are mindful of the need to ensure that our approach is appropriate for the solicitor profession. Objective 1's confirmation that we will deliver the FGCA's duty does not mean that we will then automatically standardise our approach with the FCA - and Objective 2 acknowledges this by confirming we may not replicate the FCA's approach in its entirely, but instead will do this 'as far as that is appropriate'. Our analysis and our consultation feedback shows there are some important differences between law firms and CMCs, and they need to be reflected in our rules. This thinking has informed our approach to our rules and to our broader approach.

We are also mindful that some consumers will wish to be represented. Objective 3 acknowledges that we need to ensure our rules do not impede access to justice for those consumers who wish to be represented for financial services claims. Our detailed proposals, which respond to the points of disagreement, are discussed below.

Transparent information for consumers

What did we propose?

We proposed to require solicitors to inform prospective clients for financial service claims about their options to pursue a claim without representation, and signpost them to any relevant redress schemes.

We also proposed new rules requiring solicitors to provide clear costs information to a client before they enter into a contract, including whether the fee restrictions are applicable and the basis for the estimated fee.

We said that these new requirements would strengthen our existing requirements for solicitors in paragraph 8.7 of our Code of Conduct for Solicitors, RELs and RFLs. This states: 'You ensure that clients receive the best possible information about how their matter will be priced and, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of the matter and any costs incurred.'

Alongside these requirements, we said we would use our own engagement channels and targeted digital advertising to proactively direct members of the public to plain language information, explaining different options for pursuing financial services claims and the protections in our rules.

Respondents' views

We received almost unanimous support for our proposals, including from consultation respondents and members of the public in our focus groups. Just one law firm raised concerns about the ability of firms to give their clients the detailed information needed about costs at the outset of the case. However, other law firms responding to the consultation supported our proposals.

Our response

Given the strong support received, we intend to proceed with this proposal. We consider that our proposed information requirements are necessary to make sure that consumers can make an informed decision as to how to pursue their financial service claim. We have made a minor amendment to the wording of our requirements to make it clear that solicitors must make clear to their client the circumstances in which fees could exceed an initial estimate (Rule 1.2(a)).

We will work with the statutory redress schemes and the FCA to provide consumers with information about options to progress financial service claims with or without representation, including through the Legal Choices website, to ensure that consumers are better informed.

Replicating the FCA's banding framework

What did we propose?

The FCA's rules for CMCs include a banding framework that sets maximum charges CMCs can make, based on the amount of compensation a consumer receives. We reviewed the framework of maximum charges to understand whether it is appropriate to also apply to law firms operating in the financial service claims management sector, taking into account the need to protect consumers and make sure that solicitors receive sufficient renumeration to continue making this work viable for them. This included using information from our evidence base to understand how the framework might impact both models of law firm.

Based on our analysis we considered that law firms could continue to operate profitably and remain viable if (subject to an exemption for particular cases discussed below) we replicate the framework in our rules. We also confirmed our view that a sector-wide approach would help to provide clarity and certainty for consumers and help mitigate the risk of regulatory arbitrage.

We also proposed to mirror the circumstances where the banding framework does not apply, and where solicitors must instead make reasonable charges. These include for example, any charges made for reserved activities as required already by the FGCA, to all claims that

were started before the implementation of our rules, and to claims falling outside the scope of the statutory redress schemes.

Respondents' views

Consumer groups, banks, redress schemes and others broadly supported our proposals. Consumer groups referred to the operational similarities between CMCs and law firms working in this area and the need to reduce the scope for regulatory arbitrage. Other consumer groups, including the Legal Services Consumer Panel agreed that there was a need for 'carefully crafted ' exemptions to the banding framework.

However, Liverpool Law Society, some law firms and one member of the public disagreed with our proposal. A key objection was that the proposed maximum charges would make it unviable for law firms to provide representation in some cases, leading to a contraction in the number of firms offering services in relation to some types of claims. They argued this would reduce access to representation for consumers.

Some law firms questioned the legitimacy of costings and assumptions underpinning the framework, stating that the hourly rate for representation that the FCA uses is £6.10 (based on a figure the FCA used to value an hour of a consumer's leisure time). They also felt the evidence base assumes all claims are akin to payment protection insurance (PPI) claims, which firms argued were much more straightforward and formulaic than the majority of financial service claims. The FCA's rules were introduced in March 2022 and some firms pointed out that the maximum limits had not been uplifted since then despite inflationary pressures and some changes in the claims market. In particular, in April 2023 the maximum compensation amount that the Financial Ombudsman Service (FOS) can award rose to £415,000 from £190,000. Some firms were particularly concerned about the top band where the maximum charge is £10,000 for all claims with monetary awards exceeding £50,000.

Some law firms also argued our Standards and Regulations already feature sufficient consumers protections to meet the FGCA's duty, while a member of the public was concerned that our proposals would stifle competition.

Our response

We have carefully reflected upon the views of those who responded to our consultation and taken the opportunity to review again the analysis that underpins the FCA's banding framework to ensure its suitability for solicitors, in light of feedback.

The FCA devised the banding framework using calculations based on information from CMCs about average time spent managing claims, and derivation of time estimates using data on hourly rates and staff costs. The FCA have also confirmed that the maximum charges in its banding framework are substantially higher than its estimate of the overall monetary value CMCs can bring to consumers. The banding framework was also checked against the civil court case procedures hourly figure of £19.

Although we are able to set a different framework for solicitors than the FCA has implemented for CMCs, we think that we would need strong evidence to do so because of the risks of regulatory arbitrage and consumer confusion if there are two different frameworks in place for the same types of claim. While the consumer protection objective in section 1C of the Financial Services and Markets Act applies to the FCA but not the SRA, we do have regulatory objectives to promote and protect consumer interests, and to improve access to justice. The evidence we have and presented as part of our consultation, is that

the FCA's banding framework is broadly suitable for the firms we regulate. Despite consultation and significant engagement, firms have not provided us with evidence to contradict this and our view is therefore that we should replicate the FCA's maximum charges in our rules.

We recognise that there will likely be some exceptional cases for which the banding framework may not be suitable. In our analysis, presented in our discussion paper and our recent consultation, we recognised that there were a small proportion of claims that may require a different charging approach in order to be viable for law firm representation. These include exceptionally complex and difficult cases that go before the statutory redress schemes. In line with our objectives, we are aiming to protect consumers without adversely impacting access to representation in the financial service claims sector. In the next section, we set out our approach in relation to exceptional cases.

Our consultation described our proposal to replicate exemptions within the FCA's rules to its banding framework. Following consultation we have decided to proceed with this position. This includes any charges made for reserved activities – notably including litigation work – and charges for representation on claims that are entirely out of scope of the statutory redress schemes. In any of these circumstances, solicitors are required instead to make reasonable charges for their representation.

We accept that market conditions change over time, and in response to concerns raised by firms about inflationary pressures, and other changes such as increases to maximum compensation levels within statutory schemes, we will periodically review the banding framework, to consider whether any changes should be made. We will collaborate with the FCA as we do so and will share insights from our monitoring and evaluation work.

We do not agree that our Standards and Regulations already provide the specific mechanisms for protection envisaged by the FCGA. The FGCA requires us to make rules specific to risks articulated and envisaged by that legislation. We also do not agree that a framework of maximum charges will stifle competition as firms can compete on price within the maximum limits set, and on factors other than price, such as the quality of their services. However, we will monitor the impacts of our rules on the market as part of our monitoring and evaluation work.

An exemption for complex or novel cases

What did we propose?

In our consultation, we outlined a possible exemption from the banding framework's maximum charges for claims with complex or novel characteristics brought through the statutory redress schemes, where charges for representation would reasonably exceed the framework's limits. This does not feature in the FCA's rules.

This exemption would have allowed solicitors to determine that a claim was particularly novel or complex and could therefore be exempt from the maximum charges allowed under the framework. This was intended to make sure that it remained financially viable for law firms to represent consumers in relation to the most complex claims, and therefore maintain good levels of access to representation for those consumers. Charges for representation on those claims would instead be required to be reasonable.

We explained that the implementation of this exemption was subject to evidence we received as part of the consultation.

Respondents' views

The majority of respondents agreed with the need for an exemption for particularly complex cases, including consumer groups, financial service providers and law firms. Respondents felt that such an exemption was necessary to ensure complex or novel claims remained viable for law firms, and so preserved access to justice for consumers who wanted or needed representation. Some law firms provided case studies and client testimony to illustrate particularly complex claims and consumer journeys.

Some stakeholders however were concerned that solicitors and law firms would be able to decide themselves whether a claim was eligible for exemption from the banding framework. Consumer groups and statutory redress schemes in particular highlighted risks for claims to be inappropriately categorised as being complex. Some solicitors and law firms were also concerned about the potential risk of facing regulatory action if they incorrectly defined a case as complex.

Our response

Our rules reflect our objectives by securing appropriate consumer protection measures, meeting the provisions of the FGCA, while also maintaining conditions for continued access to legal representation for financial service claims of all types.

Law firms provided some examples of cases of high complexity – with examples including claims that move across different redress schemes, or that involve mis-sold pensions or investments with inherent complexity. They also provided evidence which appears to show that, without representation, the consumer would have received a worse outcome. The evidence included some client testimony that illustrated complex cases where the claimant confirmed they had lacked capacity in some way to self-represent their claim at all. However, we did not receive evidence of charges to demonstrate that costs in the most complex cases exceed the amount that could be claimed under the banding framework.

We have also received data on a confidential basis indicating that for some financial services claims, a higher percentage of law firm-represented claims are upheld than self-represented claims.

Our survey with more than 1,000 consumers found that 5% of those surveyed are unlikely or very unlikely to pursue a claim at all if no representation was available - falling to 3% if the consumer receives clear advice about how to make a claim, including the stages, which forms to complete and how to upload evidence. People with lower levels of legal confidence were significantly more unlikely to pursue a claim themselves. FOS received 165k claims complaints in 2022/23, with 21% having representation.

Based on our survey, even with clear advice on pursuing a claim themselves around 1,040 of these consumers would not have sought redress if representation had not been available. In 2022 the Financial Services Compensation Scheme (FSCS) determined 132,000 claims, with 38% being represented by law firms, meaning around 1,504 people would not have sought redress if representation had not been available. However, this must be caveated by the fact that only a proportion of these claims will have been complex.

We are aware that the exemption we proposed carries risk of eroded consumer protection and of regulatory arbitrage, and therefore requires a high bar. Despite proactive engagement, multiple requests for data and consultation, we did not receive evidence that proves the need for the exemption as proposed. However, we are aware that not implementing an exemption creates a risk that some consumers will be unable to access

representation in the most complex cases, leading to poorer outcomes - including that they do not pursue their claim at all. We are mindful of our regulatory objectives to act protect and promote the consumer interest and improve access to justice. We are also mindful of the concerns raised by some consultation respondents that such an exemption may erode the consumer protection that the banding framework provides if firms incorrectly categorise claims as complex.

Having carefully considered the options, we have decided to implement an exemption from the banding framework for complex cases brought through the statutory redress schemes with controls. Our rules will require solicitors and firms to receive approval from us to charge outside of the banding framework for a case they believe falls within this exemption. If they receive this approval, they will instead be required to make reasonable charges. We will monitor how this exemption, including the approval process, works in practise and keep under review whether the exemption is needed and if so, whether approval from us is the right mechanism.

To qualify for this exemption, firms would need to demonstrate that the circumstances of the case are novel and without precedent (such as a test claim) or are particularly complex. We will publish guidance, including case studies, to help firms to identify eligible cases and clearly set out the application process.

We consider that eligible claims may have some or all of the following features:

- claims that move across multiple redress schemes or are reasonably expected to
- claims expected to be, or that are actually, prolonged significantly beyond the average case-determination timeframes for FOS / TPO / FSCS
- claims with multiple parties and multiple complaints
- claims with multi-jurisdictional aspects
- certain pension cases involving authorised representatives.

The list above is not intended to be exhaustive, and we recognise the need to provide certainty to applicants about the charging parameters they may use whilst making sure that the application process is flexible to assess each application individually and respond to developments in financial services claims activity. We are mindful that certain areas of claim can be complex to begin with (for example test claims) but once established may fall out of the parameters of the exemption. Conversely some types of claim may be inherently straightforward, but there may be individual examples of those claims with specific and additional complexity. We cannot therefore offer a fixed definition of complexity.

As part of the application process, we will require firms to provide us with information about their fee estimates and basis for charging. We are mindful of the need to ensure that the application process is straightforward and that decisions are made promptly. A cumbersome application process may deter or prevent firms from undertaking complex and difficult cases, which would not be in the public interest. If applications are not dealt with swiftly this may lead to delays that may hold up a claim. We will be able to expedite urgent cases, for example where a limitation period is close to expiration.

Impacts and monitoring approaches

What did we propose?

Our consultation paper set out our analysis of impacts and risks associated with our proposals. They were:

- Positive impacts on consumer empowerment, given our proposed information requirements, parity between with the FCA's banding framework to ensure that consumers have clarity around the charges that they should expect if they choose to be represented, and our proposed further exemption that helps to maintain access to justice.
- Positive impacts for consumer protection, with the framework of maximum charges providing important safeguards to consumers to protect them from excessive charges.
- Potential impacts for routes to redress, although we confirmed our view that risks that consumers would be unduly directed towards litigation were low and could be mitigated, including mechanisms in our rules to confirm when litigation may be considered.
- Positive impacts for access to justice, as our rules, together with the proposed exemptions to the banding framework, help to ensure a continued viable market for consumers.
- Risks of regulatory arbitrage, although we feel this will be mitigated by replicating core provisions already in place by the FCA, and we will engage with other regulators not covered by the FGCA's duty to ensure our rules are not having negative impacts.
- No anticipated risks for equality and diversity considerations.

Respondents' views

The majority of respondents considered we had identified the right impacts and equality considerations. Two respondents queried whether we had given sufficient consideration to access to justice and another respondent urged us to consider the impacts on vulnerable consumers. In terms of equality considerations, several respondents urged us to have regard to the accessibility of information provided to consumers as mandated through our information requirements.

Our view

The responses suggest that we have identified the right impacts and considerations, and that the risk mitigation approaches we described in our consultation are robust. This includes the proposed components of our rules, and in particular the protections around charges and consumer information, which we think will protect vulnerable consumers without adversely impacting their access to justice. We will work closely with the FCA and the statutory redress schemes to evaluate the impact of our proposals over time. We will also closely monitor the market to ensure that there are no early negative unintended consequences arising from our reforms.

Next steps

We will now apply to the Legal Services Board (LSB) seeking approval of the SRA Regulatory Arrangements (Claim Management Fees) Rules 2024.

We will develop guidance for firms to them to understand our expectations and identify exceptional cases that may be eligible for exemption from the banding framework.

We will work with the statutory redress schemes and the FCA to provide consumers with information about options to progress financial service claims with or without representation, including through the Legal Choices website.

Subject to LSB approval, our new rules will come into force on 3 June 2024, or the 42nd day after the approval date, whichever comes first.