

Claims management: how we propose to regulate CMCs: FCA CP 18/15

BSA Response

31 July 2018

 **Building Societies
Association**

Introduction and summary

- It is important for claims management companies to be regulated as strongly as currently regulated financial services firms are.
- It is clear that consumers can suffer detriment at the hands of a currently regulated firm and of a claims management company if the business in question, whatever sector, is deficient in senior management culture and accountability, TCF, conduct standards, customer communications, prudential stability etc. Therefore, regulatory equivalence is long overdue and we welcome the FCA's proposals to address the matter.
- To provide context, this response recounts our sector's experiences in the early 2010s regarding bogus PPI complaints.
- We support all the key proposals in the CP, notably that claims management companies should be subject to FCA rules and principles relating to –
 - high-level standards
 - threshold conditions
 - systems and controls
 - general provisions
 - conduct of business
 - lead third-party generators
 - call recording
 - marketing
 - pre-contract and ongoing disclosure
 - collection of fees
 - supervision and reporting
 - prudential standards and wind-down procedures
 - client money
 - dispute resolution, and
 - enforcement.

Background

The Building Societies Association (BSA) is pleased to respond to the FCA's consultation issued in preparation of the transfer of the regulation of claims management companies (CMCs) from the Ministry of Justice to the FCA from 1 April 2019. We note that HM Treasury has recently [published](#) its consultation response document and a draft statutory instrument.

We endorse the FCA's underlying objectives for the CMC industry to be well regulated and properly focused on the fair treatment of customers. We believe that, despite significant resource constraints, the Ministry of Justice has been a good regulator, but the time is right for the FCA to assume the role.

We note that, under the new arrangements, regulation of CMCs will extend to Scotland where they are currently unregulated (paragraphs 2.11 -12 of the CP refer) and we strongly support this extension.

- **Consumers generally**

Our starting point is that, from the consumer perspective, it is important for CMCs to be regulated as strongly as currently regulated financial services firms are. The FCA's summary in chapter 1 of the CP, and the further explanation in chapter 2, amply demonstrate why this should be the case. It is obvious that malpractice by currently regulated firms and by CMCs can both have adverse effects on consumers. The BSA fully supports the Brady Review's analysis of harm to consumers caused by CMC malpractice, which the CP summarises in paragraph 1.11.

It is clear that consumers can suffer at the hands of a currently regulated firm and of a CMC if the business in question, whatever sector, is deficient in senior management culture and accountability, TCF, conduct standards, customer communications, prudential stability etc. Therefore, regulatory equivalence is long overdue and we welcome the FCA's proposals to address the matter.

We recognise that for CMCs, just as for other sectors or individual products, certain differences in regulatory detail might be necessary or justified but, substantially, FCA regulation should be the same for CMCs as for banks, building societies, insurers, credit unions, consumer credit firms and other FCA-regulated organisations. In the BSA's view, the proposals in the CP strike the right balance.

- **Our sector's, and its members'/customers', experiences**

Poor practice by CMCs can unfairly affect not only consumers but also regulated firms and the Financial Ombudsman Service. The main problems have been large-scale –

- fishing expeditions by some CMCs, often in the form of data subject access requests or complaints, where there appears to be no reasonable basis for complaint, and
- bogus complaints by some CMCs, where for example the firm complained about did not sell the product complained about either to the CMC's client or at all.

For example, in early 2012, the BSA made a formal written complaint to the Ministry of Justice about certain CMCs that were submitting, on a serial basis, complaints where the firm complained about had not sold the product in question (usually payment protection insurance - PPI) to the customer – ie 'non-sale complaints'.

We believed that this was a ‘spray and pray’ business model that relied on blanket complaints that transferred the work of weeding out non-sales from the CMC to the firms and to the Financial Ombudsman Service.

Around 2011, a sample of eight building societies received 8,105 non-sale complaints from a number of CMCs. Such complaints represented customers misled by CMCs into believing that they might be entitled to compensation. It also meant that the building societies in question experienced significant costs in investigating and ultimately rejecting the complaints (with those costs ultimately borne by consumers – the third bullet point in paragraph 11.1 of the CP highlights this particular consequence of CMC malpractice).

It should be noted that this represented only a sample of building societies from a sector that had very little exposure to PPI mis-selling unlike some of the large banks (most PPI sold by our members was mortgage PPI, which was generally cleanly sold), yet it still received several thousand non-sale complaints.

One member reported that, during 2011, 66% of the PPI complaints it received overall from CMCs were non-sale cases. Another member reported that, during 2011, 45% of the PPI complaints it received overall from CMCs were non-sale cases. Some cases even included a number of complaints where the consumer was not, and never had been, a customer of the BSA member at all.

At the time, a BSA member noted that, for the building society in question, CMCs accounted for about 80% of all referrals to the Ombudsman, but that the BSA member’s success rate was over 90% (ie the Financial Ombudsman Service upheld less than 10% of the relevant complaints). It appeared that some CMCs were, therefore, fully aware that they were highly unlikely to succeed but escalated the complaints to the Financial Ombudsman Service in any event. The BSA member noted that the CMCs’ contract with their clients sometimes made it clear that they would always escalate if the firm did not uphold the complaint.

Other examples of bad practice by some CMCs reported to us by members during that period included –

- taking active steps to prevent their clients from communicating with the firm being complained about, and seeking to push complaints through to the Ombudsman with no serious commitment to mediation
- not including a letter of authority from the customer or including photocopies
- not making genuine complaints points – simply sending a generic letter (in addition to the non-sale malpractice, we were aware of complaints being made where PPI was sold but where there was no merit in the complaint ie no reasonable basis)
- making a complaint where contact with the customer by the BSA member made it clear that the customer had no concerns about the sale of the product
- sending duplicate complaints and duplicate acceptances
- not providing policy numbers of the contract being complained about
- making large numbers of subject access requests, but not using the information received when making the complaint (use of data subject access

requests purely as ‘fishing’ expeditions appeared to be commonplace in the early 2010s and we believe it continues in some cases)

- chasing up information already sent.

The practice of making serial, non-sale complaints has been costly for financial services firms and their customers because, even though the Financial Ombudsman Service does not charge a fee for ‘frivolous and vexatious’ complaints, the scale of non-sale complaints has been such that the cost of investigating them (by firms and the Ombudsman) were very significant.

At the time, we suggested to the Ministry of Justice that such behaviour breached several CMC general rules and conduct rules, details of which we provided to the Ministry (see the Annex to this response). Subsequently, the Ministry published general warnings to CMCs about such malpractice and took enforcement action against some of the CMCs.

If the FCA requires further information about our members’ experiences, or more detail on the points that we raised above, we would be happy to provide it.

On a positive note, the Ministry helped the BSA by providing contact details with compliance officers at some large CMCs. This enabled our members to get in touch with those responsible within the CMCs for compliance and, in some cases, avert further unnecessary work.

- **The wider context**

Chapter 2 of the CP discusses the harms that the FCA seeks to reduce, the planned scope of FCA regulation and other related matters. Although chapter 2 contains no specific questions, we briefly note that –

- we agree with the list of harms specified in paragraphs 2.1 to 2.9
- we support the proposals or plans to regulate all key CMC sectors except claims management conducted by legal practitioners, which are currently regulated outside the Ministry of Justice (although we believe that the matter should be monitored and then reviewed at a later stage once there is reliable comparative evidence relating to the two regulatory regimes)
- as already noted, we endorse the extension of CMC regulation to Scotland
- we welcome the 20% fee cap on PPI claims, the prohibition on cold calling, and the deadline for PPI complaints, which have all been introduced by other mechanisms
- we are strongly in favour of the proposals regarding authorisation, supervision and enforcement for CMCs, especially the proposed extension of SM&CR to CMCs (which the CP confirms will be subject to separate consultation in the Autumn). Just as individual accountability is crucial for currently regulated firms, it is also essential for CMCs.

CP Questions

We now turn to the specific questions in the CP.

- **High level standards**

Q1: Do you agree with our proposal to apply our Principles for Businesses to CMCs?

Yes, it is right that CMCs should be subject to the FCA's high-level Principles for Business. Once CMCs come within the ambit of FCA regulation, there is no logical reason why they should not (like other sectors) also come within the Principles that form the foundation of regulation by the FCA. Each of the 11 Principles is equally applicable to the business of a CMC as to that of, say, a bank or a building society.

Q2: Do you have any comments on the application of COND to CMCs?

Yes. In principle, this is the same as the point in question 1. If any the conditions was absent in a CMC, it is difficult to see how it could be regulated properly or could provide an effective service to consumers.

Q3: Do you agree with our proposal to apply SYSC to CMCs?

For the same reasoning as applies to the above questions, we endorse the FCA's proposals regarding systems and controls. We acknowledge the point that the CP makes in paragraph 3.11 that there should be proportionality regarding smaller firms, as long as outcomes are the same. CMCs must of course be subject to equivalent controls as other regulated firms regarding crucial matters such as financial crime prevention and whistleblowing.

Q4: Do you agree with our proposal to apply GEN to CMCs?

It is right that, once they are subject FCA regulation, CMCs should familiarise themselves with the General Provisions and be subject to them.

- **Conduct standards**

Q5: Do you agree that CMCs should be obliged to comply with these proposed general conduct of business rules?

The BSA strongly supports the FCA's proposals. As noted above, the presentation by some CMCs of claims that they knew, or should have known, had no reasonable grounds for success has been a major problem for consumers, firms, the regulator and the Ombudsmen.

When the BSA made its formal complaint to the Ministry of Justice (see above), we analysed the activities of some CMCs in the context of the CMC conduct rules and related legal or code provisions. For the FCA's information, we set out the analysis in the Annex to this response.

We were confident that the 'non-sale' complaints referred to above breached a number of the provisions. However, the authorities now have greater experience of CMC malpractice than existed when they first implemented the relevant rules. We believe that the list of proposed rules set out in paragraph 4.1 of the CP usefully draws on this experience. They would form a generally more cohesive and relevant set of conduct rules for CMCs.

However, the BSA also believes that it is right to build upon those current CMR Rules that remain fit for purpose and which regulatorily-compliant CMCs will be familiar with. The CP proposals would do so.

It is obvious that CMCs should be subject to a customer best interest rule, which is the same as for currently regulated firms through the relevant conduct of business rules, and the BSA strongly supports the proposal.

For the reasons we gave above, we particularly endorse the proposal to prohibit CMCs from presenting a claim that is fraudulent, has no good arguable case, or is frivolous or vexatious. We recognise that a CMC, like any other firm or individual, might make isolated mistakes and we believe that any regulator should take a proportionate approach in such cases. However, the *serial* non-sale complaint model that we discussed earlier in this response is precisely the kind of mischief that the proposed new conduct rule would address, as long as it was strongly enforced.

Some of the CMC poor practices that our members experienced will presumably have been conducted by CMCs on behalf of vulnerable customers. It is imperative for all firms to have effective procedures to identify and protect vulnerable customers, and we strongly endorse the CP's recommendation on this matter.

The BSA also strongly endorses the CP's proposal that new customers of CMCs should have a 14-day mandatory cooling-off period. In a joint consumer information note in 2015, the Ministry of Justice, the Financial Ombudsman Service, the FCA and the FSCS stated that there was no need to use a CMC (to reclaim mis-sold PPI). A cooling off period would give customers a proper chance for reflection on whether they would be better pursuing a complaint without a CMC and potentially receive compensation free from deduction of CMC fees.

Q6: Do you agree that CMCs should be obliged to comply with these proposed rules on using third-party lead generators?

We believe that this is another very important proposal. The sale of individuals' personal details, in breach of data protection law, is a scurrilous practice that some organisations have been carrying on for too long.

Q7: Do you agree with our proposal to require CMCs to record all calls and electronic communications with their existing and potential customers?

The proposals on call and message recording and retention, initiated by the Brady Review, are sensible especially given the large amount of business that CMCs conduct through such media. As paragraph 4.13 of the CP states, the requirement should also help identify breaches of the prohibition on non-consensual cold-calling.

Q8: Do you agree with our proposal to require call recordings to be kept for a minimum of 12 months from the latest of the events specified at paragraph 4.10 above?

The proposal seems sensible and proportionate.

Q9: Do you agree with our proposals for marketing by CMCs?

We fully support the proposals. It is absolutely right that all regulated firms, including CMCs once they come under the FCA umbrella, should be subject to financial promotions rules requiring marketing to be fair, clear and not misleading. It is equally right that CMCs should be

required to provide customers with the information set out in paragraph 4.20, including the fact that they may be able to make the complaint themselves for free. We also support the proposals in paragraph 4.21 about cold-calling in person etc.

We also remind the FCA of the requirements of the Consumer Protection from Unfair Trading Regulations 2008, which are potentially material – please see the Annex to this response.

Q10: Do you agree with our proposals for existing pre-contract disclosure requirements?

Just as currently regulated firms are required to provide customers with certain pre-contract information, CMCs should be subject to similar exacting standards. The proposal of a mandatory one-page summary document in paragraph 4.22, and the suggested contents, is sensible.

We also support the proposal in paragraph 4.23 that CMCs should provide certain other information but not necessarily in the one-page summary. In the past, information that regulators have mandated for key facts illustrations etc have arguably been excessive. Customers are less likely to read long publications and, although it involves certain value judgments, it is right to mandate the most important information in a one-page document.

We also strongly endorse the proposals regarding fee disclosure. As the CP suggests, this would make it easier for potential customers to compare rates at different CMCs. It would also encourage them to consider carefully whether they needed to use a CMC, given the availability of a free (to complainants) Ombudsman Service and sources of free advice and guidance.

Q11: Do you agree with our proposals for ongoing disclosure?

The proposals about ongoing information - including progress of a claim, costs (if not fixed fee), claim rejection etc) are not only sensible but also crucial to the good conduct of a claim.

Q12: Do you agree with our proposals for collection of fees by CMCs?

Again, we fully endorse these sensible proposals.

- **Supervision and reporting**

Q13: Do you agree with our proposed application of the existing SUP rules to CMCs?

The SUP rules contain very important administrative provisions, without which the FCA could not effectively regulate. Therefore, we believe it clear that they should apply to CMCs.

Q14: Do you agree with the new notification requirements and guidance we are introducing into SUP 15?

Yes. Please see the answer to question 14 above.

Q15: Do you have any comments on the reporting requirements set out in this CP and the accompanying legal instrument? We are particularly interested in any specific data requirements that you think should not apply to CMCs and any additional data to what we have set out that you think would be valuable for the FCA to collect from the sector.

Again, we view these as sensible and proportionate proposals.

Q16: Do you agree with the proposal for the FCA to impose an administration fee on CMCs for late data submissions?

Yes.

- Prudential standards and wind-down procedures

Q17: Do you agree with our proposal to apply bespoke prudential standards to CMCs, other than lead generators, and to separate these CMCs into two groups for the purposes of applying prudential requirements?

Yes, the proposals appear to be realistic and proportionate, while (as paragraph 6.5 of the CP states) broadly following the FCA's prudential regimes for other sectors.

Q18: Do you agree with our proposal to set the prudential resources requirement for CMCs, other than lead generators, on the basis of a fixed minimum amount and the fixed overheads requirement? If not, what other approach would achieve the same outcome of ensuring an orderly wind down?

Because building societies are dual regulated (ie the FCA for conduct and the PRA prudentially), we are not particularly familiar with the FCA's prudential regimes. However, the proposals set out in paragraphs 6.9 – 6.11 seem broadly comparable to those for other sectors, including MIPRU 4, CONC 10 and IPRU-INV 13. On that basis, we support the recommendations.

Q19: Do you agree with requiring CMCs that hold client money to have additional prudential resources and/or do you feel the level we propose is appropriate?

Yes, this appears to be appropriate.

Q20: Do you agree that CMCs should meet the prudential resources requirement from 1 August 2019?

Again, this seems fair and proportionate.

Q21: Do you agree with our proposal that the PII requirements for CMCs that represent customers in personal injury claims be retained but for the PII requirements not to be extended to all CMCs?

We agree with the proposal for the time being not to extend the PII requirement beyond CMCs that pursue personal injury claims, provided that, as indicated in paragraph 6.20 the FCA keeps the matter under active review.

Q22: Do you agree with our proposal to carry over the minimum terms for the PII policy as set out in the Compensation (Claims Management Services) (Amendment) Regulations 2008?

Yes, there would seem to be no reason to dilute the existing requirements.

Q23: Do you have any comments on the approach to wind-down planning that is being proposed, or evidence to support an alternative approach?

No, the proposals appear to be well thought out and appropriate.

- **Client money**

Q24: Do you agree with our proposals on appointing a CASS oversight officer? If not, why not?

Yes. The proposals appear to be consistent with those under CASS on existing relevant firms.

Q25: Do you agree with our proposals on segregating client money and paying out client money as soon as practicable? If not, why not?

Yes, the proposed rules on segregation and prompt payment are fundamental to the proper handling of client money.

Q26: Do you agree with our proposals on record keeping; reconciliations, including on top up of any shortfall and withdrawal of excess; and on notification requirements? If not, why not?

Yes, again these appear to be sensible requirements consistent with current good practice.

Q27: Do you agree with our proposals for an external client audit to be carried out? If not, why not?

Yes, such external oversight is very important and the proposals appear to be proportionate.

Q28: Do you agree with our overall proposals for a CMC client money regime? If not, why not?

Yes.

Q29: Are there any of our proposals where more prescriptive rules or additional guidance would be beneficial? If so, what rules and guidance would you propose and why?

We do not have any to recommend.

We noted above that the practice of CMCs making data subject access requests when there appeared to be no reasonable grounds for a complaint is a problem. We recognise that DSARs come within the ambit of data protection law, including the GDPR, so the scope for measures to address this mischief is probably limited. However, there should be the possibility of regulatory guidance or voluntary measures. This is a matter that merits further exploration and, if further considerations were to take place, the BSA would be keen to participate.

- **Dispute resolution**

Q30: Do you agree with our approach to apply our complaint handling rules and guidance in DISP, including the compulsory jurisdiction of the Ombudsman Service, to all CMCs we authorise?

Yes we do. Like most other recommendations in the CP, the proposals concerning dispute resolution are clearly appropriate. It makes sense for the same Ombudsman Scheme that adjudicates complaints about financial services firms to carry out the same role, and on the basis of the same rules, in respect of CMCs. This arrangement would help ensure consistency and fairness across the adjudication of all complaints.

Q31: Do you agree with our proposal to apply our rules in DISP Chapter 1 to CMCs?

Yes, on the same basis as our response to question 30 above. The DISP Rules have, broadly speaking, helped ensure strong complaint handling procedures among regulated firms and would be equally appropriate for CMCs.

Q32: Do you agree with the Ombudsman Service's proposal to grant CMCs outside our regulatory regime access to the voluntary jurisdiction?

Yes.

- **Enforcement**

Q33: Do you have any comments on our proposal to apply the same approach to enforcement investigations and action to CMCs and individuals as we do to other regulated firms, as set out in EG?

No, they are clearly sensible.

Q34: Do you have any comments on our proposal to follow the same procedures for decision-making and imposing penalties in relation to CMCs and individuals set out in DEPP?

No, again this makes sense.

- **Cost benefit and impact assessment**

Q35: Do you have any comments on the costs and benefits as set out in our cost benefit analysis?

The overall costs appear consistent with what one would expect in migrating a sector into a different regulatory framework. Presumably, the FCA experience in taking over the regulation of consumer credit firms will have provided useful intelligence.

Q36: Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

We believe that the significant potential benefits to consumers outweigh the costs involved in the exercise.

ANNEX

BSA Analysis of apparent rule breaches, by some CMCs around 2011, provided to the Ministry of Justice

“Rule Breaches

The Rule breaches in question, which are largely self-explanatory (but we provide some commentary nonetheless), appear to include the following –

(a) Conduct of Authorised Person Rules 2007

www.justice.gov.uk/downloads/guidance/inspection-monitoring/claims-management-regulation/conduct-of-authorised-persons-rules2007.pdf

The rules apply to the conduct of regulated claims management services from the date of authorisation of the business.

- **General Rules**

1. *“A business shall conduct itself with honesty and integrity”.*

It cannot be honest to encourage and conduct a bogus (‘non-sales’) complaint.

2. *“A business shall conduct itself responsibly”.*

It cannot be responsible to encourage and conduct a bogus (‘non-sales’) complaint.

3. *“A business shall observe all laws and regulations relevant to its business”.*

The *modus operandi* described above appears to breach a number of laws including the Consumer Protection from Unfair Trading Regulations 2008 (see below).

- **Client Specific Rules**

1. *“A business shall –*

a) Act fairly and reasonably in dealings with all clients.

b) Ensure that any service offered is one that meets the needs of the client and satisfies the requirements of these Rules.

c) Ensure that all information given to the client is clear, transparent, fair and not misleading”.

It is difficult to see how a *modus operandi* of complaining about products or services that had never been sold/provided to the customer in question can comply with a), b) or c) above. It is not fair or reasonable to give a client an expectation of receiving compensation when there is no prospect of such an award being made. Clearly, such practice cannot meet the client’s needs or satisfy the rules’ requirements. In addition, the practice is invariably based on deliberately or recklessly providing the client with information that breaches c) eg misleading information about the prospect of compensation.

- **Taking on Business Rules**

11. *“A business must provide the client with the following information in writing or electronically before a contract is agreed –*

a) *Honest, comprehensive and objective written information to assist the client to reach a decision including the risks involved in making a claim, in particular the possibility of losing money and, in the case of legal action, appearing in court.*

b) *The services that will be provided, in a way that does not misrepresent, either by implication or omission, any term or condition or by whom the service will be provided”.*

There seems to be no scope within these Rules to argue that the *modus operandi* described above is compliant.

(b) Marketing and Advertising

Rule 2 of the client-specific rules in the 2007 Rules require all CMCs’ advertising, marketing and other soliciting of business to conform to the relevant advertising code including the UK Code of Non-broadcast Advertising, Sales Promotion and Direct Marketing (CAP Code) – www.cap.org.uk/The-Codes.aspx. Key provisions of the CAP Code include -

Rule 2 – all marketing communications must be legal, decent, honest and truthful.

Rule 3 – businesses must be able to justify claims they make in their marketing, and

Rule 7 – requires all marketing communications not to mislead, or be likely to mislead, through inaccuracy, ambiguity, exaggeration, omission or otherwise.

The Ministry’s guidance note *Marketing and Advertising Claims Management Services* states that marketing that does not comply with the CAP Code, or which is misleading to consumers, may breach the requirements of the Consumer Protection from Unfair Trading Regulations 2008. Appendix 2 of the Ministry’s guidance provides a summary of the key provisions in the 2008 Regulations -

“The Consumer Protection from Unfair Trading Regulations 2008 introduce a **general duty not to trade unfairly**. The Regulations cover actions by a trader before, during and after any contract is formed with the consumer. They prohibit the following practices where these have an effect on the decisions that a consumer makes:

- **Misleading actions** (for example, saying your claim service is suitable for a customer when it is not, or overstating the likely claim value)
- **Misleading omissions** (for example, claiming a “success rate” without making it clear that you restrict your clients to those with a good chance of a successful claim)
- **Aggressive practices** (for example, exploiting any misfortune or circumstance which of such gravity that it would impair your client’s judgment, or threatening to sue when you could not legally do so.)

The Regulations also create an outright ban on 31 specific unfair practices.”

www.justice.gov.uk/downloads/global/business/claims-management-regulation/conduct-of-business/CMR-Marketing-Guidance-Oct-2010.pdf

Where a CMC pursues a non-sale complaint, which by definition has *no* prospect of success, the CMC may have breached the CAP Code and the 2008 Regulations unless the advertising makes it clear, in a prominent way, that the CMC will – in some cases – pursue claims that the customer cannot possibly win. Not surprisingly, we have yet to see *any* CMC advertising that carries such a notification.

Most breaches of the 2008 Regulations are criminal offences unless a statutory defence applies. For example, a defence to the general duty not to trade unfairly is that the trader did not “knowingly or recklessly engage in the practice”. It is difficult to see how any CMC engaging in serial non-sales complaints could raise this defence. Therefore, we believe that those CMCs, and their directors, that have engaged in making serial non-sales complaints may have committed criminal offences under the 2008 Regulations.”

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £393 billion, and account for 22% of the UK mortgage market and 18% of the UK savings market.