

Stakeholder team – consultation responses  
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London  
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## **AFM Response to Financial Ombudsman on consultation on ‘our future funding’**

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
  - Comment on the issues raised in the consultation; and
  - Highlight our concerns about the proposal to move to a funding model with income raised equally between levies and case fees.
2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £19.6 billion, and employ nearly 30,000 staff<sup>1</sup>.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses<sup>2</sup> and to take account of corporate diversity<sup>3</sup>.

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<sup>1</sup> ICMIF, <https://www.icmif.org/publications/market-insights/market-insights-uk-2016>

<sup>2</sup> Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

<sup>3</sup> <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

4. We appreciate the opportunity to respond on this issue, and recognise the importance of having a future funding structure for the Financial Ombudsman that provides a stable operating platform for the Service, as well as giving confidence to consumers and to the industry of its capacity to continue to operate to high standards.
5. We have some concerns that the funding proposals are not fully justified, nor clearly evidenced. The overall impression given from the consultation is that the problems the Service has had historically in projecting future complaints volumes is seen as a credible basis for overly prudent budgeting, rather than for improving forecasting techniques or improving efficiency.
6. We have responded to the specific questions raised in the consultation below, and would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,



Martin Shaw  
Chief Executive  
Association of Financial Mutuals

## Responses to the questions raised in the consultation

**Question 1** *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 are not aware of anything that would significantly expand the number of non-PPI complaints, other than the risk that claims management companies will shift their focus to other areas. The increased regulatory scrutiny of firms today means that over time we would expect fewer cases of historic mis-selling, given that there is today a much better appreciation of compliance across industry and a clearer commitment to ethical performance.

**Question 2** *Do you have any further insight into the different types of complexities apparent in complaints?*

Amongst AFM members, we see very few complaints that go to the Financial Ombudsman. Whilst most of those complaints are not necessarily complex from an industry perspective, the lower frequency and specialist nature of our member firms means that adjudicators may take longer to understand and familiarise themselves with the issue.

For a mutual, a decision to resolve a case in favour of the customer may have wider implications for all members of the mutual, particularly where the decision is marginal, or the evidence base is limited. The need for the management of a mutual to consider the wider consequences of a decision, and the fairness of the outcome to all members, has sometimes resulted in a greater propensity to seek an ombudsman referral, and in one case a successful court challenge.

The skills and knowledge of adjudicators, and a consistency of approach, are key to ensuring non-standard cases are not mis-labelled as complex.

**Question 3 a)** *To what extent do you support our wider work to help prevent complaints and encourage fairness? b)* *Do you have any further suggestions about what more we could do, or ideas for working together with us?*

We very much support the work of the Service in helping to educate and inform customers, and in providing guidance to industry. We agree with the need for more and better communication, though we do not see this as extra-curricular work that in itself justifies the need for a higher levy: the bias in fee-raising to case fees helps ensure that the Service's wider role is proportionate to the good outcomes it achieves, and to the areas where complaints volumes demonstrate there is real and tangible risk of harm to consumers. Education about the right to complain may not be productive in circumstances where there are no complaints.

**Question 4** *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?*

We would suggest that the arguments for retaining the bulk of the Service's functions in London are largely historic, and that over time there should be a commitment to running a wider range, or indeed all, of services outside the capital.

**Question 5** *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 don't agree with this proposal, which we consider regressive, with no clear evidence to support the impact of the proposition.

We believe that to the full extent possible, the Service should charge out its costs on a polluter pays principle. Whilst we consider all firms benefit from a reliable and sustainable Service, we remain of the view that firms that generate few complaints should continue to pay a small minority of costs. Moving from a current income split of around 45: 250 (levy to case fee, as per current funding), to parity, increases the likelihood that firms with high ethical standards, and few complaints, will be asked to pay proportionately more and therefore to subsidise the costs of firms that generate many complaints.

Where the Service seeks reassurance on the level of operating income it requires, we consider that the trend in complaints opened for non-PPI cases, as illustrated on page 12 of the consultation, gives sufficient reassurance on the relative stability of future activity levels, and therefore income. Combined with a high level of historic reserves, it should be possible to budget with confidence, based on a scale of levy that is consistent with that received today.

What isn't clearly set out in the consultation is the degree to which the current level of levy is dependent on PPI claims, and the degree to which the allocation of the levy would need to change post-PPI. The projections on case volumes for 2020/21 on page 8 of the consultation indicate the number of cases is expected to reduce by a third, implying that all other things being equal, income from case fees under current arrangements would reduce by more than a third.

We've assumed for the sake of illustration a figure of £155m (from £250m today), which combined with current levies, means total income in 2020/21 of £200m. Shifting to a 50:50 balance of levy to case fees, this means the proposed levy would need to increase to £100m, that is a rise of over 120%.

For small firms who generate very few complaints, including all AFM members, that suggests a very large and unwarranted increase in regulatory fees, unless the structure of the levy changes profoundly.

If the Service has any worked examples of how funding arrangements may alter, we consider it would have been appropriate to include them in the consultation. The consultation as it currently stands, expects industry to provide an open cheque book.

**Question 6** *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?*

We think the funding system should remain transparent and readily understandable, and are concerned that the introduction of risk-based approaches, complexity overrides or tiering introduces the risk of gamification and mis-use.

One option that may be worth exploring is how FOS might incentivise good behaviour. Whilst the proportion of complaints upheld may vary by product, there is plenty of evidence that some financial industry firms reject complaints out of hand and this results in high volumes of over-turns. Providing an incentive, such as a case fee discount, to companies with few decisions over-turned would encourage more organisations to work in the best interests of the customer.

**Question 7 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? 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?*

The analysis indicates that reducing the number of free cases does not significantly increase the number of firms paying case fees. On the ‘polluter pays’ argument, we would agree that the current level of free fees is higher than is justified. We think the number of free cases might more reasonably be set at a figure lower than ten, and in so doing, the assurance the Service is seeking on income would be reasserted without increasing the levy.

We suggest a figure of five free cases, with a comparable approach for groups.

**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 are not persuaded by the argument to maintain a higher level of reserves. Previous experience has shown that it is relatively easy to raise an additional levy where needed, and we think that this approach is consistent with the Service’s public/ not-for-profit position. As neither government, nor regulator, nor indeed industry would allow the Financial Ombudsman to fail, there is no argument for it setting aside large reserves.

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

We are comfortable with the timing for any changes, though we were surprised that the consultation only provides six weeks for response, and with the bulk of them over the summer holidays. This is a significant issue for the industry and consumers, and the short and inconvenient timescales creating a risk that legitimate views are not heard or that evidence to support arguments is incomplete. Our own response has been hampered by staff holidays and the limited capacity to draw on the views of members where availability of specialist knowledge is limited.

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

We felt that the tone of the consultation should have better accepted that, with changing circumstances, the nature of the Financial Ombudsman needs to change and that the Service actively accepts that need, and that a world with fewer complaints is a better one. The tone of the paper feels too much directed to safeguarding the income and interests of the Service, rather than of undertaking the role proportionately, and arriving at a funding formula that allows the Service to demonstrate that it continues to act efficiently and effectively.