The Financial Inclusion and Markets Centre

Promoting finance that works for the economy, environment, and society

HM Treasury Consultation

Review of the Financial Ombudsman Service

Submission by the Financial inclusion and Markets Centre (FIMC)

About The Financial Inclusion and Markets Centre

The Financial Inclusion and Markets Centre is a dedicated unit of the Financial Inclusion Centre which focuses on financial services policy and regulation, financial market reform, and evaluating the economic, environmental, and social utility of finance. The new unit also covers work evaluating the impact of developments at the intersection of finance and technology including AI.[1]

[1] About | The Financial Inclusion Centre

Introduction

We are pleased to submit a response to such an important consultation. For further information, please contact Mick McAteer mick.mcateer@inclusioncentre.org.uk

Summary of our submission

- The potential impact of the HMT/FCA joint reform of the redress regime currently underway cannot be considered in isolation. A number of deregulatory and 'market supporting' initiatives are currently in train to support the finance sector growth and competitiveness agenda.
- The key proposals on the fair and reasonableness test, wider implications, and mass redress events, and referral mechanisms outlined in the HMT/FCA consultations would give firms and industry lobbies greater opportunities to delay consumer access to redress and/or reduce firms' liability for redress, and influence the direction of financial services policy and regulation eg. on the interpretation of the FCA's Consumer Duty. The proposals threaten to compromise the independence of FOS and undermine the consumer protection backstop provided by an independent FOS (notwithstanding the concerns about the existing governance of FCA/FOS, see below).
- Remember that finance industry lobbies already exercise significant influence over financial services policy and regulatory policy. Compared to civil society the finance industry: dominates working groups/task forces while civil society is hugely underrepresented; has the resources to contribute significantly more responses to government and regulator consultations; and has far more meetings with senior policymakers and regulators. Regulated firms are also protected by commercial confidentiality provisions in legislation.
- Currently, six of the seven FOS board directors have current or previous direct links to the financial services industry.[2] None appear to have direct civil society/ consumer advocacy experience. Excluding the CEO, the FCA board has 12 members. Seven have current or previous links to financial services. One is a regulator (PRA), and one is an academic. Only three are recognised consumer/public interest representatives.[3]
- Overall, the proposals in this consultation and in CP25-22 would further strengthen the influence of industry lobbies to the detriment of consumers.
- To justify the proposals, HMT/FCA repeats the industry narrative that the current redress regime 'has suppressed investment and innovation in UK financial services, which can lead to firms offering fewer, less innovative products for consumers due to concerns about potential future redress', that FOS is 'acting as a quasi-regulator', and FOS retrospectively applies different rules and standards. Yet, HMT/FCA provides no evidence nor reasoning to back up these industry lobby claims. For example, there is no evidence presented that the current regime has prevented economically or socially useful financial

[2] Our Board of Directors – Financial Ombudsman service
[3] FCA Board | FCA

innovation. It is a real concern that HMT/FCA is proposing such reforms that would further weaken consumer protection and rights to redress without even presenting evidence to justify these reforms. The case has not been made for such reforms particularly in the absence of robust governance measures and safeguards.

- Weakening consumer protection and rights of access to redress might give the financial sector a short term fillip. It might cause firms to 'innovate' and sell more products in the expectation that they are less likely to be held accountable and face reduced redress bills for poor consumer outcomes. But, this is short-termist thinking and would undermine consumer trust and confidence in the medium-longer term.
- The FCA/FOS have limited resources. The HMT/FCA proposals could create opportunities for industry lobbies and individual firms to mount regular challenges to the FCA/FOS causing them to divert resources from pursuing their core consumer protection and redress objectives.
- Robust safeguards will need to be put in place to mitigate the risk of the industry using these proposals to undermine the overall end-to-end effectiveness of the consumer protection and redress system.

Response to specific questions

Question 1: **Do you agree that, where conduct complained of is in scope of FCA rules, compliance with those rules will mean that the FOS is required to find a firm has acted fairly and reasonably?**

No. The proposal to adapt the fair and reasonable test would, in effect, bring FOS closer within the FCA's orbit and undermine the independence of FOS. It would undermine an important safeguard for consumers provided by an independent FOS.

As mentioned, each of the consultation papers cannot be considered in isolation. The HMT and FCA/FOS consultations should be considered together and in the context of the wider set of deregulatory measures in train to support the finance industry's growth and competitiveness agenda.

The FCA's accompanying proposals would allow firms an opening to influence the interpretation of important elements of consumer protection to the industry's advantage. This could happen through review of wider implications issues or the proposed referral process.

A good example is the FCA's Consumer Duty. A key feature of the Consumer Duty is that it allows firms significant discretion as to how to interpret the Duty's outcomes.[4] The FCA's proposals are likely to be a Trojan Horse for the industry to undermine the effectiveness of the Consumer Duty. It must be acknowledged that the FCA is under intense pressure to support the industry's growth and competitiveness agenda by weakening consumer

[4] As an aside, the industry lobbies complained about overly prescriptive rules and now they complain about rules not being prescriptive enough and too open to interpretation.

protection and rights to redress.[5] It is easy to envisage situations where there are differences of opinion on what was intended by a particular Duty outcome and firms pressuring the FCA to activate the referral process to obtain clarification to the advantage of the industry.[6]

If that happens, then HMT's proposed adaptation of the fair and reasonable test means that the FOS would then have to default to interpreting decisions in favour of the industry and to the disadvantage of consumers. Therefore, an important separate check and balance in the system would be removed.

Question 2: Will the aligning of the Fair and Reasonable test with FCA rules still allow the FOS to continue to play its relatively quick and simple role resolving complaints between consumers and businesses?

It is not possible to say what impact HMT's proposals might have on FOS' ability to act relatively quickly. But, as explained, the proposals could undermine the independence of FOS and remove an important check and balance in the system.

Moreover, as we highlight in our response to the FCA/FOS consultation even if the FCA held firm on referrals or wider implications issues, the combined set of HMT and FCA/FOS proposals would obviously provide industry lobbies and individua firms with the opportunity for firms to delay and undermine enforcement action and access to redress by invoking the referral process and tying up the FCA/FOS in disputes.

Question 3: Do you agree with the proposed approach for dealing with law which may be relevant to a complaint before the FOS?

Question 4: Do you consider that there are some cases that are not appropriate for the FOS to determine, bearing in mind its purpose as a simple and quick dispute resolution service? How should such cases be dealt with?

It is not possible to answer Q3/4 without seeing more detail on the safeguards that would be included to protect consumers where cases are referred to the courts. Again, it is easy to envisage situations where industry pressures FCA/FOS on the interpretation of issues and asks for referrals to the courts. This could give industry a significant advantage given the level of resources firms have to represent their case in the courts. Civil society organisations have nowhere near the same level of resources. Will FCA/FOS be able to unilaterally dismiss cases or refer cases to the courts? Or will they be required to consult with consumer representatives before doing so?

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[5] For example, the Targeted Support regime weakens consumer protection and rights to redress to 'encourage' firms to sell high risk, costly investment products to consumers. See: [FCA consultation CP25/17 on 'targeted support' | The Financial Inclusion Centre]

It is important that enhanced governance and representation measures are put in place to protect the consumer interest from the potentially detrimental effects of the combined set of proposals in this consultation paper and in the FCA/FOS CP25-22.

For example, in our response to CP25-22, we propose that the FCA create an advisory panel consisting of consumer and other public interest representatives (for example, legal experts and academics). The purpose of this panel would be to help the FCA/FOS deal effectively and objectively with potential wider implications issues, MREs, the formal referral mechanism, and cases that may be referred to the courts. The Panel would:

- assess evidence of emerging harm that might have wider implications and signal a potential MRE;
- recommend the appropriate approach for considering whether a potential MRE should be considered as an actual MRE;
- recommend to the FCA/FOS whether a potential MRE is indeed a MRE and should be treated as such;
- evaluate whether the regulatory approach used in the MRE process would result in less positive outcomes for consumers than the fair and reasonable test currently used by the FOS;
- identify potential areas of disagreement on issues such as the interpretation of the Consumer Duty outcomes;
- advise FOS on whether a formal referral to the FCA would be beneficial for consumers;
- advise on the implications of the FCA's interpretation of issues for FOS determination of complaints; and
- advise on the merits and demerits of referring cases to the courts.

Question 5: Do you agree that there should be a mechanism for the FOS to seek a view from the FCA when it is making an interpretation of what is required by the FCA's rules?

HMT argues that this referral mechanism would not require the FCA to consider the merits of any individual case, nor to allow a direction to the FOS on how any individual case should be determined. But, the effect of the other proposals such as the adaptation of the fair and reasonable test would result in the FCA, in effect, directing how cases should be determined.

It is not possible to say definitively whether we agree or not without seeing the governance and representation measures that would accompany a new mechanism requiring FOS to refer to the FCA for a view.

The Government will also legislate to ensure that parties to a complaint have the ability to request that the FOS refers an issue of rule interpretation to the FCA. As we explain elsewhere, the industry lobby has substantially more resources than civil society organisations. The proposals for the referral mechanism, dealing with wider implications issues, and dealing with MREs clearly create opportunities for industry lobbies to influence FCA/FOS policy to their advantage. Robust governance and representation measures will be required to mitigate the extent to which industry lobbies can exploit these proposals - see above.

Question 6: Do you agree that parties to a complaint should have the ability to request that the FOS seeks a view from the FCA on interpretation of FCA rules where the FCA has not previously given a view?

Again, it is not possible to answer definitively in the absence of proposals for enhanced governance and representation measures to mitigate the risks of industry lobbies using this referral mechanism to influence FCA/FOS policy to their advantage and to the detriment of consumers.

At the very least, the FOS must be allowed to reject a request from the industry to refer to the FCA.

Question 7: Do you agree that parties to a complaint should have the ability to request that the FCA considers whether the issues raised by a case have wider implications for consumers and firms?

The issue here is not whether parties to a complaint should have the ability to request that the FCA considers issues raised by a case, but the governance measures deployed to mitigate the risk that industry lobbies will exploit this ability to influence FCA/FOS policy to the detriment of consumers.

Obviously, we would like to see reforms that enhances the effectiveness of the regulatory system (FCA, FOS, FSCS). So, any new framework for dealing with potential wider implications issues or MREs should have two primary purposes to ensure that:

- significant episodes of consumer detriment are dealt with effectively and the consumers affected obtain due redress in the most efficient way.
- the FCA learns lessons and enhances its supervision of the finance sector.

With regards to dealing with potential MREs, the proposed criteria suggested by the FCA are where an issue: a. Affects a high number of consumers; b. Has a significant impact on individual consumers, including those in vulnerable circumstances; c. Is likely to lead to a high redress bill; d. Results in a significant number of firms being unable to meet their redress liabilities; e. Leads to a high number of Financial Ombudsman complaints; and f. Driven by a systemic/repeatable failing that damages confidence in the financial system.

No doubt, similar criteria will be used to determine whether a case might have wider implications and should be referred to the FCA for consideration.

We would argue that if FCA/FOS intends to use these criteria these should be grouped into two categories – primary and secondary. The primary categories, the most important ones, are: a. Affects a high number of consumers; and b. Has a significant impact on individual consumers, including those in vulnerable circumstances. These should be used to determine whether a referral to the FCA would be likely to improve the process for obtaining redress or result in improvements to consumer protection. The potential impact on the industry/sectors/firms responsible for that detriment should be a secondary consideration.

HMT says that in making its assessment, the FCA will be required to consult its statutory consumer and industry panels. This is not sufficient. As outlined above, we propose the creation of a new advisory panel to advise and make recommendations to the FCA/FOS on issues such as wider implications and MREs.

FOS should be allowed to reject a request from industry to refer issues to the FCA. The FCA should be able to reject industry requests to consider issues raised by a case which may have wider implications or the potential to be a Mass Redress Event.

Question 8: As part of implementing the proposed referral mechanism, do you think there are any issues which should be considered in order to ensure the mechanism works in the interests of all parties to a complaint?

The risks of these proposals (individually and taken together) creating opportunities for industry to delay/ deny access to redress or adversely influence FCA/FOS policy are obvious. New governance and representation measures will be needed to mitigate these risks, see above.

Question 9: Do you agree that the Chief Ombudsman should have overall authority for determinations made by FOS ombudsmen, and through that authority, should be responsible for ensuring consistent FOS determinations?

It is not clear whether this proposal would result in a more effective redress regime. Giving such a degree of responsibility to one person could end up slowing down the process as that individual is likely to want exercise even more scrutiny over determinations made by individual ombudsmen.

This proposal vests a significant amount of authority in the office of a single person. Therefore, it will result in a greater concentration of risk that FOS policy can be influenced to the advantage of industry lobbies and to the detriment of consumers.

So, as with the other proposals in these consultation papers, what matters are the governance and representation measures deployed to mitigate the risks of industry exploiting these new arrangements. The role of the FOS board will be critical. Currently, six of the seven FOS board directors have current or previous direct links to the financial services industry.[7] None appear to have direct civil society/ consumer advocacy experience. If HMT is determined to introduce this new regime then addressing the imbalance of representation on the FOS board is a priority.[8]

Question 10: What approach to transparency arrangements would provide the most accessible way for consumers and firms to understand what outcomes to expect for particular types of cases that the FOS deals with?

We would support the idea of FOS publishing thematic documents. However, this should be in addition to FOS publishing individual decisions to allow civil society to analyse trends in issues and to assess whether FOS is drawing the appropriate conclusions in thematic publications.

Question 11: Do you think the package of reforms outlined above, taken together, will be sufficient to address the problems identified by the review and ensure the FOS fulfils its original purpose?

No. The 'problems' identified by the review are to a large degree those asserted by the industry. Worryingly, HMT and FCA/FOS consultation papers cite claims that the current redress regime 'has suppressed investment and innovation in UK financial services, which can lead to firms offering fewer, less innovative products for consumers due to concerns about potential future redress', that FOS is 'acting as a quasi-regulator', and FOS retrospectively applies different rules and standards. Yet, HMT/FCA provides no evidence nor reasoning to support these industry lobby assertions.

There is a clear risk that the package of proposed reforms, as currently presented, would compromise the independence of FOS, threaten the necessary separation of roles between regulator and Ombudsman and, more generally, create opportunities for the industry lobbies and individual firms to intervene to delay/ deny access to due redress and influence FCA/ FOS policy to the detriment of consumers.

Robust governance and representation measures will be needed to safeguard the consumer interest if the Government proceeds with these industry-positive reforms.

Question 12: Taking into account the other reforms proposed in this consultation, do you think that the FOS should be made a subsidiary of the FCA? If so, what are your views on the appropriate institutional arrangements?

Certainly not. It is important to maintain a separation of governance, roles, and responsibilities between regulators and Ombudsmen. Ombudsman independence is an important principle of consumer redress, and a critical safeguard. The proposals in the

[7] Our Board of Directors – Financial Ombudsman service

[8] It is also worth noting that excluding the CEO, the FCA board has 12 members. Seven have current or previous links to financial services. One is a regulator (PRA), and one is an academic. Only three are recognised consumer/public interest representatives. Again, a minority but not as imbalanced as the FOS board.

consultation documents risk compromising the independence of FOS. This development is worrying enough. Making FOS a subsidiary of the FCA would compromise FOS independence even further. If anything, HMT should be improving the governance of FCA/FOS by addressing the serious imbalance in industry/ consumer representation.

Question 13: Do you agree that 10 years is an appropriate absolute time limit for complainants to bring a complaint to the FOS?

Question 14: Do you agree that the FCA should have the ability to make limited exceptions to this time limit?

No. We do not support a general, absolute time limit for complaints. This could limit access to redress in cases of long term products or when it may be some time for detriment (caused by prior decisions) to emerge.

For example, new developments such as the targeted support regime will weaken consumer protection standards. It will create opportunities for financial institutions to in effect electronically cold call consumers to sell them higher risk, high cost long term investment products. It could be a long time before the detriment caused by aggressive selling practices fully materialises. Mortgages, which are being sold with ever longer mortgage terms, are another example.

Similarly, some of the major UK life insurers appear much stronger than they really are due to the weak Solvency UK regime. The insurance lobby has been pushing for further weakening of Solvency UK.[9] Life insurers manage significant amounts of pension assets and we have seen a growth in pension transfers to life insurers. We are not saying that any life insurer is at immediate risk of failure. But, we think there is a risk that, due to the Solvency UK regime, serious problems could emerge in the long term. Imposing a 10 year limit could mean that consumers would not be able to take a complaint against an adviser (independent or sales) for recommending taking out a pension with a specific poorly capitalised insurer without having done sufficient due diligence.

We cannot see how the FCA could usefully make limited exceptions to this time limit on an *ex ante* basis. This would require an impossible degree of foresight on the part of the regulator to cover major eventualities

[9] See: Submission to HM Treasury Review of Solvency II consultation | The Financial Inclusion Centre

Question 15: Do you agree that the FCA should have more flexibility, when investigating a potential MRE, to take steps that are designed to avoid disruption and uncertainty for consumers and firms? In addition to the proposals made above, do you think there are other tools for the FCA which should be considered?

Question 16: Do you agree that there should be a simpler legal test for the FCA to satisfy in deciding that a section 404 redress scheme is needed to respond quickly and effectively to an MRE?

The issue here is not one of flexibility but the criteria the FCA should be required to consider before determining a MRE and the governance around handling MREs.

As we outline in Q7, any new framework for dealing with potential wider implications issues or MREs should have two primary purposes to ensure that: significant episodes of consumer detriment are dealt with effectively and the consumers affected obtain due redress in the most efficient way; and the FCA learns lessons and enhances its supervision of the finance sector.

With regards to dealing with potential MREs, the proposed criteria suggested by the FCA are where an issue: a. Affects a high number of consumers; b. Has a significant impact on individual consumers, including those in vulnerable circumstances; c. Is likely to lead to a high redress bill; d. Results in a significant number of firms being unable to meet their redress liabilities; e. Leads to a high number of Financial Ombudsman complaints; and f. Driven by a systemic/repeatable failing that damages confidence in the financial system.

We would argue that if FCA/FOS intends to use these criteria the most important ones, are: a. Affects a high number of consumers; and b. Has a significant impact on individual consumers, including those in vulnerable circumstances. These should be used to determine whether implementing the MRE process would be likely to improve access to due redress or result in improvements to how the FCA regulates the market. The potential impact on the industry/sectors/firms responsible for that detriment should be a secondary consideration.

It is very concerning that with regards to MREs, the Government will amend FSMA so that, where the FCA judges that immediate pausing of the complaint handling process is in the interests of affected consumers and firms, the FCA will be exempt from the usual obligation to consult before making rules.

Even if the FCA is exempt from conducting the usual consultation process, it would not be appropriate to allow the regulator to avoid any form of consultation. This goes against the principles of good regulation and regulatory accountability.

As outlined above, we propose the creation of a new advisory panel to advise and make recommendations to the FCA/FOS on issues such as wider implications and MREs. This advisory panel could provide quick and informed views to the FCA on whether a MRE scheme would benefit consumers, how a MRE scheme might be operated, and whether any legal test has been met.

Question 17: Do you agree that the FCA should be able to direct the FOS to handle complaints consistently with relevant redress schemes, or to direct the FOS to pass related complaints back to firms, to be dealt with by those redress schemes?

No. We think this would further compromise the independence of FOS and further weaken the backstop provided by FOS.

This marks the end of our submission.

Financial Inclusion and Markets Centre (FIMC)
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