Financial Ombudsman Service: Our future funding. A 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 £137 billion of new finance to UK businesses and households.

We welcome the opportunity to comment on FOS's future funding proposals. We are concerned that whilst opting for the funding model that best suits FOS's financial needs, there is no indication of what the levy will look like in 2020 for different sized firms. No detailed modelling of the impact of a move away from a predominately 'case fees' based model more towards an 'income based' model has been provided. A detailed Cost Benefit Analysis (CBA) should have been undertaken. It is also disappointing that such an important issue is given just 6 weeks for response by key stakeholders over the peak holiday season in July-August. While we appreciate that FOS has mentioned possible changes to the funding model in earlier papers, it is important that the industry has sufficient time to consider the final proposals.

Executive Summary

- We are concerned that FOS is moving away from a predominantly 'polluter pays' model to a 'levy based' model. This is being done without a proper analysis of other potential future funding models or a Cost Benefit Analysis of the impact on different sized businesses.
- In light of the above, we would like to see a comprehensive costing of these proposals and an analysis of all other options already proposed and rejected.
- FOS also needs to bear in mind that these proposals (which are likely to substantially increase the cost of FOS to firms) comes at a time when other regulatory costs have been spiralling, including the MAPS 'debt advice' levy. Firms will be asked to pay more, at a time when FOS is actually proposing to reduce the scale of its business in light of the PPI deadline on the 29 August.
- The timing of this consultation also means that FOS is unlikely to get the full feedback this important consultation deserves. A 6-week consultation over July/August when many people are away on holiday is poorly timed.

Questions

Q1: Our planning assumptions reflect our expectation that our service will be smaller in the future, and that our overall cost to the sector will significantly fall. Are you aware of anything that might affect this expectation – for example, issues that could create significant demand for our service?

We question FOS's assumption that the cost to the sector will reduce as a result of the proposed changes. The increase in the levy and reduction in the number of free cases will see costs rise for many firms. The only element which will reduce is the case fees in respect of PPI complaints post-August 2019 – but this is due to the PPI deadline and not FOS's funding proposals. For example, one member's calculation alone suggests that even without additional cases, the cost of FOS to their business is increasing by over 3,500%.

As already noted, a detailed Cost Benefit Analysis of these proposals and their impact across different firms should have been undertaken and the results included. It would also be helpful if the FOS could provide an online calculator, similar to the one FCA provides, to help firms work out what these future proposals are likely to cost them.

With regard to future trends in complaints, we remain concerned with the increasing number of spurious CMC complaints being sent to FOS. Has this been built into FOS's future predictions? We also note that with two new jurisdictions now within FOS's remit (SME's and CMCs), these may have some impact on complaint numbers – particularly with regard to CMCs.

Putting the above aside, we agree with FOS that the reduction in PPI volume will mean that the FOS is likely to have fewer complaints to process than it has done in the past. 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 FOS.

Q2: Do you have any further insight into the different types of complexities apparent in complaints?

We note that FLA members, especially within motor finance, are often in the position whereby they need to educate the adjudicator about the products they are assessing. For example, asset-based leasing products. However, we do not believe that this is about the complexities of FOS's current workload per se but more to do with the lack of technical skills and knowledge of some FOS adjudicators. We note that a similar point was made in the ***Dispatches Programme***. We hope this issue will be addressed going forward. This situation may not have been helped as FOS employs a large number of contract staff – effective quality assurance will be essential.

In addition, different complaints require different degrees of knowledge and specialism depending on the type of financial product and goods or services funded. This often needs reliance on external experts and we would expect the FOS to adopt a similar approach to assist with their understanding going forward. The FLA is always willing to collaborate with FOS if there are gaps in product-knowledge and we have worked together on motor-finance sessions in the past.

As to future complexities, we understand that certain CMCs are beginning to focus on encouraging consumers to challenge interest rate calculations and if it is correct this is an example of potential increased complexity.

Q3: a) To what extent do you support our wider work to help prevent complaints and encourage fairness?

We support the FOS 's work and efforts to prevent complaints and encourage fairness. FLA members want to minimise causes of complaints and an independent ombudsman is important to helping to resolve situations where disputes occur. Where possible, FLA members will always look to learn any lessons following a FOS adjudication and how they can take forward any lessons to avoid complaints in the future and / or make changes that will benefit the non-complainant population.

b) Do you have any further suggestions about what more we could do, or ideas for working together with us?

As already noted above, FOS needs to ensure that its staff has the requisite skills and expertise to adjudicate on complaints across a broad range of products. This has been lacking in the past. Anecdotal evidence from FLA member experience is that cases are sometimes managed by individuals lacking knowledge of the automotive/leasing sector which means more time and effort is required to explain some of the industry basics in order to get to the right decision based on current legislation. As a result, this can then cause delays in customers receiving a final decision.

We also receive regular feedback from FLA members about the inconsistency of FOS decisions. So whilst firms endeavour to make changes to processes in light of FOS adjudications (see a) above), this is difficult when there are inconsistencies between adjudications on very similar cases. This presents challenges in embedding any learnings into any BAU practices.

Easier access online to information from FOS, about general complaint situations and scenarios and how FOS might consider investigating them, would help firms get it right first time and prevent future complaints. The current "ombudsman decision" tool and case studies on FOS's website can be difficult to navigate to get to the right answers. FOS could also explore how it might work more closely with firms in particular areas where complaint trends have arisen. This could be via Roundtables etc.

Q4: To complement the work we've already done to improve our efficiency we'd welcome your ideas for how we could work in partnership to deliver additional savings in future. Do you have any suggestions?

See comments above on improving efficiency and achieving time/effort savings through greater investment in specialist training, to deliver greater/more consistent expertise within the FOS teams.

Where cases are referred to FOS, it would be helpful if consumers could provide a level of rationale as to why they are escalating a case to FOS and why they disagree with the original outcome decision? This could potentially lead to some cost savings across the industry and reduce any spurious referrals from customers/CMCs.

We believe that FOS should review its current office location. We do not see a London-based office is necessary as FOS is not a client-facing business and does all its communications with its stakeholders (both its customers and firms) via electronic means. We note that FOS already has an office in Coventry and further work could be undertaken to see if this could be extended to include other FOS departments. If the reason given is staff retention, then we'd recommend FOS looks for cheaper workspace within London, similar to the approach taken by the FCA.

Q5: To what extent do you agree or disagree that our levy and case fee income should be rebalanced, so there's a broadly 50:50 split?

We strongly disagree with FOS's proposals to move further away from a 'polluter' pays model. This potentially penalises well-run firms and does little to incentivise firms with a poor tract record on customer service to improve their practices. The proposed model may work well for FOS but it isn't a fair or proportionate system for firms who handle complaints well and have few (if any) complaints referred to FOS. We strongly believe in a 'polluter pays' model.

To put these proposed changes into perspective, one of our members has reported that these proposed changes to a more 'income-based' model for the FOS will effectively mean that the cost to their business will increase from approximately £1,200 per annum to over £43,000 p/a, a 3,675% from 2019 to 2020. This increase also shouldn't be seen in isolation as this firm and many others are also seeing other regulatory costs spiral e.g. the new Money and Pensions Service (MAPS) 'debt advice' levy (see response to Q 10 below).

If the intention is to collect more income via the levy and therefore firms will be paying more, shouldn't there be a reduction in the case fee to counteract this cost? Although details of how this increase will be applied are far from clear (hence our request for a proper CBA), this will presumably mean that most firms end-up paying more to FOS (particularly with the reduction in 'free' cases) - at a time when FOS is expecting the number of complaints to significantly reduce post-PPI.

If FOS is unwilling to change these proposals, we see some merit in the FOS undertaking a further review of the case fee structure, to incentivise effective complaint handling at firm level whereby cases where the FOS upholds in the firm's favour should be eligible for some form of rebate or future discount.

Q6: In refining our proposal, we carefully considered different funding options – including different types of risk-based models. Do you have any thoughts about alternative approaches to overcoming the obstacles we identified, in ways that are consistent with our funding principles?

Any future funding model needs to be 'fair and proportionate' to all stakeholders. This current proposal is neither. Any proposal needs to be predominately made up of case fees (a 'polluters pay' type model) as opposed to an 'income-based' model.

To give an example of the negative affect of these proposals, one member has suggested to us that the new 'income-based' approach to FOS and reduction in the number of 'free' cases effectively means that if they undertake exactly the same activity next year (25 cases) as this year, then a service which currently costs them £1,100 per annum will now cost over £50,000 per annum. This is a significant additional cost to their business at a time when margins are increasingly under pressure.

Where a firm and the FOS agree a standard Remediation Programme involving high volumes and a redress model, there should be flexibility for the FOS to agree a lower case fee given the significantly lower volume of cases likely to be subject to detailed FOS review.

As alluded to in our response to Q7 (a) below, some CMC activity continues to be of concern. With PPI income streams likely to dry up for such firms the concern is their efforts are redirected to other areas with 'spurious' complaints with no merit being submitted. We would therefore like to see this built into any future funding model. For example, there should be an ability in cases of clear abuse of the FOS process to refund fees paid by the firm and to impose them on the CMC instead.

Q7: a) To what extent do you agree or disagree with our proposal to reduce the "free" case threshold for non-group account fee firms from 25 to 10?

We disagree as the change brings a further cost (for cases) to many FLA businesses, in addition to the increase in the FOS levy fees. For example, in the example mentioned above the firm is one of the 90% of businesses who do not currently pay a case fee. However, the proposed move will not only cost £8,250 for the 'additional' 15 'free' cases but will also cost them approximately £43,000 for the revised 'income-based' FOS fee (hence the £50,000 cost per annum detailed above).

We do question whether it is fair for the levy to increase and for the case fee to remain unchanged. Should either the case fees drop, or the number of 'free' cases be maintained?

There is also a concern with CMC activity. With regard to reducing the number of 'free' cases firms sometimes find when a CMC is involved in the complaint, they will frequently refer the complaint to the FOS even when there is clearly no merit to the complaint (e.g. there is little regard to the underlying facts and evidence of the case) and the CMC is also aware that the chances of the complaint being upheld by FOS is low. This results in the 'free' threshold being used up with wasted complaints that have no merit or chance of being upheld by FOS. With a reduction in the number of free cases, firms will now have to shoulder the cost of these often spurious complaints. Would FOS consider a charging structure here to accommodate the ability in certain such circumstances to charge penalty fees to CMCs which operate in this manner, in an attempt to raise complaint threshold standards overall.

Similarly, there is a concern by some that complaints outside of Jurisdiction (e.g. from a Limited Company) might also be counted once a firm has exceeded their 10 ‘free’ complaints. In this scenario it is imperative FOS recognises and rejects without charge complaints that fall outside of their Jurisdiction.

Related to the above, is an increasing concern around the use of ‘unethical’ complaints/blackmail. For example, a customer makes a spurious complaint with no basis in fact or background. They ask for £200 compensation. Potentially a firm would simply pay up, not because it’s the right thing to do or because there is any merit in the complaint, but simply because it is the lower cost option.

b) To what extent do you agree or disagree with our proposal to reduce the “free” case threshold for groups within the group account fee arrangement from 125 to 50?

No comment as it’s not applicable to the majority of FLA members.

Question 8: To what extent do you agree or disagree that we should look to maintain a level of reserves of six months’ operating income or higher?

We agree that FOS should look to maintain a level of reserves of six months’ operating income in order to be able to offset a future spike in a particular type of complaint. It also makes sense to enable the FOS to take more strategic decisions and direction by holding more working capital funding. However, we think FOS should keep any reserves to a maximum of 6 months. We note that in the past FOS has built-up excessive reserves which we do not think is now necessary. Similarly, we would expect this to be modelled on operating income excluding revenue generated by PPI.

Question 9: Do you have any comments about the timing for implementing any changes to our funding model that arise from this consultation?

The more notice the better for the implementation as clearly there is a significant additional cost impact to many FLA member businesses. We’d also like to see any funding changes applied once the PPI situation has been fully resolved – therefore April 2020 at the very earliest.

Question 10: Do you have any additional feedback about our future funding or the proposals presented here?

This change needs to be viewed in the context of the other changes in authorisation and regulatory costs.

Currently FLA member businesses face significant increased costs for regulation – well above inflation and growth rates – across the board. For example, overall costs just to the UK business already mentioned above for total FCA fees and levies are a 26% increase in costs year on year, without any increase in activity. For this same firm Illegal Money Lending (IML) is increasing 35% this year and the Financial Guidance Levy (FGL) is increasing 37%. The over 3,500 percent (3,675%) increase in FOS costs mentioned above should be viewed in this context.

Looking at the wider picture, in our response to the FCA in their recent FCA regulated fees and levies for 2019/20, we gave a number of further examples of spiralling regulatory costs (response attached). This included one large motor captive whose total fees bill collected by the FCA (including on behalf of the FOS) has more than doubled between 2017/18 to 2019/20 from just under £1 million to just shy of an estimated £2 million if all these draft proposals remain unchanged.

Our members firmly believe in 'treating customers fairly' and the obligations of being responsible lenders but it is wrong to position this change as reducing the cost burden to the industry. With the demise of PPI, it seems increased costs are being put on business in conjunction with a reduction in the number of complaints going to the service going forward.

Finance & Leasing Association
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