

# **SME access to the Financial Ombudsman Service – near-final rules**

## **Policy Statement**

PS18/21

October 2018



## This relates to

This relates to Consultation Paper 18/03 which is available on our website at [www.fca.org.uk/publications](http://www.fca.org.uk/publications)

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### How to navigate this document onscreen



returns you to the contents list



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## Contents

<b>1</b>	Summary	3
<b>2</b>	Summary of feedback and our response	8
<b>3</b>	Next steps	28
<b>Annex 1</b>		
	List of non-confidential respondents	29
<b>Annex 2</b>		
	Abbreviations used in this paper	31
<b>Appendix 1</b>		
	Made rules (legal instrument)	

# 1 Summary

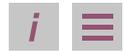
## Introduction

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- 1.1** The Financial Ombudsman Service ('the ombudsman service') was set up under the Financial Services and Markets Act 2000 (FSMA) to provide a quick and informal independent dispute resolution service. It is free for those making a complaint and can require firms to pay redress up to its binding award limit of £150,000. Our powers in relation to the ombudsman service in FSMA include powers to make rules on who can complain to the service and how much compensation it can award. These rules can be found in the 'Dispute resolution: complaints' (DISP) section of the FCA Handbook.
- 1.2** This Policy Statement (PS) sets out our response to the feedback we received on our proposals to enable a wider range of complainants to complain to the ombudsman service. We proposed to do this by changing the definition of an 'eligible complainant' in DISP to include more small and medium-sized enterprises (SMEs), charities and trusts, as well as personal guarantors of loans to a business they are involved in.<sup>1</sup>
- 1.3** Our proposals were published in our January 2018 Consultation Paper (CP), 'Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services' (CP18/3).
- 1.4** We focused our CP – and this PS – on SMEs and personal guarantors, rather than charities or trusts. This is because there are many more SMEs than charities or trusts and they are likely to be more dependent on financial services. However, where we received feedback specific to our proposals on charities or trusts, we have made this clear.
- 1.5** We have also provided our response to feedback on the issues that our CP presented for further discussion, rather than consultation. These included a question about raising the ombudsman service's award limit to improve access to redress for SMEs.
- 1.6** Following consultation, it is our intention to proceed with our proposals, although we have made some changes to our approach in response to the feedback we received. This PS explains these changes and publishes near-final rules, with a provisional start date of 1 April 2019. We expect to make final rules before the end of 2018. In paragraphs 1.8-1.11, we explain why we have decided to include this intermediate stage in our policy making.
- 1.7** Alongside this PS, we have published a new CP, 'Increasing the award limit for the Financial Ombudsman Service (CP18/31)'. Notably, our award limit CP proposes a new binding award limit for the ombudsman service of £350,000. The new limit would apply to complaints about acts or omissions by firms on or after the date it comes into force (provisionally, 1 April 2019). Our CP also proposes increasing the existing £150,000 limit to £160,000 for complaints about acts or omissions before the coming-into-force date. We propose to automatically adjust both award limits each

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<sup>1</sup> Provided the guarantee or security relates to an obligation or liability of a person which was a micro-enterprise or small business at the time it was given.



year, in line with the Consumer Prices Index (CPI). We have published these proposals in response to concerns that:

- because we have not increased the award limit for over 6 years (when it went up from £100,000 to £150,000), many existing complainants are failing to receive adequate compensation
- the existing limit may be too low to meet the needs of some of the proposed newly-eligible complainants – although we have considered and rejected the option of only having a substantially higher limit for larger SMEs as our evidence suggests that existing complainants (individual consumers and micro-enterprises) also experience complaints where compensation exceeds the current award limit

### Why we have decided to publish 'near-final' rules

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- 1.8** We are clear that the ombudsman service is the right scheme to consider complaints from larger SMEs, charities and trusts, and personal guarantors of loans to a business they are involved in. However, some of the respondents to our January 2018 CP said that the service may need some time to develop the necessary new components to do this. We agree. This is why we are publishing near-final rules, which will give the ombudsman service the degree of certainty it needs to take reasonable, concrete steps in order to implement our proposals. These steps include hiring any extra staff and consultants with the necessary skills and expertise the ombudsman service feels are appropriate. It is important that the ombudsman service can take these steps now if the extension of the service to SMEs is to start on 1 April 2019. This will ensure that the proposed newly-eligible SMEs are able to benefit from having access to the service as soon as possible.
- 1.9** Our approach also ensures we can discharge our relevant oversight functions before making final rules. We will do this as part of our normal scrutiny of the ombudsman service's business plan and budget. This is to help ensure we can meet our statutory responsibilities to ensure that the ombudsman service can carry out its work effectively at all times.
- 1.10** In November 2018, the Oversight Committee will formally consider the ombudsman service's draft business plan and budget for 2019-20, ahead of the service's own public consultation. This will include looking at how the extension of the service to larger SMEs and others fits within the draft business plan and budget. The Oversight Committee will also consider the ombudsman service's progress towards meeting the recommendations made by Richard Lloyd's recent independent review (the 'Lloyd Review'). If, at that point, we are satisfied with the ombudsman service's preparations, we intend to finalise our rules on extending the service. We will most likely do this in December 2018.
- 1.11** We know that the extension may have a significant impact on some stakeholders' view of our award limit proposals. While publication of near-final rules shows that we expect the extension to go ahead, our award limit CP asks for feedback on the way the 2 possible changes may affect each other.

## Who does this affect?

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**1.12** This PS affects:

- providers of regulated and unregulated financial services to SMEs, charities and trusts, including advisers, credit providers and intermediaries dealing with SMEs
- people who are self-employed, own or manage SMEs, charities or trusts, or provide guarantees for finance given to SMEs, charities and trusts
- those who provide business support to SMEs, charities and trusts, and to organisations that represent businesses and self-employed individuals

## Is this of interest to consumers?

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**1.13** The rules we intend to make will provide access to the ombudsman service and other protections in DISP for more SMEs and for personal guarantors of loans to a business they are involved in. Currently, only individual consumers and 'micro-enterprises' (the smallest SMEs) can refer disputes to the ombudsman service, including when acting as guarantors. To qualify as a micro-enterprise a business must employ fewer than 10 persons and have an annual turnover or balance sheet total of less than €2m.

**1.14** Making it easier for SMEs and these personal guarantors to resolve disputes with firms by giving them access to the ombudsman service will help to further our consumer protection objective. At present, many SMEs are likely to struggle to resolve disputes with firms as they do not have the necessary financial management and legal resources. These SMEs may therefore be unable to pursue redress when firms have treated them poorly.

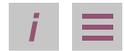
**1.15** We also believe the rules we intend to make will support our duty to promote effective competition in the interests of consumers. A common minimum standard of complaints-handling for more businesses and guarantors will promote effective competition. This is because it will give newly-eligible complainants greater confidence to deal with unfamiliar firms, such as those that are new or recently-founded.

## Context

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**1.16** In November 2015, we published a Discussion Paper (DP), 'Our approach to SMEs as users of financial services' (DP15/7). We reviewed the regulatory protections available to SMEs and asked whether and how we could improve them. Our analysis and the feedback we received suggested that our rules broadly strike the right balance between protecting businesses and ensuring SMEs can access financial services. However, they also confirmed that many SMEs and personal guarantors of loans to a business they are involved in struggle to resolve disputes with firms and seek redress through the courts.

**1.17** In January 2018 we published a combined CP and Feedback Statement, 'Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services' (CP18/3). This set out our analysis that there were SMEs



outside the micro-enterprise category that, in the absence of any alternative forum for dispute resolution, would be likely to lack the resources necessary to resolve disputes with financial services firms through the legal system.

**1.18** Using publicly-available, large scale quantitative surveys of UK SMEs, we judged the annual turnover, balance sheet total and headcount thresholds below which it is unlikely an SME would have access to financial management and legal expertise. We proposed that SMEs should be able to access the ombudsman service on the same terms as micro-enterprises and individual consumers if they fell below all the following thresholds:

- annual turnover of £6.5m
- annual balance sheet total of £5m
- headcount of 50 people

**1.19** We also recognised that the changes proposed would not cover the resolution of all disputes between SMEs and firms. This is because some disputes will involve SMEs above the proposed eligibility thresholds for the ombudsman service, while others will involve sums far greater than the service's binding award limit. So, we asked stakeholders for their views on further changes we could make without the need for changes to legislation. Given our remit, we focused this discussion particularly on whether we should use our powers to increase the ombudsman service's binding award limit to take account of newly eligible SMEs being more likely to have higher value disputes with firms.

**1.20** We also explained that other factors that might prevent SMEs getting the outcome they want from the ombudsman service are a matter for Government. For example, enabling directors of dissolved companies and companies in insolvency proceedings to get redress through the ombudsman service would require changes to the corporate insolvency regime.

## Summary of feedback and our response

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**1.21** Our consultation ran from 22 January to 22 April 2018 and received 65 responses. A list of the non-confidential respondents can be found at Annex 1.

**1.22** Most respondents supported the principle of enabling the ombudsman service to handle a wider range of complaints about firms' SME business. They also agreed with our assessment of where the line is likely to lie between SMEs that have the resources to protect their interests in disputes with firms and SMEs that do not.

**1.23** However, in response to feedback, we have made some changes to our approach. We discuss these changes in more detail in Chapter 2, but in summary we have:

- relaxed our proposed eligibility criteria for SMEs so that they would only have to meet the turnover test and one of either the headcount or balance sheet total tests
- allowed the ombudsman service more time to prepare for the changes and allowed the FCA more time to consider the changes as part of its wider consideration of

the ombudsman service's business plan and budget for 2019-20 (see paragraphs 1.8-1.11)

- 1.24** In Chapter 2, we also explain in more detail how the ombudsman service will approach complaints involving newly-eligible SMEs. This is in response to concerns raised about whether the ombudsman service has the resources it needs to handle these cases.

## Equality and diversity considerations

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- 1.25** In developing our proposals, we modelled the age, disability, gender and race of business owners. We stated in our CP that we did not believe our proposals would negatively affect any groups with these protected characteristics. We also considered the potential equality and diversity implications on people with other protected characteristics, including pregnancy and maternity, religion and belief, sexual orientation and transgender. We stated our proposals would not adversely affect any of these groups of people. We received no comments from respondents to our CP on this assessment and, therefore, believe it still stands.

## Next steps

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### What you need to do next

- 1.26** Appendix 1 gives the near-final text of the rules and guidance we intend to make. As we explain in paragraphs 1.8-1.11, we expect to finalise these once we have considered and approved the ombudsman service's business plan and budget for 2019-20. At this stage, we do not expect to make any changes to the near-final rules.
- 1.27** If you want to respond to our CP on increasing the ombudsman service's award limit (CP18/31), the deadline for responses is 21 December 2018.

### What we will do

- 1.28** We intend to finalise our near-final rules before the end of 2018. We intend these final rules to come into force on 1 April 2019.
- 1.29** We will carry out a post-implementation review of the impact of our finalised new rules when they have been operating for long enough to assess consumer outcomes. We expect to commence this review within 24 months of our finalised new rules coming into force.
- 1.30** The post-implementation review will also provide an opportunity for us to consider two issues that were raised in feedback to our CP, but which are outside the scope of this PS. These were whether the micro-enterprise test should be amended to only cover payment services complaints (see paragraph 2.14), and whether new rules are needed to prevent certain types of special purpose entity (SPE) from accessing the ombudsman service (paragraph 2.16).



## 2 Summary of feedback and our response

- 2.1** This chapter summarises the feedback we received to the questions we asked in our CP and sets out our response. Due to the overlap between some of the questions we have structured this chapter using broad headings which may cover several questions, rather than dealing with each question in turn.
- 2.2** Most of the 65 responses we received were from financial services firms and financial services membership bodies. However, a significant number came from SME representatives, individual SMEs, and the commercial dispute resolution industry. We give a list of the non-confidential respondents at Annex 1.

### Appropriateness of our proposed eligibility criteria for small businesses, charities and trusts

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- Q1:** *Do you agree with our proposed changes to the definition of an eligible complainant? Are the proposed size thresholds broadly correct or would different thresholds or criteria be more appropriate?*
- Q2:** *Do you agree that all 3 tests (employees, turnover and balance sheet) would need to be met for the ombudsman service to consider an SME a small business?*

- 2.3** A significant majority of respondents agreed with the principle of giving larger SMEs access to the ombudsman service. These included firms and organisations representing SMEs.
- 2.4** However, many of these responses also raised practical concerns. These were mainly about the application of the eligibility criteria and whether the ombudsman service is sufficiently resourced to deal with complaints involving larger SMEs.
- 2.5** We also received 13 responses from stakeholders who raised more fundamental objections to the proposal to extend eligibility to SMEs. We address these objections below before turning to the practical concerns raised by those who supported our proposals.

#### Fundamental objections to our proposals

- 2.6** Responses from individual SMEs (although not from the two SME membership bodies that also responded to our CP) said our proposals were insufficient to meet SMEs' needs. They argued that a separate 'tribunal', providing a court-like process for financial services disputes, should be set up instead.
- 2.7** The All Party Parliamentary Group (APPG) on Fair Business Banking echoed this view. The FCA Smaller Business Practitioner Panel (SBPP) recognised the need for a mechanism to help more SMEs resolve disputes with firms, but said extending the ombudsman service's remit was not the solution and could lead to unintended consequences. The APPG said it was concerned about complainants facing long

delays and incorrect decisions because the ombudsman service would not be equipped to deal with complex disputes. On the other hand, the SBPP said that firms would face uncertainty because the ombudsman service has more discretion than the courts when adjudicating on disputes. As a result, firms would take steps that could reduce SMEs' access to finance, such as increasing prices to reflect the increased risk, or withdrawing from the market altogether.

**2.8** Six financial services membership bodies were opposed for a different reason. These organisations disagreed with our proposals because they considered the proposed newly-eligible SMEs should be large enough to look after their own interests in disputes with firms, with no need for a special redress channel. Reasons given by these organisations included:

- many of the proposed newly-eligible SMEs would have legal expenses insurance
- the recently introduced Insurance Act 2015 would improve protections for SMEs and lead to a reduction in disputes, reducing the need for access to the ombudsman service in the commercial insurance sector
- the proposed newly-eligible SMEs would be larger than most small financial services firms and so would already have greater bargaining power
- the FCA's consumer protection objective should not be read as a duty to protect business customers

**2.9** Another membership body agreed with the need for a better redress system for SMEs, but said this should be developed as part of a wider reform of the regulatory framework for business lending. The body believes the current framework is not fit for purpose for business customers.

### Our response

We have publicly stated our support for a tribunal that could deal with disputes that fall outside the ombudsman service's remit. We see a role for both an extended ombudsman service and a tribunal, as they meet different needs. For example, the ombudsman service's expertise lies in providing a quick and informal process for financial services disputes. A tribunal, on the other hand, would provide a more formal, court-like approach for some higher value disputes, or disputes involving complainants above the ombudsman service's eligibility thresholds. However, we do not have the power to set a tribunal up. This would require primary legislation and is therefore a matter for the Government.

For the ombudsman service's compulsory jurisdiction (CJ), we have the power to decide which complainants can refer complaints to the ombudsman service, and how much compensation the service can require firms to pay them. We also have the power to designate as eligible complainants 'persons other than individuals' (FSMA s.226).

We do not agree that the newly-eligible SMEs would always be able to protect their interests in disputes with firms. In our CP, we provided evidence from large-scale, independent surveys of UK SMEs that



businesses below the proposed eligibility thresholds were, on average, unlikely to have access to financial management and legal expertise. Those who disputed this analysis did not provide any evidence of their own to support their position.

We accept that certain types of firm, such as independent financial advisers and insurance and mortgage brokers, will typically be smaller than most of the newly-eligible SMEs they might end up in dispute with. However, we think this argument largely ignores the gulf in financial services expertise between specialist firms, who must also meet FCA training and competence requirements, and SMEs for whom purchasing financial services is not their core business. Financial services firms will, therefore, be better at gauging the risks involved with the product or service they offer than their SME clients.

Finally, regarding the perceived need for wider reform of the regulatory framework for business lending, the regulatory perimeter is a matter for Government. However, when proposing or reviewing rules for regulated business lending, we do take account of the differences between lending to businesses covered by our rules and lending to individual consumers. For example, our rules on assessing creditworthiness for consumer credit are focused on high-level principles, and we give limited prescription of what firms must do to meet them. This gives firms flexibility to adjust their approach according to the nature of the customer, their financial situation and other circumstances. As we explain below, the ombudsman service also considers the nature of the customer when deciding what is fair and reasonable in all the circumstances of the complaint.

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### **Application of the proposed eligibility criteria for small businesses**

- 2.10** Most respondents agreed with our analysis. This found that SMEs with annual turnover below £6.5m, a balance sheet total of less than £5m and fewer than 50 employees would be unlikely to have the financial management and legal resources to protect their interests in disputes with firms.
- 2.11** However, in contrast to the view of some firms that our proposals would overprotect SMEs (see paragraph 2.8), a significant number of respondents said it would be too restrictive to apply the turnover, balance sheet and headcount thresholds cumulatively. Respondents in this group, which included firms and SME representatives, said only one or two of the thresholds should apply, with turnover typically seen as the most important determinant of eligibility.
- 2.12** Some stakeholders, including a major financial services membership body and a major SME membership body, said our proposed approach could unintentionally exclude some SMEs that would not have the resources to protect their interests in these disputes. They saw SMEs that employ a lot of people but have relatively low turnover or assets as particularly at risk of unintentional exclusion.

## Our response

We agree that a business's turnover and, to a lesser extent, its assets (or balance sheet), are the most useful proxies for assessing an SME's financial management and legal expertise. Accordingly, a mandatory headcount threshold of fewer than 50 employees would exclude SMEs who have many staff but not significant financial resources. Office of National Statistics data suggest such businesses are typically found in labour-intensive, relatively low-wage sectors, such as accommodation and food service and health and social work.

So, we have changed our approach. SMEs would have to be below an annual turnover threshold of £6.5m and below only one of either the headcount threshold of 50 employees or the balance sheet total threshold of £5m. This will help ensure SMEs are not excluded from the ombudsman service on grounds of headcount alone. We note this could mean SMEs below the headcount and turnover thresholds, but with substantial assets, could be eligible for the ombudsman service. However, it is likely that most of these assets will be long-term assets that are not easily available to pay for financial management or legal expertise. For example, property, plant, equipment, intellectual property and other illiquid assets that cannot feasibly be turned into cash within one operating cycle.

We have used independent survey data to model the impact of relaxing our proposed 'three-limb' eligibility test in this way. We found that it would increase the number of eligible complainants by around 4%. These surveys were the [Legal Services Board's 'Legal needs of small businesses' surveys](#), and [BVA BDRC's quarterly 'SME Finance Monitor' surveys](#). This would increase the annual number of complaints that we estimated would be referred to the ombudsman service by newly-eligible SMEs by around 50 complaints (to approximately 1,300). As our cost benefit analysis (CBA) for our CP sets out, any increase in the number of complaints increases the quantifiable net benefits of our proposals, so the policy that would be implemented following finalisation of our near-final rules remains net beneficial. Compared to our CBA for our CP, because of this change, the net benefit of our proposals has increased from £0.92m to £0.96m at the lower bound and from £6.71m to £6.98m at the upper bound (excluding redress).

Given that the impact of this change is relatively small, we are satisfied that we do not need to consult again before making rules. This change also has support among both SME and financial services industry representatives.

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### **Other issues with our proposed eligibility criteria – alignment with existing thresholds, retention of the micro-enterprise test, guidance on assessing eligibility, and Special Purpose Entities**

#### **2.13**

Some respondents pointed out that our proposed eligibility thresholds were not aligned with other 'business size' thresholds in common use, including the existing micro-enterprise definition in DISP and the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014. Some of these respondents said



an additional set of thresholds could be confusing and administratively complex for both firms and SMEs.

**2.14** Respondents also had questions about the relationship between the proposed small business test and the existing micro-enterprise test. One firm pointed out that it might be possible for an SME to be above the proposed small business thresholds but qualify as an eligible complainant under the micro-enterprise test. They gave the example of a business with very high turnover but a small headcount and balance sheet. Two respondents from the insurance industry suggested we should amend the micro-enterprise test to only apply to complaints about payment services. This is because EU legislation in the payment services areas give additional rights specifically to micro-enterprises.

**2.15** Several firms also questioned how easy it would be, in practice, to determine whether an SME satisfied the relevant thresholds. The headcount and balance sheet total thresholds were seen as particularly challenging. Reasons for this view included uncertainty about the definition of an employee and whether all SMEs would be able to document up-to-date information about their assets. Some firms asked for guidance on technical issues, including whether SMEs could use management accounts, rather than statutory accounts, as evidence of their turnover.

**2.16** On our proposal to amend DISP 2.7.4G to exclude otherwise eligible SMEs if they are part of a larger corporate group, one firm said we should be more specific about the nature of this relationship. The firm was specifically concerned about special purpose entities (SPEs) that are incorporated by larger corporate groups, typically for limited liability or tax planning purposes. The firm said SPEs could, ostensibly, have the characteristics of an SME complainant, but may, in fact, have access to far greater resources than their size would suggest.

### Our response

We understand the concern about the increase in thresholds. However, in deciding what an appropriate threshold might be in this case, we needed to judge how 'large' an SME would need to be to have access to sufficient financial management and legal expertise to protect its interests in a dispute with a firm. We used large-scale surveys of UK SMEs to make informed judgements about the annual turnover, headcount and balance sheet total thresholds, below which an SME would be unlikely to be in this position.

The alternative – adopting thresholds designed for a different purpose, such as ring-fencing core banking services for certain customers to protect them from risks outside the ring-fence – conflicts with our goal of being an evidence-based regulator. With specific regard to the turnover, headcount and balance sheet total thresholds in the Ring-fencing Order, we note that qualifying SMEs must only be below any one of the thresholds. We believe this approach would be inappropriate for determining eligibility for the ombudsman service as it could mean SMEs with very high turnover being able to access the service. Our approach, on the other hand, imposes a mandatory turnover threshold, reflecting our view that turnover is likely to be

the most useful proxy for an SMEs financial management and legal expertise (see previous section).

The concerns about keeping the existing micro-enterprise test alongside the new small business test have greater merit. It is possible that some SMEs could 'fail' the small business test but still be eligible as a micro-enterprise, although it seems unlikely there would be many businesses with such a profile.

Just applying the micro-enterprise definition to complaints about payment services, as proposed, could be confusing for firms and complainants. This is because the current (unamended) micro-enterprise definition would continue to apply to conduct that took place before the definition changed. Moreover, we do not believe it would be appropriate to make changes that could reduce regulatory protections for some SMEs without further consultation. Specifically, these would be SMEs with non-payment services complaints who would be eligible complainants under the micro-enterprise definition but not the small business definition. This is because the central intent of the proposals in our CP was the expansion of protections for SMEs. So, we will keep the future application of the micro-enterprise test under consideration.

Regarding firms' request for technical guidance on assessing SMEs eligibility, we note that when we made micro-enterprises eligible complainants in 2009 we stated the definition was intended to cover 'all elements' of the EU SME Recommendation on the definition of micro, small and medium-sized enterprises. This means firms and the ombudsman service should use the method set out in the EU SME Recommendation when carrying out an eligibility test to determine whether a business's headcount and turnover or balance sheet total is below the micro-enterprise thresholds. We recognise, however, that this could be clearer in our rules, so we have updated them accordingly (see Appendix 1).

In our CP, we proposed that, in determining whether a business was a small business, account should be taken of a business' 'linked' or 'partner' enterprises. This is because those terms are defined in the EU SME Recommendation. We have decided the detailed method for the calculation of headcount, turnover and balance sheet in the EU SME Recommendation, which currently applies to micro-enterprises, should also apply to small businesses – we think this will assist firms in determining eligibility. As the number of SMEs that would qualify under the small business test, but not the micro-enterprise test, is relatively small, we consider it would be disproportionate to require a different approach to be taken in assessing the eligibility of small businesses.

Firms are reminded that if they are in doubt about the eligibility of a business, charity or trust they should treat the complainant as eligible (see DISP 2.7.5G). This is because firms could be in breach of our rules if they assess complainants as ineligible – and as a result deny them relevant protections or rights, such as informing them about the possibility of referring unresolved disputes to the ombudsman service



– if the complainant is, in fact, eligible under the rules. Regarding SPEs, DISP 2.7.4G already says that firms and the ombudsman service should take account of a micro-enterprise's 'partner' or 'linked enterprises' when assessing its eligibility. These terms are defined in the EU SME Recommendation. For example, linked enterprises include business relationships where one enterprise has 'the right to exercise a dominant influence over another enterprise'. In our CP, we proposed amending the guidance at DISP 2.7.4G to cover small businesses as well as micro-enterprises.

However, SPEs can be created with various degrees of operational independence from their 'parent' companies. Reflecting this, the European Commission has noted there is no 'universally accepted definition of an SPE'. For example, once set up, it may be necessary for some SPEs to be managed and owned completely separately from their parent. In reality, as the Commission has also noted, many SPEs will not be 'managed' in the conventional sense as they will have no or few non-financial assets and employees, little or no production or operations and sometimes no physical presence beyond a 'brass plate' confirming its place of registration. So, it may not automatically be the case that an SPE would be able to draw on any financial management or legal resources from its parent.

Accordingly, rather than making further changes to our rules at this stage, we will keep our current approach under review. We expect our current approach to be effective as a way of excluding businesses, including certain SPE arrangements that have greater resources than they appear to. But we will monitor whether this approach is effective, and if necessary we will make changes. We also note that the Commission is currently evaluating the EU SME Recommendation. If this results in relevant aspects being revised, we may want to take this into account.

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## Whether the ombudsman service is capable of dealing with complaints involving newly eligible SMEs

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- 2.17** Among respondents who supported our proposals, around a fifth said they had concerns about the ombudsman service's ability to deal with disputes involving newly-eligible SMEs. They felt these disputes were likely to be more complex than the ombudsman service's existing caseload. Some of these respondents referred to Channel 4's Dispatches investigation into the ombudsman service, which was broadcast around 7 weeks after we published our proposals and made several allegations of poor practice at the service, including a lack of expertise.
- 2.18** Respondents with concerns about the ombudsman service's expertise suggested this issue could be resolved through improvements to resourcing and training, but these improvements were not accounted for in our CBA for our CP, which assumed no change to the ombudsman service's current average unit cost (or cost per case) of £619. We calculate the ombudsman service's average unit cost by dividing its total annual running costs (less financing costs and bad debts) by the number of complaints resolved that year.

- 2.19** Some respondents also said it would take time for the ombudsman service to be ready to handle complaints involving newly-eligible SMEs and so disagreed with our proposal for the new rules to take effect on 1 December 2018.
- 2.20** Most of the respondents concerned about the ombudsman service's expertise were from the general insurance sector. For example, one membership body told us that individual consumers and micro-enterprises usually buy insurance with fixed cover limits which they said allows firms to take a more standardised approach when dealing with complaints. However, according to this respondent, larger businesses have more bespoke and so more complex insurance needs. This means a standardised approach is not always appropriate, and those resolving disputes will need to have the technical expertise to assess the complaint in much more detail.
- 2.21** Finally, several responses from the industry pointed out that newly-eligible SMEs would be more likely to use unregulated financial services than individual consumers and micro-enterprises. These respondents asked how the ombudsman service would approach complaints about these products and services, when industry does not have a consistent view of what 'good practice' looks like. Responses from the insurance industry focused specifically on how the ombudsman service would consider complaints under the Insurance Act 2015, claiming the newness of the legislation means there is a lack of legal precedent to which the service could refer. One membership body said a lack of legal certainty in how the ombudsman service would treat such complaints would affect its members' ability to design and price their products with a good expectation about how they will operate.

## How SME complaints will be handled

The ombudsman service will create a ring-fenced, specialist unit to handle complaints from SME customers under the proposed extended jurisdiction. Key components – to be in place from day 1 – include:

- a dedicated team of 20 SME investigators with specialist knowledge and skills, recruited internally and externally
- teams led and managed by people with specialist SME knowledge and experience, including specialist SME ombudsmen
- dedicated legal resource to support SME complaint handling and access to additional expertise and technical advice, eg forensic accountants or experts on novel or complex financial products and services
- a panel of external experts to support the knowledge of the service's SME teams and provide access to sector expertise and insight
- an SME advisory group with representatives from industry and small business sectors to provide helpful insight and support
- deployment of decision-making tools to ensure business size threshold tests for the new SME jurisdiction are applied consistently
- a professional practice group and SME lead to develop the service's approach to SME cases, ensuring casework consistency and generating insight to feed back to industry and stakeholders
- a dedicated microsite and phone-line for SME complainants

### Our response

Our CP recognised that the financial services needs of the proposed newly-eligible SMEs are likely to be more than those of individual consumers or micro-enterprises. So, it is reasonable to assume that disputes between firms and these businesses will often be more



complex and require the ombudsman service to use more or different resources to resolve them.

The independent Lloyd Review was commissioned by the ombudsman service's board in response to concerns raised in early 2018 and published in July 2018. The Review has found that the ombudsman service provides an 'effective and essential service for many thousands of people'. But it also made several recommendations – specifically, recommendations 1, 2, 4, 7, 8 and 10 – about complex complaints, and the general quality of the ombudsman service's casework. The ombudsman service recognises the importance of addressing these recommendations before it starts handling complaints from newly-eligible complainants. It will publish a report on its progress towards all the review's recommendations at the end of 2018.

In our view, the ombudsman service is the right scheme to resolve complaints from the type of businesses covered by our new eligibility criteria. However, as explained in paragraphs 1.8-1.11, we are not finalising our rules until we have formally considered and approved the ombudsman service's plans for 2019-20, including for extending the service to larger SMEs and others. We expect to be able to make our decision on whether to finalise our near-final rules before the end of 2018. We have provided an update from the ombudsman service on its preparation for complaints from the newly-eligible SMEs in the sidebar on page 15.

We believe firms' uncertainty about how the ombudsman service approaches disputes about unregulated financial services is not well founded. The ombudsman service is required to decide complaints based on what is fair and reasonable in all the circumstances of the case (FSMA s228(2), DISP 3.6.1R). In doing this, the ombudsman service will take into account: relevant law and regulations, regulators' rules, guidance and standards, codes of practice and, where appropriate, what it considers to have been good industry practice at the relevant time (DISP 3.6.4R). So, firms can be confident the ombudsman service will take relevant law into account when it deals with complaints. For example, in commercial insurance cases, the ombudsman service has indicated that legal standards will be particularly important when it decides what is fair and reasonable for complaints from large businesses – and for others with a more sophisticated knowledge of insurance.

The ombudsman service works in a legislative and regulatory environment that is constantly evolving. It is, therefore, accepted that legal precedent may not always be available for a complaint – but this should not be a barrier to the ombudsman service taking on cases. As a fallback, the ombudsman service has the power, in some circumstances, to refer a complaint that raises 'an important or novel point of law with significant consequences' to the courts so that it can be considered as a test case (DISP 3.4.2R).

On the cost of our proposals, we expect the ombudsman service to be proportionate about the extra expertise it needs. A number of factors require the ombudsman service to have a proportionate approach,

including the obligation in FSMA to resolve disputes 'quickly and with minimum formality' and that the ombudsman service's decisions not binding on complainants if they do not accept them.

We have discussed the arguments of those who disagreed that our proposals would not increase the service's average unit cost of £619 with the ombudsman service. It has told us that because the exact nature of newly-eligible complainants' complaints is uncertain, it would be sensible to assume the average unit cost for such complaints would double to around £1,200. However, this additional cost would not affect the net benefits of our proposals. We treat the increased cost to firms as a benefit to the ombudsman service and, ultimately, consumers (who would be harmed without our intervention). These payments from firms are known as transfers and are 'netted out' in our calculations – they do not affect the net benefits of our proposals.

We acknowledge that if the costs of resolving complaints from newly-eligible complainants is higher than the ombudsman service's current costs, then the average unit cost for firms will go up. However, we estimate our proposals would not increase the ombudsman service's caseload by more than 0.5% (based on our upper estimate of 1,300 complaints per year from newly-eligible complainants). This would only make a small impact on the overall average unit cost. Based on our upper estimate of complaints from newly-eligible complainants, an average unit cost of £1,200 for these complaints would increase the overall average unit cost by less than £2 (0.3%). At our lower estimate of 380 complaints per year, the increase to the overall average unit cost would even smaller (0.2%).

In our award limit CP, we look at whether a much higher award limit would require the ombudsman service to develop extra skills and expertise. In summary, we don't believe this should be the case because the current award limit has no impact on the amount of compensation the ombudsman service can recommend complainants are paid. So – and given its very limited ability to decline to deal with complaints – the ombudsman service should already be ensuring it has the skills and expertise it needs to decide on any complaint quickly, with minimum formality, and what is, in its opinion, fair and reasonable in all the circumstances of the case.

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## Charities and trusts

- 2.22** Data to analyse the financial management and legal capabilities available for SMEs, were not available for charities and trusts. However, with one exception, respondents accepted our proposal to align the charity and trust thresholds (income and net asset value, respectively) with the relevant small business thresholds (turnover and balance sheet total, respectively).
- 2.23** The exception was two membership bodies from the life insurance sector who both questioned our proposal to increase the net assets threshold for standalone group



life insurance trusts to £5m. Both said the existing threshold of £1m is sufficient. This was because such trusts typically only have a value immediately before their assets are distributed to beneficiaries (ie after the insurance claim is paid in).

### Our response

We proposed raising the eligibility thresholds for charities and trusts so that they are similar to the new small business category. No data were available to assess the financial management and legal resources available to charities and trusts. However, we considered that the resources available to businesses with less than £6.5m annual turnover or £5m gross assets would be a reasonable proxy for the resources available to charities with annual income of under £6.5m or trusts with a net asset value of under £5m.

For trusts that hold relatively realisable assets on a long term basis, we believe our approach is appropriate as the net asset threshold is likely to provide a reasonable guide to the resources available to the trustee to, for example, pursue a dispute with a firm.

For trusts where the value of the trust lies in an individual insurance policy or group of policies, or an individual pension or group of pensions, setting any net asset value threshold – whether £1m or £5m – is unlikely to be meaningful. This is because the values of such trusts can fluctuate significantly as claims are paid in and then distributed to beneficiaries.

However, for policies or pensions held in trust, the beneficiaries of such policies or pensions (or anyone acting on their behalf, noting that some beneficiaries may be 'non-consenting', eg minors, incapacitated or unborn) may be able to complain themselves (DISP 2.7.6R(4), (5) and (6)). As such, in the event of the trustee being ineligible, a complaint may be able to be brought by the beneficiary instead.

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## Appropriateness of our eligibility criteria for personal guarantors of loans to a business they are involved in

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### **Q3:** *Do you agree with our proposal to make guarantors eligible complainants?*

**2.24** We received 34 responses to our question about making personal guarantors of loans to a business they are involved in eligible complainants. Of those, around two thirds gave clear support to our proposals. These proposals would give such guarantors the same rights in DISP as consumers, micro-enterprises and small businesses who provide guarantees or securities for loans, mortgages and regulated credit or hire agreements.

**2.25** A minority of respondents objected outright to our guarantor proposals. Generally, these were the same stakeholders who were opposed to our proposed extension to small businesses, giving similar reasons (see paragraph 2.8). One membership body,

however, gave further reasons. It said it was concerned that newly-eligible guarantors could include large, sophisticated businesses, who themselves would not be eligible complainants.

- 2.26** The remainder supported our proposals in principle but had some concerns. One firm said it was concerned the proposals could cover unregulated commercial products, including trade loans, invoice financing, asset based lending, commercial mortgages and flexible business loans of over £25,000. However, the firm did not explain why it was concerned about this.
- 2.27** One membership body and three firms felt the draft Handbook text in our CP did not give enough clarity on what newly-eligible guarantors would actually be able to complain about. This draft text would limit the scope of a newly-eligible guarantor's complaint to 'matters relevant to the relationship with the respondent [firm]'. One firm contrasted the draft text with the different language in paragraph 3.25 of our CP, which referred to 'matters that are relevant to a guarantee or security they have given', although they did not say whether they considered this a better formulation.
- 2.28** These respondents were concerned that the draft text was open to misinterpretation and could lead to unintended consequences. A particular concern was that newly-eligible guarantors might be able to complain to the ombudsman service 'by the back door' about the wider actions or conduct of a firm towards an SME that might otherwise be ineligible for consideration. One firm suggested, for example, that the draft text would not prevent a newly-eligible guarantor of a loan to an SME that was in an insolvency process being able to claim that the SME would not have failed if the firm had behaved differently and so not needed to call on the guarantee.

### Our response

Since 2014, the ombudsman service has treated personal guarantors of business loans, mortgages and regulated credit or hire agreements as ineligible if they are involved in the business they are providing the guarantee or security for. This is because they do not fall under the current eligible complainant category of 'consumer'. This followed a successful legal challenge to the ombudsman service's assessment that the director of a company was a consumer, although the case was not about loan guarantors.<sup>2</sup> Certain guarantors of business loans do, however, meet the consumer definition. For example, where a person provides a personal guarantee for their spouse's business.

In terms of the resources available to them, these personal guarantors are in a similar position to individual consumers when pursuing disputes. It is not necessarily the case that not acting for 'purposes wholly or mainly outside that individual's trade, business, craft or profession' (the definition of a 'consumer' in DISP) means a personal guarantor of, for example, a business loan would be able to protect their interests in a dispute with a firm.

We considered it appropriate that such personal guarantors were eligible complainants before the courts clarified the position under existing



rules in 2014. This is why we proposed in our CP to restore this status by creating a specific guarantor category for guarantors who are neither consumers nor micro-enterprises.

We do not agree our rules should prescribe the issues newly-eligible guarantors would be able to complain about to the ombudsman service more tightly than they do for a consumer guaranteeing a personal loan. Or, indeed, for a personal guarantor of a corporate loan who meets the consumer definition, because they are not involved in the business for who they are providing the guarantee.

There may be some issues giving rise to complaints by newly-eligible guarantors that are specific to the guarantee itself. These could include the guarantor being given inadequate information by the firm when they agreed to provide the guarantee, or the steps taken by the firm to recover money under the guarantee. It is reasonable for guarantors to always be able to complain about conduct that directly affects them.

On the other hand, newly-eligible guarantors may also experience problems indirectly as a result of a firm's unreasonable conduct towards the borrower. Whether these matters will be covered will depend on the circumstances and whether the complaint arises out of matters relevant to the relationship the newly-eligible guarantor has with the respondent firm.

As was the case before the courts clarified the position in 2014, our new rules on personal guarantors will apply to guarantees provided for both regulated and unregulated commercial products. This is because most lending to businesses is unregulated. As the firm that expressed concern about including unregulated products did not say why it was concerned, it is difficult for us to comment further. However, we do not see why the issues a guarantor might legitimately complain about would be different depending on whether a product was regulated or unregulated.

Finally, it will not be possible for large businesses who act as guarantors to be eligible complainants as our rules specify that a guarantor must be 'an individual' in the natural meaning of the word. However, businesses that act as guarantors and which meet the micro-enterprise criteria are currently eligible complainants and this right will be extended to small businesses when the rules we intend to make come into force.

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## Commencement date and non-retrospective application of rules

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- Q4:** *Do you agree that the changes introducing small businesses as eligible complainants should come into effect on 1 December 2018 and that they should apply only to complaints made to a firm regarding acts or omissions of the firm which occur from 1 December 2018? If not, what transitional period do you consider appropriate?*

**Q5:** *Do you agree that the changes introducing guarantors as eligible complainants should come into effect on 1 December 2018 and that they should apply only to complaints made to a firm regarding guarantees or security given on or after 1 December 2018?*

**2.29** Respondents to our CP generally felt our proposed implementation timings were too ambitious. In particular, they raised two distinct concerns in response to our questions on when our proposed changes should come into force:

- Some respondents said we should not make final rules before knowing the outcome of the Lloyd Review, which considered the *Dispatches* allegations (see paragraph 2.17)
- Many more respondents raised concerns that both firms and the ombudsman service would not have enough time to implement the necessary changes between the publication of the Policy Statement and our proposed commencement date of 1 December. In particular, firms requested an implementation period of 6-8 months, rather than 5 months. Several firms also suggested that it would be sensible for the commencement date to align with firms' complaints reporting periods.

**2.30** The majority of respondents, in particular financial services firms and various trade associations representing them, agreed our rules should apply only to complaints about firms' conduct that occurred after the commencement date. Five respondents said the rules should be applied retrospectively, so that newly eligible complainants would be able to take disputes to the ombudsman service about firms' conduct before the commencement date.

### Our response

As set out above, we consider the ombudsman service is the right scheme to resolve complaints that might be referred to it by the type of businesses covered by our new eligibility criteria. However, we are not finalising our rules until we have formally considered the ombudsman service's plans for 2019-20, including its extension to SMEs and others. We expect to be able to make our decision on whether to finalise our near-final rules before the end of 2018.

If we do make final rules, we intend for them to come into force on 1 April 2019. If we made final rules at the end of 2018, firms would only have an 'official' implementation period of around 3 months. However, publishing near-final rules around 6 months in advance shows that we intend to expand the ombudsman service's remit in the relatively near future and so firms should start to prepare for this. We are confident our proposed timings allow enough time for the ombudsman service to make any necessary changes to its processes to ensure it is fully prepared for its expanded remit, including addressing the relevant recommendations from the Lloyd Review.

We do not find the arguments for firms needing a 6-8 month transitional period from the point of us making final rules persuasive. Most firms will already have processes in place to identify micro-enterprises and handle



complaints from them according to the requirements in DISP. Having to now do this for a new, but much smaller, group of larger SMEs should not require firms to significantly redesign their existing processes. We believe that giving firms and the ombudsman service at least 3 months to prepare for the changes from finalising our near-final rules should be enough, particularly given the advance notice provided by the publication of near-final rules.

We agree that, where feasible, our rules should come into effect on a date that would align with most firms' complaints reporting periods. However, sticking rigidly to this approach would mean we could only make our proposed changes on 1 January or 1 July. We think it is more important to provide access to redress for newly-eligible complainants as soon as possible, while ensuring firms and the ombudsman service have enough time to prepare themselves.

In view of the potential unfairness to firms of applying our rules to complaints about firms' conduct that occurred before the commencement date, we will apply the new rules only to acts or omissions by firms that take place after the rules come into effect.

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## Comments on our cost benefit analysis

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**Q6:** *Do you agree with our cost benefit analysis? Are there other costs or benefits we ought to have considered?*

- 2.31** Responses to our question on our cost benefit analysis were mixed. Four respondents indicated it was difficult for them to readily verify the analysis and the data underpinning it.
- 2.32** Around half of the respondents, including financial services firms, SMEs and their representatives, as well as legal services and dispute resolution providers, said they did not agree with our analysis. Financial services firms tended to question the credibility of our assumption that the ombudsman service's remit could be expanded with no increase in the average cost per complaint of £619. On the other hand, SMEs and their representatives didn't agree with the analysis because they felt our proposals did not go far enough to help SMEs who have a dispute.
- 2.33** Firms also believed the cost benefit analysis did not correctly capture the actual costs for firms to identify newly eligible complainants, undertake internal training, potentially develop new IT systems and to generally investigate more complex cases from newly eligible complainants.
- 2.34** A financial services membership body said that the analysis had not reflected the new costs to lenders because of the new rules, such as re-assessing the risk of lending to SMEs, and the likely negative changes in the risk profile for SME lending. This respondent also said the CBA did not consider likely changes to complainant behaviour as a result of the new rules, such as an increase in frivolous complaints referred to the ombudsman service.

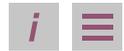
- 2.35** The APPG said that the CBA considerably underestimated the amount of redress due to businesses.
- 2.36** Two respondents representing financial advisers and insurance firms said our proposals could make it harder for some small firms to get Professional Indemnity Insurance (PII) for SME business. They felt this could indirectly lead to important consumer needs not being met and a reduction in effective competition. Another, representing insurance brokers, said our CBA failed to take account of the perceived long term impact of the Insurance Act 2015 on reducing complaint volumes, potentially skewing the estimates in our CBA.
- 2.37** One SME representative stated that although they broadly agreed with the analysis, we may have underestimated the benefits of the proposals. This is because many SMEs are currently reluctant to seek external finance to grow because of their lack of trust in the financial services industry. Extending eligibility to the ombudsman service should rebuild trust in the industry and increase the number of SMEs willing to use credit to grow. This could have positive implications to the overall growth of the economy.

### Our response

We discussed the datasets and assumptions we used in detail in our CBA. We also provided details on the calculations we used. We also discuss the analysis underlying our assumption about the average cost per complaint from newly eligible complainants in our response to the feedback in paragraphs 2.17-2.20 of this PS. The ombudsman service's complaints handling cost is covered by a case fee and a levy paid by firms. As we note above, this is a cost for some market participants, but a benefit to the ombudsman service (and, ultimately, consumers of financial services who are eligible for the service). It is therefore a transfer and does not affect the net benefits.

We consider firms' costs for the newly eligible complaints are mainly due to the obligations to increase consumer awareness of the protections available to them (DISP 1.2.1R and DISP 1.2.2R) and the obligations to investigate, assess and resolve complaints (DISP 1.4.1R). We have included the costs of complying with consumer awareness rules and the costs of handling the additional complaints in our assessment of costs and benefits. We have considered that firms may do more for the newly eligible complaints (paragraph 42 of the CBA). As we explained in our CP, the remaining costs (training and IT changes) should not be significant as most of the administrative cost of complaint handling is not additional. The structures to deal with new complaints are already in place, as firms are already dealing with complaints in the absence of regulation, and already have to deal with complaints from micro-enterprises under DISP rules (see paragraph 42 of our CP).

Firms who already deal with at least some eligible complainants will need to have complaints handling processes in place that allow them to identify eligible complainants, inform them of their protections and to generally investigate, assess and resolve complaints in line with the DISP obligations. Some firms responding to our 2015 DP (DP 15/7) also told



us they apply the same complaints handling procedures to smaller and larger SMEs, as well as to their unregulated dealings with business clients.

So, we believe it reasonable to assume that firms would apply the same complaints handling procedures they currently operate to the complaints arising from the newly eligible SMEs. Therefore, the costs to firms due to the change in complainant eligibility are likely to be both one-off and minimal.

The consultation did not provide us with better information on the size of redress that the ombudsman service might potentially award. Even if we have underestimated this, at worst this would mean we have underestimated the net benefits of the proposals. As such, any underestimation would not undermine the proportionality of our proposals.

We did not consider it reasonably practicable to try to quantify the costs from lenders re-assessing the risk profile of SME lending because of our proposals. This is because we would have had to identify lenders' risk assessment approach to new category of borrowers for which there is no history of data. However, as we have indicated in the CBA, we consider that the likelihood of lenders reducing lending to SMEs because of the new near-final rules is negligible. We also do not consider that the behaviour of newly eligible complainants is likely to differ from the behaviour of already eligible complainants, or that frivolous complaints would increase disproportionately among the newly eligible complainants.

Similarly, in our CBA we said we did not consider it feasible to identify PII insurers' underwriting and pricing approaches to a category of complaints for which the ombudsman service has no history of claims. We asked a specific question on whether respondents agreed with our CBA. But neither of the respondents that raised the impact of the proposals on the provision of PII for financial services firms provided evidence contradicting our position on this point.

We noted the non-quantifiable benefits due to greater trust of SMEs in the financial services markets in paragraph 64 of our CBA.

We will carry out a post-implementation review of the impact of our new rules when they have been operating for long enough to assess consumer outcomes.

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## Responses to questions on SME disputes not covered by our consultation proposals (including the ombudsman service's binding award limit)

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- Q7:** *Do you have any views on how SMEs' access to redress might be improved without the need for changes to legislation, including but not limited to the areas where we have powers to make changes?*

**Q8:** *Without legislative change, do you think the ombudsman service might be an appropriate body to consider a greater share of complex or higher value complaints from SMEs than is implied in our proposals for consultation in Chapter 3? What changes would be needed to make this effective? What risks might this introduce?*

- 2.38** Our CP was divided into proposals for consultation (covered by questions 1 to 6) and issues for further discussion (questions 7 and 8). We received a variety of responses to questions 7 and 8, which we summarise in this section.
- 2.39** Several respondents restated their fundamental opposition to our proposals. This was either because the proposed newly-eligible SMEs did not need any additional help resolving disputes with firms, or because the ombudsman service could not be a suitable place for such disputes.
- 2.40** Some firms said they were supporting the independent review of dispute resolution commissioned by UK Finance. Some suggested that a mechanism designed specifically for SMEs might be preferable to making fundamental changes to the ombudsman service in order for it to consider disputes that are higher value or more complex than those implied in our proposals.

### **Increasing the ombudsman service's binding award limit**

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- 2.41** Those who supported our proposals generally focused on whether the ombudsman service's current binding award limit of £150,000 should be increased, rather than whether we should extend eligibility to larger SMEs larger than those covered in our proposals. This is reflected in the responses to questions 1 and 2, which tended to agree with where we had drawn the line between SMEs with and without the resources to protect their interests.
- 2.42** Industry respondents used these questions to argue against an increase in the ombudsman service's current award limit. They believed a significantly higher award limit could only be justified if it was accompanied by substantive changes to the ombudsman service's approach. Some responses were clear, or otherwise strongly implied, that their support for our eligibility proposals was conditional on no significant increase in the ombudsman service's award limit.
- 2.43** Some firms and financial services membership bodies said the ombudsman service should only be able to consider much higher value complaints if these were assessed based on strict legal liability (rather than against the 'fair and reasonable' standard in FSMA) and if firms had the right to appeal decisions. They also said the ombudsman service would need to increase its technical expertise even more than under the proposals in our CP. Without these changes, they felt there could be a detrimental impact on the supply of financial services to SMEs due to firms' uncertainty, or lack of confidence, in how the ombudsman service might approach high value disputes. One firm pointed out that there would be practical difficulties with any model that required the ombudsman service to take a different approach to disputes of different value, because the value of a dispute is not always clear at the start.



- 2.44** Other responses to the question of the award limit divided broadly into two groups. One group believed the case for a higher award limit was already made and said it should be increased to between £250,000 and £500,000. The other group said the limit should be reviewed due to the amount of time since the last review and the need for the award limit to keep pace with inflation. This group offered no view on what the limit should be set at. Respondents in these groups were generally from outside the financial services industry.

### Our response

Together with this PS, we have published a new CP, 'Increasing the award limit for the Financial Ombudsman Service (CP18/31)'. This CP proposes increasing the ombudsman service's binding award limit to £350,000 for any complaints about firms' acts or omissions on or after the date the new limit comes into force (provisionally 1 April 2019). We also propose to increase the £150,000 award limit for all other complaints to £160,000. We propose to automatically adjust both award limits each year, in line with the Consumer Prices Index (CPI).

We have set out the analysis and evidence to support a higher award limit for the ombudsman service in our award limit CP.

## Other issues raised by respondents

- 2.45** Finally, respondents raised a number of other issues for our consideration:
- A law firm said SMEs should be able to sue for breaches of FCA rules, claiming that the current restriction to 'private persons' is illogical, unfair and contrary to the legitimate expectations of customers. They also said commercial lending to SMEs should be made a regulated activity.
  - A financial services consultant said there was no justification for excluding regulated firms in the definition of an eligible complainant. This was seen as a particular issue for small financial services intermediaries, who are unable to enforce complaints against private indemnity insurers.
  - A professional services membership body said there was a need to raise SMEs' awareness of the ombudsman service and its eligibility criteria. The body suggested the FCA should work with third parties, such as SME membership bodies and the Small Business Commissioner.
  - The APPG for Fair Business Banking said we should consider options to introduce a duty of care and a requirement to act in good faith into all financial services supplier and consumer relationships.

## Our response

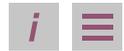
Whether commercial lending is a regulated activity is a matter for the Government. Likewise, only the Government is able to amend section 138D of FSMA, which restricts the right of action against a breach of our rules to 'private persons'.

Regarding the eligibility of regulated firms to complain to the ombudsman service, we believe our current approach is appropriate. This is to allow firms that are micro-enterprises or – once the rules in this PS come into force – small businesses to complain to the ombudsman service. The exception to this approach is if the complaint is about an activity the complaining firm has permission to carry on, as in such cases it is reasonable to expect the firm to understand the risks involved.

We agree with the need to raise awareness among any group of newly-eligible complainants of their right to refer complaints to the ombudsman service. For SMEs, we consider membership bodies are better placed than the FCA to carry out this important task and intend to work closely with them as they develop their communications.

Finally, we published our duty of care DP (DP18/5) in July 2018 and will consider these issues through that process. The closing date for feedback is 2 November 2018.

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## 3 Next steps

### This Policy Statement

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- 3.1** The near-final text of the rules and guidance we have made is in Appendix 1. We intend these to come into force on 1 April 2019.
- 3.2** We intend to finalise our near-final rules before the end of 2018 and for them to come into force on 1 April 2019.
- 3.3** Once our near-final rules are finalised, we expect firms to check that they are able to comply with the rules. They must take necessary steps to ensure compliance by 1 April 2019.
- 3.4** We will also carry out a post-implementation review of the impact of our new rules after they have been in operation for long enough to assess consumer outcomes. We expect to do this review by 2021.
- 3.5** Contact details, for any comments or queries on this PS, are at the start of this paper.

### Other redress policy work

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- 3.6** Alongside this PS, we have published a new CP, 'Increasing the award limit for the Financial Ombudsman Service (CP18/31)'. This proposes increasing the ombudsman service's binding award limit to £350,000 for any complaints about acts or omissions by firms on or after the date the new limit comes into force (provisionally 1 April 2019). We also propose to increase the £150,000 award limit for all other complaints to £160,000. We propose to automatically adjust both award limits each year, in line with CPI.

## Annex 1

# List of non-confidential respondents

Association of Accounting Technicians

Adam Samuel

Annette Bishop

All Party Parliamentary Group for fair business banking

Association of Alternative Business Finance

Association of British Insurers

Association of Mortgage Intermediaries

AXA

Bridge Insurance Brokers Ltd

British Insurance Brokers Association

Broker Network

CBI

Chartered Institute of Credit Management

Consumer Finance Association CFA

Credit Services Association

Darby's Glass & DIY Ltd

Electronic Money Association

Federation of Private Residents Associations

Financial Services Consumer Panel

Finsec Limited

Finance and Leasing Association

Flaxmans

Forum Chambers

Four Wynds Guest House

FS Legal

The Federation of Small Businesses



Group Risk Development  
Harmonic Intelligent Solutions Ltd  
HSBC  
Investment and Life Assurance Group  
Independent Banking Advisory Service  
Institute of Chartered Accountants in England and Wales  
International Underwriting Association of London  
Jane Farmer  
Jim Shannon MP  
John MCGough  
Lloyd's Market Association  
Managing General Agents' Association  
National Association of Commercial Finance  
Nigel Sanitt  
Pan  
PIMFA  
PJT Enterprises Limited  
RBS  
RPC on behalf of the International Underwriting Association of London  
RSA  
Smaller Business Practitioner Panel  
Society of Lloyd's  
Society of Pension Professionals  
Threshold Properties  
Transpact  
UK Crowdfunding Association  
UK Finance  
Zurich

## Annex 2

### Abbreviations used in this paper

<b>APPG</b>	All Party Parliamentary Group
<b>CJ</b>	Compulsory Jurisdiction
<b>CBA</b>	Cost benefit analysis
<b>CPI</b>	Consumer Prices Index
<b>EU</b>	European Union
<b>PII</b>	Personal Indemnity Insurance
<b>DP</b>	Discussion Paper
<b>CP</b>	Consultation Paper
<b>FCA</b>	Financial Conduct Authority
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>DISP</b>	Dispute Resolution: Complaints Sourcebook
<b>SME</b>	Small and medium-sized enterprise
<b>SPE</b>	Special purpose entity

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

All our publications are available to download from [www.fca.org.uk](http://www.fca.org.uk). If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: [publications\\_graphics@fca.org.uk](mailto:publications_graphics@fca.org.uk) or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN



# Appendix 1

## Made rules (legal instrument)

**SMALL BUSINESS (ELIGIBLE COMPLAINANT) INSTRUMENT 2018**

**Powers exercised by the Financial Ombudsman Service**

- A. The Financial Ombudsman Service Limited makes and amends the Voluntary Jurisdiction rules and guidance, and fixes and varies the standard terms for Voluntary Jurisdiction participants as set out in the Annexes to this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 227 (Voluntary Jurisdiction);
  - (2) paragraph 8 (Guidance) of Schedule 17;
  - (3) paragraph 18 (Terms of reference to the scheme) of Schedule 17; and
  - (4) paragraph 22 (Consultation) of Schedule 17.
- B. The Financial Ombudsman Service Limited notes that, for the avoidance of doubt, the Transitional Provisions at TP 1.1 in Annex B below apply equally to the Voluntary Jurisdiction of the Financial Ombudsman Service and the Compulsory Jurisdiction.
- C. The making and amendment of the Voluntary Jurisdiction rules and guidance and the fixing and varying of the standard terms for Voluntary Jurisdiction participants by the Financial Ombudsman Service Limited is subject to the approval of the Financial Conduct Authority.

**Powers exercised by the Financial Conduct Authority**

- D. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions of the Act:
- (1) section 137A (The FCA’s general rule-making power);
  - (2) section 137T (General supplementary powers);
  - (3) section 139A (Power of the FCA to give guidance);
  - (4) section 226 (Compulsory jurisdiction); and
  - (5) paragraph 13(4) (FCA’s rules) of Schedule 17.
- E. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.
- F. The Financial Conduct Authority approves the Voluntary Jurisdiction rules and guidance to be made and amended and the standard terms for Voluntary Jurisdiction participants to be fixed and varied by the Financial Ombudsman Service Limited under this instrument.

**Commencement**

- G. This instrument comes into force on [1 April 2019].

**Amendments to the Handbook**

- H. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- I. The Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with Annex B to this instrument.

**Notes**

- J. In the Annexes to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

**Citation**

- K. This instrument may be cited as the Small Business (Eligible Complainant) Instrument 2018.

By order of the Board of the Financial Conduct Authority  
[*date*] 2018

By order of the Board of the Financial Ombudsman Service Limited  
[*date*] 2018

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text unless otherwise stated.

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

- enterprise* any *person* engaged in an economic activity, irrespective of legal form, including, in particular:
- (a) self-employed *persons* and family businesses engaged in craft or other activities; and
  - (b) *partnerships* or associations regularly engaged in an economic activity.

[Note: article 1 of the Annex to the *Micro-enterprise Recommendation*]

Amend the following definitions as shown.

- guarantor* (1) (in *PR*) a *person* that provides a *guarantee*.
- (2) (in *DISP*) an individual who:
- (a) is not a *consumer* (as defined in *DISP*); and
  - (b) has given a guarantee or security in respect of an obligation or liability of a *person* which was a *micro-enterprise* or *small business* as at the date that the guarantee or security was given.

- micro-enterprise* an ~~enterprise~~ *enterprise* which:
- (a) employs fewer than 10 *persons*; and
  - (b) has a turnover or annual balance sheet that does not exceed €2 million<sub>2</sub>.

and in determining whether these criteria are met articles 3 to 6 of the Annex to the *Micro-enterprise Recommendation* must be applied.

~~In this definition, “enterprise” means any *person* engaged in an economic activity, irrespective of legal form and includes, in particular, self-employed *persons* and family businesses engaged in craft or other activities, and *partnerships* or associations regularly engaged in an economic activity.~~

[Note: article 4(2636) of the *Payment Services Directive* and the Annex to the *Micro-enterprise Recommendation*]

*small business*

(1) (in *COMP* and in the definition of *relevant credit union client*) a *partnership, body corporate*, unincorporated association or mutual association with an annual turnover of less than £1 million (or its equivalent in any other currency at the relevant time).

(2) (in *DISP*) an *enterprise* which:

(a) is not a *micro-enterprise*;

(b) has an annual turnover of less than £6.5 million (or its equivalent in any other currency); and

(i) employs fewer than 50 *persons*; or

(ii) has a balance sheet total of less than £5 million (or its equivalent in any other currency),

and in determining whether these criteria are met articles 3 to 6 of the Annex to the *Micro-enterprise Recommendation* must be applied.

## Annex B

### Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 2 Jurisdiction of the Financial Ombudsman Service

...

### 2.7 Is the complainant eligible?

...

Eligible complainants

2.7.3 R An *eligible complainant* must be a *person* that is:

(1) a *consumer*; or

(2) a *micro-enterprise*;

...

(b) otherwise, at the time the complainant refers the *complaint* to the *respondent*; or

(3) a charity which has an annual income of less than ~~£1~~ £6.5 million at the time the complainant refers the *complaint* to the *respondent*; or

(4) a trustee of a trust which has a net asset value of less than ~~£1~~ £5 million at the time the complainant refers the *complaint* to the *respondent*; or

(5) (in relation to *CBTL business*) a *CBTL consumer*; or

(6) a *small business* at the time the complainant refers the *complaint* to the *respondent*; or

(7) a *guarantor*.

2.7.4 G In determining whether an ~~enterprise~~ enterprise meets the tests for being a *micro-enterprise* or a *small business*, account should be taken of the ~~enterprise's~~ enterprise's 'partner enterprises' or 'linked enterprises' (as those terms are defined in the *Micro-enterprise Recommendation*). For example, where a parent company holds a majority shareholding in a *complainant*, if the parent company does not meet the tests for being a *micro-enterprise* or a *small business* then neither will the *complainant*.

[~~Note: Articles~~ articles 1 and 3 to ~~7~~6 of the Annex to the *Micro-enterprise Recommendation*]-

...

2.7.5A     R     A guarantor shall be an eligible complainant only to the extent that their complaint arises from matters relevant to the relationship with the respondent referred to in DISP 2.7.6R(10).

...

**TP 1     Transitional provisions**

1.1     Transitional provisions table

(1)	(2) Material provision to which transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
45	<u>DISP 2.7.3R(6)</u>	<u>R</u>	<u>DISP 2.7.3R(6) applies only in relation to a complaint concerning an act or omission which occurs on or after [1 April 2019].</u>	<u>From [1 April 2019]</u>	<u>From [1 April 2019]</u>
46	<u>DISP 2.7.3R(7)</u>	<u>R</u>	<u>DISP 2.7.3R(7) applies only in relation to a complaint concerning a guarantee or security given on or after [1 April 2019].</u>	<u>From [1 April 2019]</u>	<u>From [1 April 2019]</u>

...

