Financial Ombudsman Service: 2020/21 plans and budget and future strategy Consultation
FLA Response

The Finance & Leasing Association (FLA) is the leading trade association for the UK consumer credit, motor finance and asset finance sectors. FLA member companies include banks, the finance subsidiaries of major manufacturers and independent finance firms. They offer credit services to customers from all social groups, via credit and store cards, personal loans, point of sale finance, motor finance and a number of other consumer credit products, as well as a wide range of leasing and hire purchase services to businesses of all sizes. In 2018, members of the FLA provided £138 billion of new finance to UK businesses and households in the 12 months to November 2019.

We welcome the opportunity to comment on FOS's Plans, Budget and Future Strategy for 2020/21. We responded with our concerns to FOS's earlier future funding proposals in August 2019. With little change to the draft proposals, we remain seriously concerned that whilst FOS has opted for the funding model that best suits it's financial needs, there is no indication of what this will mean in practice for different-sized firms. No detailed modelling of the impact of a move away from a predominately 'case-fee' based model towards an 'income based' approach has been provided. Although not required under FSMA, in order to be both accountable and transparent a detailed Cost Benefit Analysis (CBA) should have been undertaken. We would like to see any modelling/analysis that FOS has undertaken on these proposals, in order to better understand the full cost implications for FLA members.

It is also disappointing that such important issues have been allocated a very short consultation period (6 weeks), over the peak Christmas holiday season. It is important that the industry has sufficient time to consider the final proposals, and that they are properly evidenced from both a FOS and industry perspective.

In our response we have concentrated on FOS's updated funding proposals and continuing issues around PPI.

Executive Summary

- While we agree that FOS should be properly funded to meet its statutory objective of 'resolving disputes quickly and informally based on what is fair and reasonable', we remain concerned at the proposed move away from a predominately 'case-fee' based model to a 'levy based' approach. Firms will pay more irrespective of the number of complaints they have received and at a time when FOS is proposing to reduce the scale of its operation post-PPI.

- The change in funding methodology is being undertaken without an open and transparent analysis of the cost implications for different-sized firms. At the very least, FOS should provide an online fees calculator.
- We do not support the new higher case fee (increased from £550 to £650) being applied retrospectively. This is totally unacceptable and places firms at a disadvantage where FOS has failed to deal with complaints efficiently – there are examples of certain cohorts of complaints sitting with FOS for over 18 months. Firms will not have budgeted for this retrospection and it could be viewed as the FOS seeking to accrue additional financial advantage from the high volume of PPI complaints still being administered. The new fee should instead be effective for new complaints received on or after 1 April 2020.

Questions

Current outlook for 2019/20

Q1: What do you think about our projections for the volumes of complaints we'll receive and resolve in 2019/20

We think the volume of PPI complaints is likely to remain flat for 2019/20, but that FOS might need to gear-up for a rise in the number of complaints from mid-2020 onwards. This is due to the large number of complaints brought by the Official Receiver ('OR') immediately before the end-August PPI deadline. Lenders are still working through these and any FOS referral rights on these cases is unlikely to be seen until 2020/21.

Q2: What's your perspective on the trends we've identified in 2019/20?

We believe that affordability/creditworthiness-related complaints will continue to be generated via CMCs and in response to online blogs in a post-PPI world. With these cases, the FOS will need to be careful that these are genuine cases and not just CMCs pursuing all customers in the higher-cost credit markets. We are currently monitoring how the FOS is administering these complaints and the responsibilities apportioned to both lenders and consumers. We would be happy to discuss our findings with the FOS.

It's also likely that scams continue to be a theme in 2019/20 and going into 2020/21.

Q3: Are there other trends you're seeing, or any insights you have, that you think we should take into account for the rest of 2019/20

We understand that certain CMCs are beginning to focus on encouraging consumers to challenge interest rate calculations.

Q4: Do you have any views about how our new CMC and SME jurisdictions have been operating?

While it is still very early days for both the new jurisdictions, we think it's likely that both these jurisdictions will see an increase in the number of complaints in 2020/21, from their current low base.

We have welcomed the opportunity to join the FOS's SME Advisory Panel as this has proved a useful forum to discuss industry trends and gain a clearer insight into how the new redress regime will work. We understand that the FOS intends to issue guidance clarifying what type of funding is covered by the new regime and hope to see that in the near future.

Q5: Do you have any other feedback about our year so far?

We are concerned that some cohorts of complaint areas are not always being dealt with on a case-by-case basis. Some firms are being asked to revisit whole cohorts of complaints by the FOS, before the FOS has even looked at them (off the back of either adjudicator/Ombudsman decisions). It's also important not to lose sight of the fact that the FOS was originally established to resolve disputes quickly and informally based on what is fair and reasonable. We note that in areas, the FOS have been sitting on large volumes of cases for 12-18 months. Firms are required to deal with complaints within set time parameters to ensure good customer outcomes – which is not reflected when cases are then delayed when reaching the FOS.

In some of these older cohorts of cases, it's important that FOS is consistent in its adjudications over time. If it's not, then it needs to be very clear and transparent as to why its approach has changed over time. Similarly, on technical points such as the use of 'Limitation Periods' and the application of Section 75, the FOS should be acting within the confines of these statutory provisions and not changing their parameters which are clearly defined in the Consumer Credit Act (CCA).

Our plans for 2020/21

Q6: What do you think about our projections for the volume of complaints we'll receive and resolve in 2020/21?

See our response to Q1 above.

Q7: What are your views on the challenges we're facing in PPI – including your expectations around the timing and volumes of referrals to us?

We agree with both the FOS and the FCA that it's likely to be the Summer before the backlog of PPI cases is cleared. This is because the Official Receiver ('OR') brought many of these claims very close to the 29 August deadline and the respective parties are still working through these large numbers of cases. In many cases it's likely that firms will need to use their rights under DISP 1.6.2R(2) to extend the 8-week period up until the Summer. With 6-month referral rights and with likely heightened CMC activity, the FOS could see an uplift in PPI complaints between April and the end of the year. This is likely to be in the 100,000’s based on the volumes submitted by the ‘OR’.

Q8: What are your views on the potential for complaints volatility in short-term lending?

The FOS has already seen an increase in short-term lending complaints, especially around affordability/responsible lending. We believe CMCs will keep bringing these cases regardless of their merits. The FOS will need to work through these cases in light of the regulations at the time these cases refer to.

Q9: Are there other trends, themes or complexities you’re aware of, or any insights you have, that you think we should take into account as we plan for 2020/21

See response to questions 2 and 3 above.

One member has anticipated a spike in responsible lending-related complaints in 2020. Whilst they take reasonable and proportionate checks and meet their regulatory requirements in relation to responsible lending, it’s their view that this will not decrease the amount of FOS escalations. There appears to be an increase in the claim culture, along with CMC’s pushing complaints to the FOS. These are costly and have a negative impact on smaller firms, especially with the number of free cases decreasing and fees increasing overall.

Q10: What are your views on our plans to resource and develop our service in 2020/21

We agree that FOS should be building its knowledge, skills and capacity and in particular its online capabilities for both businesses and complainants. A programme of work to help stop complaints in the first phase would be very much welcomed.

<u>Our budget for 2020/21</u>

Q11: What are your views on our proposed budget and funding arrangements for 2020/21

As we said in our response to earlier drafts of these proposals, we have serious concerns with these proposals. The proposed model will see some firms paying considerably more, irrespective of the volume of complaints they receive.

The retrospective application of the increased case fee (£550 to £650) is fundamentally unfair as firms will not have provisioned for this increase – at a time when all firms are seeing higher volumes of PPI and other cases subject to delays at the FOS. The application of the proposed funding arrangements retrospectively will have significant impact on companies. Some FOS cases referred during 2018/2019 are still outstanding pending a decision and should be charged in line with the funding arrangements which were in place at the time of referral.

A detailed breakdown of FOS's budget forecast shows that despite a smaller service costs appear to be increasing. For example:

- The total income for 2020/21 (draft) appears to have increased by £20 million from 2019/20
- Staff and staff-related costs also appear to have increased by £13 million for the draft 2020/21 budget compared to 2019/20. Contractor costs are also similar
- Total proposed expenditure has increased by £8 million in 2020/21, compared to 2019/20
- At the same time, the FOS have forecasted a reduction in the number of new cases down from an expected 315,000 in 2019/20 to 245,000 (down 70,000).

We are extremely concerned that our members appear to be paying substantially more at a time when the size of the FOS service is supposed to be getting smaller. However, without a proper costing for different-sized financial service firms from FOS, it's difficult to verify the overall likely effect on consumer credit firms. At the very least, we expect the FOS to provide a fees calculator similar to the one the FCA provides to regulated firms. A fees calculator would allow firms to work out and budget for the likely increased costs over the coming year.

Funding methodology changes example

In previous responses to the FOS's fee proposal changes, we have provided a few smaller member firm examples of how the changed fees methodology will affect them financially. Using a number of assumptions (e.g. total amount paid to FOS stays the same as do the number of complaints) below is a number of examples of how these funding methodology changes will affect a range of FLA members of different sizes across different consumer credit sectors.

Small sized FLA member in the motor finance space

	Existing costs	**Projected costs**
FOS complaints	97	
General levy	£6,296.13	£16,789.68
Case fees	£39,600	£56,550.00
Total cost	£45,896.13	£73,339.68
Projected increase	£27,443.55 or 59.8%	

Medium-sized FLA member in the motor finance space:

	2019/2020	2020/2021	Change
FOS general fee	£38,625 (based on 15%)	£103,000 (based on 40%)	+£64,375
Case Fees	120c 95 x £550 = £52,250	120c 110 x £650 = £71,500	+£19,250
Total annual fees paid to FCA in 2019	£514,000	£600,000	+ 17%

Similarly, using the same assumptions as above below is another example of how these funding methodology changes will affect a:

Larger-sized FLA member in the consumer credit space:

Cost	2019 (actual)	2020 (estimated)	Change
FOS annual levy	£123,000	£329,000	+£206,000
FOS case fees (less 25 'free' cases in 2019 and 10 in 2020	£508,000	£610,000	+£102,000
Total	£631,000	£939,000	+49%

In the above scenario (which includes 2020 estimates, including PPI) they estimate almost a 50% increase in the total amount of FOS levy / case fees for the coming year under the new funding methodology which FOS will bring in on 1 April 2020. In a post-PPI world in the above scenario the general levy will increase over £200,000, regardless of the number of complaints or No of complaint fees they have to pay.

Again using the same assumptions as above below is another example of how these funding methodology changes will affect a:

Larger-sized FLA member in the motor finance sector:

	2019/2020	2020/2021	Change
FOS general fee	£125,071 (based on 15%)	£333,523 (based on 40%)	+ £208,452
Case Fees	504c £263,450	504c £321,100	+ £57,650
Total	£388,521	£654,623	+ £266,102 (+68.5%)

In the above example, this firm will be paying over a quarter of a million pounds more for the same number of complaints made against it (in the region of 500 annually). This is nearly a 70% rise.

Larger-sized FLA member in the motor finance sector:

Year	April 2019/April 2020 (Actual costs)	April 2020/April 2021 (Estimated costs)	April 2021/April 2022 (Estimated costs)
Number of inherited cases from previous year		14	0
Number of new cases estimated		25	25
Total number of cases	0	39	25
Case fee - threshold	First 25 free	First 10 free	First 10 free
Number of chargeable cases	0	29	15
Cost – Case Fees	*£0*	*£18,850*	*£9,750*
FOS Levy applicable	April 2019 (based on 15% for the period Apr18-Apr19)	September 2019 (actual cost based on 15% for the period Apr19-Apr20)	Post April 2020 (estimated cost - based on 40% for the period Apr20-Apr21)
Cost – FOS Levy	*£1,173.03*	*£26,760.07*	*Circa £74,000*
Total Anticipated Cost	***£1,173.03***	***£45,610.07***	***c.£83,750.00***

In this example above, projected costs illustrate the estimated financial impact if the proposed funding arrangements go ahead. In summary, the costs represent a 3788% increase for April 2020-21, rising to over 7000% for April 2021 and beyond.

We are concerned with the levels of cross-subsidisation that appear to be occurring here. This change in charging structure/methodology appears to over-charge at least some prime lending firms in the consumer credit markets, with a move away from penalising those who create the complaints and work to a charging structure based more on size than the number of complaints raised. These same members have also seen this in the debt advice levy which FCA raise on behalf of the Money and Pensions Service (MaPS). Cross-subsidisation also appears to be happening across all sectors within the financial services markets. This being the case, consumer lenders and their customers are ultimately paying more than they should in comparison to the number of complaints they generate and their complexity (e.g. on the reasonable assumption that a 'vehicle quality' complaint is simpler and less complex to solve than say a complex investment complaint).

On page 24 of the Consultation Paper, the FCA state: "*We propose changes to our case fee arrangements that will help improve the sustainability of our funding, **while recognising the impact on businesses which generate very few cases for us***". Is FOS able to explain where this recognition is within these proposals?

We also note FOS state in this CP that: "*We note that some businesses will pay more in case fees than they currently do.* ***However, there will still be a significant level of protection for firms that generate only a very small part of our workload***" (page 27). However, FOS do not explain what this significant level of protection is or what it will mean for these firms.

We think a much better way forward would be to continue with a similar funding structure to the current one, with the option to raise more funds if need be via a special levy as has happened in the past in relation to PPI.

<u>Our future strategy</u>

Q12: Is there anything else you think we need to take into account as we develop our future strategy?

We think it's vital that more consideration is given to the impact assessment of costs for smaller businesses and the unintended consequences of the new model.

With regard to future trends in complaints, we remain concerned at the increasing number of spurious CMC complaints being sent to FOS. Has this been built into FOS's future strategy? There is now the added concern that with an increase in the case fee, CMCs could use this to try and settle smaller claims (less than £650), particularly in markets such as higher cost credit where smaller sums are involved. This could lead to scenarios where firms are settling cases for financial reasons, even though they know they would likely be rejected by the FOS.

The FCA is about to commence a piece of work looking at business models which promote unaffordable lending. CMCs might also see this as a potential future opportunity.

We agree with the FOS that the phasing-out of PPI complaints over the next few years will mean that the FOS is likely to have fewer complaints to process than it has done in the past and therefore it should become a smaller arbitration service compared to now. We are unaware of any issues within the markets in which our members are active that would see future significant demand for the FOS, beyond those already identified by the FOS and by us in this response.

Q13: Do you agree with our proposed strategic priorities?

These proposed strategic priorities look about right to us, with our main concern being around a change to the funding methodology which appears to penalise good complaint handling.

Key for our members in the future will be the work FOS does to help firms prevent complaints going to the FOS in the first place. We would also like to see the service develop into a quicker, faster, more informal arbitration service that delivers consistent judgements based on the individual facts, taking account of the regulations at the time the complaint relates to.

31 January 2020
FLA