

Increasing the award limit for the Financial Ombudsman Service

Consultation Paper
CP18/31***

October 2018



How to respond

We are asking for comments on this Consultation Paper (CP) by 21 December 2018.

You can send them to us using the form on our website at: <https://www.fca.org.uk/cp18-31-response-form>

Or in writing to:

James Tallack
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Telephone:

020 7066 0324

Email:

cp18-31@fca.org.uk

How to navigate this document onscreen

returns you to the contents list



takes you to helpful abbreviations

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1 Summary

Why we are consulting

- 1.1** This consultation paper (CP) explains our proposals to increase the award limit for the Financial Ombudsman Service's ('the ombudsman service') Compulsory Jurisdiction (CJ). Our proposals will ensure more complainants receive fair compensation when the ombudsman service upholds their complaint against a financial services firm.
- 1.2** The ombudsman service proposes to mirror our proposed changes to the CJ in the Voluntary Jurisdiction (VJ), which it oversees. As such, this consultation is issued jointly by the FCA and the ombudsman service.

Who this applies to

- 1.3** This CP should be read by:
- all firms and other financial businesses covered by the ombudsman service's CJ and VJ
 - consumer groups
 - financial services and other industry representative bodies
 - professional indemnity insurance insurers and brokers
 - legal services providers
- 1.4** This CP will also be of interest to:
- groups who are currently eligible to complain to the ombudsman service (including consumers and micro-enterprises)
 - the small and medium-sized enterprises, charities, trusts and personal guarantors who will become eligible for the ombudsman service following finalisation of the near-final rules in the Policy Statement (PS) we have published alongside this CP (see paragraphs 1.16-1.21)

The wider context of this consultation

- 1.5** The ombudsman service was set up under the Financial Services and Markets Act 2000 (FSMA) to resolve financial services disputes quickly, with minimum formality, and at no cost to those who complain. Our powers in relation to the ombudsman service's Compulsory Jurisdiction (CJ) include the ability to make rules on who can complain and



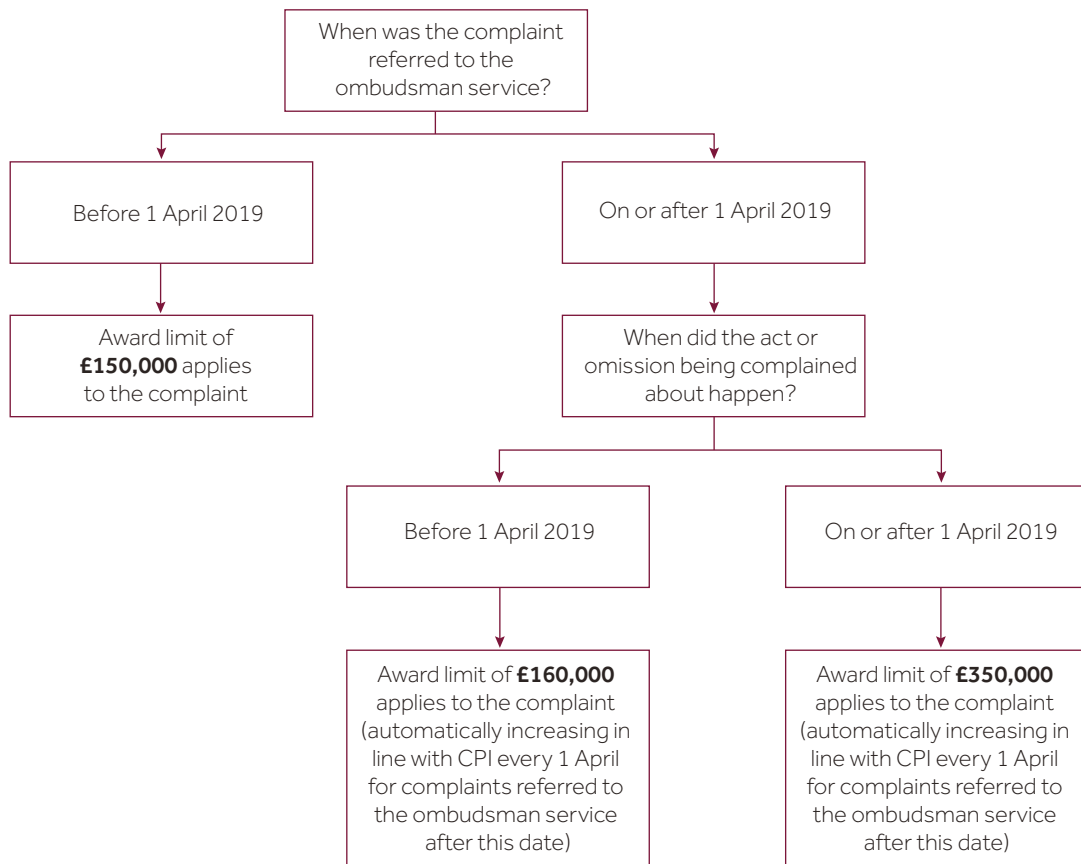
how much compensation can be awarded. These rules can be found in the 'Dispute resolution: complaints' (DISP) section of the [FCA Handbook](#).

- 1.6** The ombudsman service can require firms to pay awards of up to £150,000 to complainants. This is known as the ombudsman service's award limit. If the ombudsman service considers fair compensation requires payment of a larger amount, it can recommend that firms pay the balance to the complainant, but it cannot require them to. We review the ombudsman service's award limit from time to time to ensure that it continues to provide appropriate redress for complainants who are unable to resolve their complaints with firms themselves, and who would typically struggle to pursue these through the court system.
- 1.7** We last increased the ombudsman service's award limit in January 2012, when it rose from £100,000 (the limit when the service was set up in 2001) to £150,000. In this CP, we explain why we think a £150,000 award limit is no longer adequate, and why we think it should be increased to £350,000 for new complaints. The limit of £350,000 would apply to complaints about firms' acts or omissions that happen on or after the date the new award limit comes into force, provisionally 1 April 2019. For all other new complaints (ie about acts or omissions prior to 1 April 2019), we propose to increase the current limit to £160,000. We also propose to ensure both limits are automatically adjusted in line with inflation in future.

What we want to change

- 1.8** We propose that, on 1 April 2019, the ombudsman service's £150,000 award limit should change to:
- £350,000 for complaints about acts or omissions by firms on or after 1 April 2019.
 - £160,000 for complaints about acts or omissions by firms before 1 April 2019, and which are referred to the ombudsman service after that date. This is so that the limit for these complaints reflects changes in inflation, as measured by the Consumer Prices Index (CPI), since the £150,000 limit was put in place in 2012.
- 1.9** We also propose that, from 1 April 2020 onwards, both award limits should be automatically adjusted on 1 April, using the CPI for the preceding January. The inflation-adjusted limit would be rounded down to the nearest £5,000. We explain how this will work in Chapter 3.
- 1.10** For any complaints referred to the ombudsman service before 1 April 2019 the limit will remain at £150,000.

Figure 1: How the proposed award limits will be applied



Outcome we are seeking

- 1.11** The FCA's strategic objective is to ensure that relevant markets work well. We also have an operational objective to secure an appropriate level of protection for consumers.
- 1.12** We have rules that aim to ensure that users of financial services can obtain fair compensation from the ombudsman service when they cannot resolve a complaint with a firm themselves. This helps to further our consumer protection objective. When we last increased the ombudsman service's award limit, we committed to reviewing the limit periodically.
- 1.13** As we explain in more detail in Chapter 2, we believe our proposed rules will:
- ensure more consumers and smaller businesses will receive fair compensation when things go wrong in their relationship with a financial services firm and the firm is at fault
 - strengthen firms' incentives to resolve complaints quickly and informally, or to avoid them altogether, in turn helping to build consumer trust in the integrity of the industry



- support our duty to promote effective competition in the interests of consumers, because:
 - firms that cause substantial financial harm to consumers will have to pay more redress because of poor conduct, meaning firms with better conduct may be able to outcompete them
 - consumers will know that all firms will be required to pay higher amounts of compensation in the event of a dispute, rather than this being at individual firms' discretion (and therefore not knowable at the time of purchase)

Next steps

What do you need to do next?

- 1.14** We want to know what you think of our proposals. Please send us your comments by 21 December 2018. Please use the online response form on our website or write to us at the address on page 2.

What will we do?

- 1.15** We will consider your feedback and intend to publish our rules in a PS in early March 2019.

Extension of the Financial Ombudsman Service to larger SMEs

- 1.16** Only individual consumers, small charities and trusts, and 'micro-enterprises' – the smallest category of business – are currently eligible to complain to the Ombudsman.
- 1.17** Alongside this CP, we have published a [PS with near-final rules](#) on extending access to the ombudsman service to a larger category of small and medium-sized enterprises (SMEs), as well as charities and trusts of a comparable size, and personal guarantors of loans to businesses they are involved in. We consulted on what we refer to as the '[SME extension](#)' in early 2018 and received 65 responses. 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 should be drawn between SMEs that have the resources to protect their interests in disputes with firms and SMEs that do not.
- 1.18** 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.

- 1.19** 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.
- 1.20** 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 make final rules on extending the service. We will most likely do this in December 2018.
- 1.21** We recognise that, for some stakeholders, the SME extension may have a significant impact on their view of our award limit proposals. As publication of near-final rules signals that we expect the extension to go ahead, we welcome feedback on the interaction of the 2 possible changes.

Equality and diversity considerations

- 1.22** We have considered the equality and diversity issues that may arise from the proposals in this CP.
- 1.23** Overall, we do not consider that the proposals in this CP adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.
- 1.24** Moreover, we believe there will be positive impacts for all consumers, including those with protected characteristics, if the ombudsman service is able to require firms to pay larger money awards.
- 1.25** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.
- 1.26** We welcome feedback to this consultation on these matters.



2 Why we are considering a change to the Financial Ombudsman Service's award limit

2.1 In this Chapter, we set out our assessment of consumer harm and the evidence in support of our proposal to increase the ombudsman service's award limit to £350,000. In Chapter 3, we explain this proposal in more detail and consider the potential wider effects and unintended consequences. Our cost benefit analysis of our proposals (CBA) is in Annex 2.

The Financial Ombudsman Service's award limit

2.2 We have powers under FSMA to set the monetary award limit for awards made by the ombudsman service for complaints within the CJ. The award limit is currently £150,000. The ombudsman service has equivalent powers for the VJ.

2.3 If the complainant accepts the decision, compensation recommended by the ombudsman service is only binding and enforceable up to the award limit. If the ombudsman service considers that fair compensation requires payment of an amount above the award limit, it can recommend that the firm pays the balance. But, any amounts above this limit are voluntary for the firm. There is no external appeal mechanism, although either party can challenge a final decision by judicial review, and complainants (but not firms) can reject the decision, including any monetary award, and go to court instead. However, the cost of court action is likely to be prohibitive for most eligible complainants. It is also very unlikely that a complainant could accept an award of £150,000 and then successfully pursue the firm for the (unpaid) balance through the courts if their claim was substantially the same as their complaint. The ombudsman service's decisions are, therefore, effectively offered on a 'take it or leave it' basis.¹

2.4 The ombudsman service's awards are not made with reference to the award limit, but, as set out in FSMA, what the service 'considers fair compensation for loss or damage suffered by the complainant' (FSMA s.229(2)(a)). This means the award limit does not influence the amount of money the ombudsman service might decide to recommend. Rather it governs how much of what the ombudsman service thinks is fair compensation must be paid, versus what is left to the firm's discretion. When we last consulted on changing the award limit (see below), some firms said they were concerned that increasing the award limit may have an inflationary effect on all compensation awarded by the ombudsman service. We did not accept this argument at the time for the same reasons set out above, and this remains our view.

Our last review of the Financial Ombudsman Service's award limit

2.5 We last changed the award limit in 2012, when we increased it from £100,000. We said that, because the limit had not been changed since the ombudsman service was set up in 2001, the consumer protection provided by the service had declined in real terms.

¹ See *Clark v In Focus Asset Management & Tax Solutions* 2014 EWCA Civ 118.

The increase to £150,000, effective from 1 January 2012, was based on general price inflation since 2001.

- 2.6** Our 2012 increase included an allowance for future price inflation to avoid the need for another review in the short term, as this could be costly for firms and confusing for complainants. While we were unable to say at the time how long the limit would be 'future-proofed' for, we have calculated that the value of the £150,000 award limit began to decline in real terms from 2015 onwards (using the CPI as the measure of inflation).
- 2.7** Of the 64 respondents to our consultation on the 2012 increase, around 80%, including most firms and trade associations who responded, accepted our argument for an increase in the award limit to maintain consumer protection in real terms.
- 2.8** We applied our 2012 increase to the award limit to all new complaints referred to the ombudsman service, including about acts or omissions by firms that occurred before the date the limit was increased. We did this because the increase was based solely on general price inflation and, as such, the award limit did not actually increase in real terms. Finally, we committed to reviewing the limit periodically, and adjusting it as necessary to ensure it kept pace with inflation.

The harm we are trying to address

- 2.9** One of the reasons we provide access to the ombudsman service for individual consumers and businesses is because we think they are unlikely to have the resources to pursue a complaint against a firm through the legal system, if they cannot resolve that complaint with the firm themselves.
- 2.10** In our CP on the SME extension, we published analysis showing that businesses with annual turnover below £6.5m and gross assets below £5m would be unlikely to have access to sufficient legal and financial management expertise to protect their interests in legal disputes with firms. While we have not analysed the resources available to individual consumers, it is reasonable to assume that, if businesses of this size are unlikely to have sufficient resources, then neither will the vast majority of individuals.
- 2.11** Being able to complain to the ombudsman service reduces the risk of harm to financial services consumers, both individually and in aggregate. As a basic matter of fairness, people who have suffered – because of a firm's act or omission – a financial or non-financial loss, such as distress or inconvenience, need to be directly compensated by firms for those losses. If it is not easy for individual consumers and businesses to get redress, firms' incentives to maintain high standards of behaviour, culture and product governance will be reduced. Potentially, this could affect even larger numbers of consumers and reduce trust in the integrity of the market as a whole.
- 2.12** The benefits of consumers having access to the ombudsman service will not be fully realised if the award limit means that complaining to the service does not result in payment of all – or at least a substantial portion – of the compensation the service believes is due for loss or damage. So, it is important that we periodically review the award limit and ensure it is set at an appropriate level.



2.13 We recognise that some firms do voluntarily pay consumers large amounts of compensation above the award limit. However, we believe that firms having this discretion risks such decisions being based on considerations other than what is fair compensation, as determined by the ombudsman service. For example, whether the firm wants to retain the consumer's business. We believe it would be unfair if, for example, 2 complainants that had suffered the same harm were treated differently by a firm because one was more valuable to the firm than the other.

2.14 In addition, whether firms voluntarily pay compensation above the award limit in the event of a complaint is not visible to consumers. Consumers cannot, therefore, take this into account when making decisions to buy financial services. A higher limit will reduce the effect of this information asymmetry on consumers, as all firms will be required to pay compensation up to £350,000 for relevant complaints, meaning fewer consumers will be affected by the limit. This could boost competition if it gives consumers greater confidence to deal with firms that are unfamiliar to them, such as those who are new to the market.

Our review of the Financial Ombudsman Service's award limit

2.15 To determine whether the Ombudsman's current award limit remains appropriate, we have considered 3 factors:

- Firstly, and most importantly, how many complaints made to the ombudsman service by current eligible complainants involve compensation of more than £150,000, and the likely impact complaints resulting from the SME extension may have on this figure (see paragraphs 1.16-1.21).
- Secondly, the evidence on the value of higher value financial products held by consumers, micro-enterprises and newly-eligible SMEs, and – using case studies provided by the ombudsman service – the kind of compensation recommendations they could reasonably give rise to.
- Finally, options that may enable eligible complainants to take court action at no upfront cost, because this could help identify an upper bound for the award limit.

Estimating the volume and value of high value complaints made to the Ombudsman ***Estimating the volume of high value complaints***

2.16 We estimate that approximately 2,000 complaints upheld by the ombudsman service each year involve fair compensation recommendations above £150,000.² We refer to such complaints as 'high value complaints'. This is an estimate, rather than a precise figure, for a number of reasons.

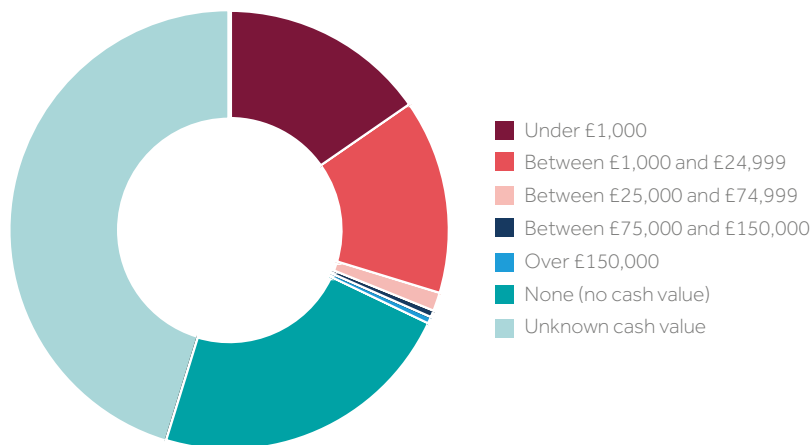
2.17 Firstly, the most precise data we have on the amount of compensation recommended by the ombudsman service are for complaints determined by an ombudsman in a formal 'final decision'. Complaints decided by ombudsmen account for around 1 in 10 complaints resolved by the service, with the rest resolved informally at an earlier stage by adjudicators and investigators with the agreement of the parties. We have therefore assumed that complaints resolved by adjudicators and investigators have a similar

² Between 2013/2014 and 2017/2018 the Ombudsman's average uphold rate was 43%. The average annual number of complaints resolved by the Ombudsman for the same period was 391,947.

distribution of agreed compensation payments as those resolved by ombudsmen (see Figure 2). The ombudsman service agrees this is likely to be a reasonable assumption.

2.18 Secondly, a significant proportion of upheld complaints with money awards have ‘unknown’ compensation values. This is because the ombudsman service’s decision specified the basis or formula for the calculation of compensation, rather than the actual amount. Examples of such decisions include where the ombudsman service tells a firm to review a pension transfer in accordance with the Pensions Review, reconsider an insurance claim, calculate an amount and pay it (or credit it to an account or an investment), or purchase an annuity. We have, therefore, assumed that decisions with unknown compensation have the same distribution as those with a specified money amount (see Figure 2). Again, the ombudsman service agrees that this is likely to be a reasonable assumption.

Figure 2: Proportion of all complaints in each compensation range



Based on average percentages for all upheld complaints between 2015/2016 to 2017/2018.
Source: Financial Ombudsman Service.

Q1: Do you agree with our estimate of the volume of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?

Estimating the value of high value complaints

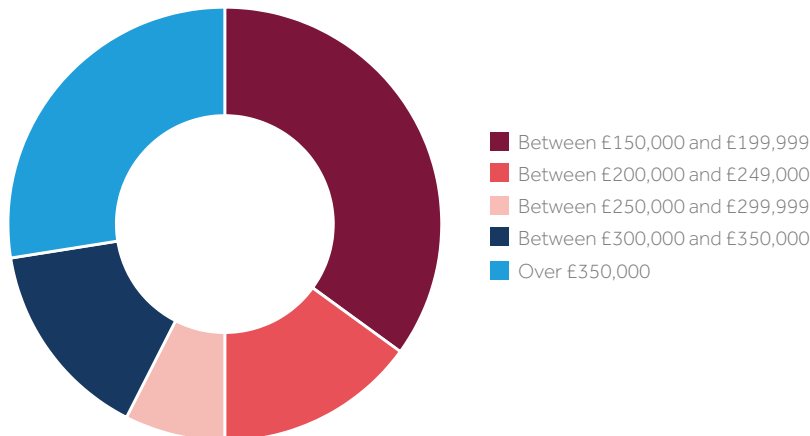
2.19 In terms of total complaints upheld each year by the ombudsman service, the 2,000 or so high value complaints are a small proportion by volume (just over 1% of all upheld complaints). However, because they are high value complaints they are likely to represent a much larger proportion by value, and, for individual complainants, the risk of very significant harm if the award limit means fair compensation is not paid by firms.

2.20 Based on the ombudsman service’s analysis of a sample of 40 high value complaints, the mean compensation for a high value complaint is around £305,000, with a range of £150,000 to approximately £921,000. These complaints relate predominantly to business loans, interest rate hedging products (IRHPs), portfolio management and self-invested personal pensions (SIPPs). We have used this analysis to estimate the distribution of compensation for high value complaints (see Figure 3).

2.21 Assuming firms currently only pay compensation for such complaints up to the current award limit then the shortfall for complainants with complaints with compensation between £150,000 and our proposed new limit of £350,000 – and, therefore, the

aggregate financial harm – could be around £113 million per year. We have calculated this figure using the median of each money award range as the average money award in that range (see Figure 3).³

Figure 3: Proportion of high value complaints in each money award range



Based on analysis by the ombudsman service a sample of 40 complaints from 2016/2017 and 2017/2018 where the award was over £150,000. While the ombudsman service is confident all awards made in these complaints were over £150,000, it has not been able to calculate a precise value for every case.

Q2: Do you agree with our estimate of the value of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?

Impact of complaints from newly-eligible SMEs on our estimates

2.22

Our estimate of the number of high value complaints includes those from the proposed newly-eligible SMEs, charities and trusts (see paragraphs 1.16-1.21). However, based on analysis carried out for our SME extension proposals, we only expect these complainants to make between 5 and 50 high value complaints to the ombudsman service each year.⁴ Unlike for consumers and micro-enterprises, there is no history of complaints to the ombudsman service by the newly-eligible SMEs. This makes it challenging to form empirical estimates of the value of their high value complaints. However, business population statistics show that most of the newly-eligible SMEs will be more like micro-enterprises than larger, ineligible SMEs. We do not, therefore, expect them to have, on average, significantly higher value complaints than existing complainants.

Q3: Do you agree with our assumptions about the volume and value of high value complaints that might be referred to the ombudsman service by newly-eligible SMEs? If not, are you able to provide any data to support your view?

³ The figure of £113m is derived from our estimate of 2,026 upheld high value complaints (as defined in paragraph 2.17) per year. We have used the distribution of high value complaints set out in Figure 3 to estimate how many high value complaints fall into each of the 4 compensation bands below £350,000. We have then taken the median of each band as the average compensation paid to complainants. For example, we estimate there are 711 complaints in the £150,000 to £199,999 band (2,026*0.35). The median award for this band is £175,000, therefore the total amount of compensation awarded for these 711 complaints is £124.4m. From this figure, we have subtracted £106.6m (the amount of compensation that would be paid under the current £150,000 limit) to give a figure for the shortfall in compensation of £17.8m.

⁴ In our CBA for the SME extension proposals (CP18/3), we cited evidence from a Legal Services Board survey suggesting that between 4% and 7% of complaints between firms and businesses of a similar size to the proposed newly-eligible complainants would be high value. Applied to the 380 to 1,300 complaints that small businesses might refer each year, and allowing for an uphold rate of between 26% and 52% (as per our CP18/3 CBA), gives an annual figure for high value complaints by small businesses of between approximately 5 and 50.

Impact on our estimates of complaints that are not referred to the Financial Ombudsman Service because of the award limit

2.23 We do not have any information that would help us understand how many high value complaints between firms and currently-eligible, or proposed newly-eligible, complainants that are currently pursued through the courts (or not pursued at all) because of the award limit. Substantial numbers of complaints in this category could affect our estimate of the number of high value complaints that may be made to the ombudsman service. This is because a higher award limit could mean these complaints 'switch' from the courts to the ombudsman service.

2.24 However, we do not think it is likely there are many such complaints, because:

- Based on our assessment of the resources available to them, in general, eligible complainants already lack the means to take court action – as we explain in paragraphs 2.9 and 2.10, this is one of the main reasons we make them eligible complainants.
- It seems likely that, if eligible, most (if not all) complainants would approach the ombudsman service in the first instance. This is because there are high levels of prompted awareness of the ombudsman service (88%), firms are required to signpost it to complainants, it is free to complainants (who are not bound by its decisions), and it can recommend any amount of compensation.
- The ombudsman service itself sees little evidence of complainants deciding not to complain to it because of the award limit, although we accept that this is inherently difficult to evidence.

Q4: Do you agree with us that, for the reasons given, the number of high value complaints that are not currently made to the ombudsman service because of the award limit is unlikely to be significant? If not, are you able to provide any data to support your view?

Value of higher value financial services products

2.25 As well as the volume and value of high value complaints that are made to the ombudsman service, or are likely to be made to it in the future, it is also important to consider the evidence on the value of financial products that typically give rise to high value complaints. This is because, in some complaints, the full value of such products can be in dispute. Some of the scenarios we have included in this section, which are based on real-life complaints resolved by the ombudsman service, illustrate this point, for example the home insurance case study in paragraph 2.34.

2.26 We think the ombudsman service's award limit should be set a level that means it can ensure complaints about higher value products can be fairly compensated, at least where the product has typical or average values. This is because high value products tend to be either insurance products that protect people in the event of a very significant loss, or long-term investment products that they will rely on for an income in retirement. The nature of these products is such that their value is rarely a good proxy for the consumer's disposable income, and, therefore, the resources available to them to pursue a complaint about the product through the courts.

2.27 Developing an understanding of the typical values of high value products has also helped us to identify possible outliers in the ombudsman service's data on high value



complaints (see paragraph 2.20). This makes it more likely that we have proposed an award limit that is no higher than it needs to be to cover most high value complaints.

2.28 The higher value products we have considered and the evidence we have assembled on their value are set out below. We have also included scenarios based on actual complaints seen by the ombudsman service to illustrate how the product could give rise to a high value complaint.

Interest rate hedging products

2.29 In 2012, we identified failings in the way that some banks sold IRHPs to businesses. IRHPs are designed to protect borrowers against interest rate movements. They include structured collars, swaps, simple collars and cap products.

2.30 The banks involved agreed to review their sales of IRHPs to unsophisticated customers since 2001. To date, around 13,900 customers have accepted a redress offer and £2.2 billion has been paid out. The average pay-out is, therefore, around £150,000, but many will be significantly higher. For example, the average compensation for IRHP complaints in the sample of 40 high value complaints reviewed by the ombudsman service to support our analysis was approximately £373,000, with a range of approximately £181,000 to £921,000.

2.31 The higher the value of the underlying loan, the higher the cost of the mis-sold IRHP, and, therefore, the money that might be at stake in a dispute. As our case study below shows, a loan of £1.5 million could result in overpayments on the loan's IRHP of around £400,000, compared to a more suitable product. Loans of this value are not uncommon among businesses who can complain to the ombudsman service. Our analysis of 3 years of data from the BVA BDRC SME Finance Monitor has found that, each year, between 1% and 8% of UK businesses with annual turnover below £5m and fewer than 50 employees are granted a loan of between £1m and £4.9m. This equates to between 50,000 and 375,000 businesses, the vast majority of which would be eligible for the Ombudsman as either a micro-enterprise or small business.

Example: Interest rate hedging products

A business receives a 25 year swap and 25 years of lending, both for £1.5m, to fund a new facility.

If the Ombudsman upholds the complaint that the swap was mis-sold, and says that the swap should be replaced with a 25 year cap for the same notional amount then the final compensation is likely to be in excess of £400,000, plus interest.

Pensions

2.32 The average compensation for self-invested personal pension (SIPP) complaints in the sample of 40 high value complaints reviewed by the ombudsman service was approximately £241,000, with a range of approximately £155,000 to £400,000.

2.33 FCA data about potential pension transfer mis-selling cases involving authorised firms and individuals indicate similar losses, with over 4,000 customers potentially facing a maximum loss of over £200,000. Similarly, of 214 cases of alleged pension transfer fraud reported to Action Fraud (the UK's national fraud reporting centre) in 2017, around a third reported losses of over £150,000, with a median loss of around £230,000.

Example: Pension transfer

A consumer complains about advice received to transfer out of the defined benefits pension scheme of their former employer. They had been a member of the scheme and accrued around 18 years of pensionable service. There were also a number of guaranteed benefits as part of the pension scheme. At a review meeting with an Independent Financial Advisor, it was recommended that they transfer to a new personal pension plan; and around £22,000 was transferred. 10 years later, the transfer became subject to the pension review.

If the Ombudsman decides that in this case the advice was unsuitable, and instructs the business to put the consumer in the position that they would have been in had they not made the transfer, the final redress amount is likely to be in excess of £150,000.

Home insurance

- 2.34** According to the Association of British Insurers' residential rebuilding cost calculator, the rebuild cost of a typical UK home (a 3-bedroom semi-detached house) that would need to be covered under a buildings insurance policy can be between £142,000 and £288,000 depending on the quality and location of the property being rebuilt.

Example: Home insurance

A home insurance claim is rejected because of a policy exclusion that the consumer feels was not made clear to them. The consumer brings the complaint to the ombudsman service.

If in this instance, the Ombudsman agrees that the policy exclusions were not clear, it might recommend that the insurer pay for the cost of repairing the property. The cost of making such repairs may well exceed the £150,000 award limit.

Life and critical illness insurance

- 2.35** House prices are a key driver of the sums assured under life and critical illness insurance policies, due to the need to provide cover for mortgage debts. According to the Nationwide House Price Index, the average UK house price is around £215,000, with a range of £127,000 (North England) to £469,000 (London). A borrower with a loan-to-value ratio of 70:30 or more could, therefore, have a sum assured under such a policy of at least £150,000 rising to substantially more for some homes or parts of the country.

Example: Critical illness cover

A consumer has a complaint where a business has said that the consumer's condition didn't meet the definition contained in their critical illness cover policy. The cost of the claim is £250,000.

The cost of the claim in this instance is £250,000, so if the Ombudsman upholds the complaint there would still potentially be a significant amount of the compensation – which is likely to be particularly important to the consumer at this point – not covered by the award limit.



Business interruption insurance

- 2.36** Around two thirds of UK SMEs have business interruption insurance (BII). According to recent research by Direct Line, over 550,000 small businesses in the UK were forced to suspend trading in the past 2 years due to business disruption, with the suspension lasting 3 months on average.
- 2.37** For a business turning over £1.5m a year (eg a relatively large micro-enterprise) and insured on a gross earnings basis (the most common type of policy globally, according to the Risk Management Society), a claim against its BII policy for an interruption of average duration could easily run to £375,000. One 2015 survey found that around a fifth of BII claims made in the previous 5 years were disputed, reduced or delayed by the insurer.

Example: Business interruption insurance

A business's bank account is shut down. The business brings a complaint saying that they have lost suppliers and contracts as a consequence.

It transpires that the bank has contacted the business asking for additional information as part of an anti-fraud safeguard. The business says that it didn't receive these. The total loss to the business totals £200,000.

Litigation options

- 2.38** We have discussed the following 'no upfront cost' litigation options with the Legal Services Board, the Civil Justice Council (CJC) and a third-party litigation funding (TPLF) expert referred to us by the CJC:
- conditional fee arrangements (CFAs)
 - TPLF, which can provide a further risk-sharing mechanism for legal services providers in high value disputes
- 2.39** None of the experts we spoke to could quantify the point (in terms of damages claimed) at which they become viable options for consumers or commercial contract disputes. They did, however, note that CFAs were more common for personal injury claims than disputes about financial services.
- 2.40** While all those we spoke to noted that TPLF was starting to become available for claims of under £1m, they were clear that the market for so-called 'lower value' claims remained unproven. A 2012 review by academics at the University of Oxford and the University of Lincoln concluded that: 'The UK [TPLF] market is currently unable to support cases involving damages under £100,000. In practice, most cases involve [damages] over £500,000, and most are in the range of £1m to £50m.'
- 2.41** Given the limited insight available into the viability of these litigation options for financial services disputes, we are not convinced that these options yet provide a realistic alternative to the ombudsman service for complainants.

3 Our proposals

3.1 In this Chapter, we set out our proposed approach to addressing the harm set out in Chapter 2. We also consider the wider effects and potential unintended consequences of our proposals. Finally, we explain why we have decided to rule out certain options that are, or may be, within our powers to implement. Our CBA for our proposals is in Annex 2.

Our proposals

Complaints about acts or omissions on or after 1 April 2019

- 3.2** We propose to increase the ombudsman service's award limit for complaints about acts or omissions by firms that take place on or after 1 April 2019 from £150,000 to £350,000. We refer to this limit as 'Limit 2' (L2) to distinguish it from the limit for complaints about firms' acts or omissions before 1 April 2019, which we refer to as 'Limit 1' (L1, see below).
- 3.3** Based on the analysis set out in Chapter 2, setting L2 at £350,000 will mean that in around three quarters of the 2,000 complaints we estimate to be above the current award limit each year, the complainant would receive the full amount of compensation that the ombudsman service considers due. This equates to around £113m in compensation, which may not currently be paid by firms because of the present award limit (see paragraph 2.21).
- 3.4** A limit of £350,000 is also broadly consistent with the value of awards that the higher value products we have considered in Chapter 2 could realistically give rise to.
- 3.5** We estimate there could be around 500 complaints upheld by the ombudsman service each year with compensation above £350,000. However, our analysis suggests that around half of these complaints may involve compensation between £350,000 and £400,000. So, a limit of £350,000 would ensure complainants still receive a substantial amount of the compensation the ombudsman service considers due.
- 3.6** We also intend that our longstanding policy of ensuring the award limit keeps pace with general price inflation, as measured by the CPI, is applied to L2. We, therefore, also propose that:
- L2 is automatically adjusted on 1 April every year by:
 - applying the percentage increase in CPI between January 2019 and January of that year (published in February by the Office of National Statistics); and
 - rounding down to the nearest £5,000 to ensure simplicity for firms and complainants
- 3.7** We propose to use the version of the CPI that does not include owner occupiers' housing (OOH) costs as it remains the measure of inflation targeted by the Bank of England. The version of CPI that includes OOH is known as CPIH. CPIH was reinstated



as a national statistic in July 2017, following withdrawal of this status while certain methodological problems were addressed. CPI and CPIH tend to track each other closely.

How inflation-based adjustments will work in practice

3.8 An example of how annual inflation-based adjustments – calculated using the approach set out in the House of Commons Library's [Statistical literacy guide – How to adjust for inflation](#) – would affect an L2 of £350,000 introduced in April 2019 is set out below:

- if the CPI for January 2020 was 110.0 and the CPI for January 2019 was 107.0 then L2 would, in the absence of rounding down, increase to £359,813 on 1 April 2020⁵
- due to rounding down to the nearest £5,000, L2 would increase to £355,000 until 31 March 2021
- if the CPI rate for January 2021 was 113.0 then L2 would, in the absence of rounding down, increase to £369,626
- due to rounding down, L2 would increase to £365,000 on 1 April 2021

3.9 Inflation-based adjustments would mean there are multiple 'versions' of L2 for the ombudsman service, firms and complainants to deal with. This is because the value of L2 that will apply is the value that was current in our rules at the time the complaint was made to the ombudsman service.

3.10 Building on the example in paragraph 3.7, this would mean a complaint about a claim against an insurance policy that was denied by the firm on 1 April 2019 would be subject to:

- a £350,000 award limit if it was referred to the ombudsman service between 1 April 2019 and 31 March 2020
- a £355,000 limit if it was referred to the service between 1 April 2020 and 31 March 2021
- a £160,000 limit if it was referred to the service between 1 April 2019 and 31 March 2020 but related to an act or omission before 1 April 2019 (eg to do with the sale of the policy)

3.11 As multiple versions of the award limit for complaints about acts or omissions on or after 1 April 2019 could be confusing, we propose to publish a table in our Handbook and on our website, so firms and complainants can easily see which limit applies at any point in time.

Why we are not proposing to apply the new award limit to complaints about acts or omissions before 1 April 2019

3.12 While we propose to ensure the newly-increased award limit keeps pace with general price inflation in future, we have not based the one-off increase from £150,000 to £350,000 on general price inflation, but on the findings of the analysis set out in Chapter 2.

5 $350000 * (110/107)$

3.13 As such, the £350,000 limit introduced on 1 April 2019 – and any subsequent inflation-based changes to it – will not apply to complaints about firms' acts or omissions prior to 1 April 2019. We note that this will result in additional complexity for financial businesses and the ombudsman service and could be more confusing for consumers and smaller businesses who want to complain. However, we do not believe it is reasonable use of our powers under FSMA to apply an above inflation rise to complaints about firms' acts or omissions that occurred in the past.

Q5: **Do you agree with our proposal to increase the ombudsman service's award limit to £350,000 for complaints about acts or omissions by firms on or after 1 April 2019?**

Q6: **Do you agree with our proposal to automatically adjust, in line with general price inflation, the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 every year from 2020 onwards?**

Q7: **Do you agree that the measure of general price inflation used to automatically adjust the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?**

Complaints about acts or omissions before 1 April 2019

3.14 Because the proposed £350,000 award limit – and any subsequent inflation-based changes to it – will not apply to complaints about firms' acts or omissions before 1 April 2019 (see paragraphs 3.12-3.13), we propose to retain the £150,000 award limit for all other complaints. We refer to this award limit as 'L1', to distinguish it from the substantially higher 'L2' limit for complaints about acts or omissions on or after 1 April 2019.

3.15 However, we intend to make a one-off, inflation-based adjustment to L1. This is because the increase to L1 in 2012 was 'future-proofed' for several years, that is, we increased it by more than the inflation rate applicable at the time to avoid the need to carry out another review in the short term. While we were unable to say at the time the point at which the value of L1 would start to decline in real terms, we now know that this happened around 2015. The one-off adjustment to L1 that we propose making on 1 April 2019 will, therefore, reflect the increase in inflation between January 2015 and January 2019.

3.16 For the same reason, we cannot say with certainty at this stage what the one-off, inflation-based adjustment to L1 will be. It will depend on the inflation rate between now and January 2019. However, based on the current path of inflation, we expect the one-off adjustment to increase L1 from £150,000 to £160,000, once it has been rounded down to the nearest £5,000.

3.17 As with our proposal for L2, we also propose that the L1 limit will be automatically adjusted by CPI on 1 April every year from 2020 onwards to ensure it keeps pace with inflation. An explanation of how these inflation-based adjustments will work is provided in paragraph 3.8.

3.18 Again, as with L2, our proposals mean there would be multiple 'versions' of L2 for the ombudsman service, firms and complainants to deal with. This is because the value



of L1 that will apply is the value that was current in our rules at the time the complaint was made to the ombudsman service. We propose to publish a table in our Handbook and on our website, so firms and complainants can easily see which limit applies at any point in time.

- Q8:** Do you agree with our proposal for a one-off adjustment, reflecting general price inflation between 2015 and 2019, to the Ombudsman's award for complaints about acts or omissions by firms before 1 April 2019?
- Q9:** Do you agree with our proposal to automatically adjust every year from 2020 onwards, in line with general price inflation, the Ombudsman's award limit for complaints about acts or omissions before 1 April 2019?
- Q10:** Do you agree that the measure of general price inflation used for both the proposed one-off and automatic adjustments to the Ombudsman's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?

Wider effects and potential unintended consequences

Impact on the Financial Ombudsman Service

- 3.19** We recognise that if the ombudsman service has the power to require firms to pay substantially higher amounts of compensation, stakeholders may want to be confident it has the skills and expertise to decide such complaints fairly and reasonably.
- 3.20** However, there is currently no limit on the amount of compensation that the ombudsman service can recommend – and the grounds the service has for refusing to deal with a complaint are rather limited (DISP 3.3.4A). So, the award limit should not, in principle, have any bearing on the skills and expertise needed by the service. The ombudsman service should already be ensuring it has the skills and expertise necessary to determine any complaint from currently eligible complainants quickly, with minimum formality, and with reference to what, in its opinion, is fair and reasonable in all the circumstances of the case.
- 3.21** Further, it is not self-evident that the value of a complaint is strongly correlated with its complexity. For example, other things equal, a complaint about a rejected claim against a buildings insurance policy should be no more complex if the property was insured for £300,000 than if it was insured for £100,000. Similarly, the assured value of a critical illness policy should make no difference to the determination of a complaint about the grounds on which an insurer rejected a claim against that policy.
- 3.22** If the ombudsman service needs additional skills and expertise to meet its statutory obligations then it is the service's responsibility, as an independent body, to ensure it has the revenue (from the levy and case fees paid by firms) to fund these additional resources. Even if the ombudsman service did need further resources specifically because of our award limit proposals, we would not expect these to be significant. There are likely to be relatively few high value complaints, and around a third of these are within £50,000 of the current award limit (see Figure 3).

3.23 Finally, we recognise that introducing an additional award limit, and potentially increasing both limits in line with inflation each year will create additional complexity for financial businesses and the ombudsman service. In particular, there will be costs associated with updating online information and training materials and, possibly, reprinting the leaflet which financial businesses are required to send to everyone who complains under the DISP rules.

Q11: Do you agree with our assessment of the impact of our award limit proposals on the ombudsman service?

Impact on the professional indemnity insurance market

3.24 There is a possibility that professional indemnity insurance (PII) premiums will increase as the amount of compensation that the ombudsman service can require firms to pay rises.

3.25 For some small firms, where PII premiums are already relatively high as a proportion of total income, a material increase in PII premiums could have a significant effect on the individual firm. This could include the firm deciding to withdraw from certain markets, such as pension transfer advice. If widespread, this may weaken competition in those markets.

3.26 We would expect most of the increase in premiums would be offset by the reduction in compensation directly borne by firms. As insurance will not be actuarially fair for all consumers, an increase in claims will lead to additional insurance costs for firms. Assuming a claims ratio (the percentage of claims costs incurred in relation to the premiums earned) of 63%⁶, this would imply an overall increase in insurance costs of £77m, based on our estimated shortfall of £113 million between compensation recommended and compensation paid because of the award limit (see paragraph 2.21). We would expect this to be an overestimate of the increase in insurance costs. This is because not all claims will be insured or fully insured.

3.27 Further, claims ratios will include fixed costs of providing insurance which will not increase proportionately with the size of claim. Finally, we would not expect many additional insurance claims to arise as a result of increasing the amount that might be claimed.

3.28 To underline the importance we attach to this issue, we are asking a specific question about the likely impact of our proposals on PII premiums. We welcome detailed submissions on this point. We are particularly interested in the relative influence of different factors in PII insurers' pricing decision, for example the risk profile of individual firms versus changes to the legal and regulatory framework that affect all firms, such as increases to the ombudsman service's award limit.

Q12: Do you agree with our assessment of the impact of our award limit proposals on the professional indemnity insurance market?

Q13: Do you have any analysis or evidence to present in relation to how the costs of professional indemnity insurance (PII) might change if the ombudsman service's award limit is raised to £350,000?

6 Source: ABI (2018), Liability Insurance Income & Outgo, claims ratio for professional indemnity insurance in 2017



Impact on individual firms

- 3.29** We recognise that for some smaller firms, such as financial advisers, mortgage intermediaries and general insurance brokers, the payment of substantially higher compensation to complainants because of an increased award limit could put pressure on the viability of their business.
- 3.30** This is one reason we require these firms to hold PII, which can help firms pay justified claims and prevent insolvency and excessive claims on the Financial Services Compensation Scheme (FSCS), which is funded by firms which are still trading. These firms must also meet our training and competence requirements and, in time, the Senior Managers and Certification Regime. Both help ensure firms do not behave in ways that are likely to cause complaints that might result in the payment of substantial compensation in the first place.
- 3.31** Most firms are likely to be limited companies, which means the liability of each of the directors of the firm in the event of a failure is limited to the amount they personally invested. Complainants, on the other hand, will be fully exposed to the consequences if the award limit means they are not fairly compensated for their loss.
- 3.32** We are more concerned about the indirect impact of our proposals on individual firms because of increased PII premiums than the direct impact of having to pay more compensation. This is why we are seeking detailed submissions on this point (see paragraph 3.28).

Q14: Do you agree with our assessment of the impact of our award limit proposals on individual firms?

Impact on the Financial Services Compensation Scheme

- 3.33** Where the ombudsman service has made a money award against a firm in default, the complainant may be able to claim compensation from the FSCS instead. Redress awarded by the FSCS is covered by a levy on the industry.
- 3.34** Firms may fail if they cannot afford to pay higher awards made by the ombudsman service because of our proposals. Active firms will have to cover any compensation awarded by the FSCS against firms who fail for this reason through a higher levy than would otherwise be the case.
- 3.35** We have been unable to estimate how many firms might fail because of our proposals. This is because isolating the impact of an unaffordable award made by the ombudsman service from other factors that might cause a business to fail is extremely difficult.
- 3.36** However, we think it unlikely that an ombudsman service award would cause larger firms – who account for a greater share of high value complaints – to fail. So, the risk of failure is limited to smaller firms, as they are likely to be less resilient. As we explain in paragraph 3.30, we require firms to hold PII to prevent failures that impose costs on consumers and – through claims to the FSCS – other firms.

Q15: Do you agree with our assessment of the impact of our award limit proposals on the Financial Services Compensation Scheme?

Options we have decided to rule out

Different award limits for different types of complaint

3.37 Our powers include being able to set different award limits for complaints about different financial products or by different categories of complainant (for example consumers versus businesses). However, we prefer not to differentiate between these things. In principle, we are not persuaded that, other things equal, complainants should be entitled to different amounts of compensation because of who they are or what they are complaining about. This could amount to us making a value judgement on the harm caused between, for example, a pensioner who has lost £200,000 of their retirement savings due to poor investment advice, and the director of a business that lost the same amount because they were mis-sold an interest rate hedging product on a commercial loan.

3.38 Differential award limits also present more practical risks. These include the possible increased costs for the ombudsman service from potential judicial reviews on the boundaries between complaint and complainant types. Differential limits are also likely to be less easy than a single limit for firms and complainants to understand.

Q16: Do you agree with our decision to rule out having different award limits for different types of complaint or complainant? If not, why do you think there should be different limits?

No award limit at all

3.39 FSMA provides that the monetary limit is such amount as may be specified and that a money award may not exceed the monetary limit. We currently believe there should be a limit to the amount of compensation the ombudsman service can require firms to pay. One reason for this is that, under FSMA, determinations by the ombudsman service that are accepted by the complainant are final, ie there is no automatic right of appeal for firms. We believe that, without the ability to appeal a determination, it would not be appropriate to expose firms to unlimited liability. The award limit also provides certainty for firms and their PII insurers on the extent of their liability, at least as far as the ombudsman service's decisions are concerned.

Q17: Do you agree with our view that there should be a limit to the amount of compensation the ombudsman service can require firms to pay to complainants? If not, how – if at all – would the Ombudsman's approach to dispute resolution need to change for it to be able to require firms to pay any amount of compensation?

Aligning the Financial Services Compensation Scheme's compensation with the proposed new award limits

3.40 The proposed new award limits for the ombudsman service will be significantly higher than the Financial Services Compensation Scheme's (FSCS) compensation limits, except for the limit for temporary high bank balances, which is £1 million. For some activities covered by FSCS – insurance business and general insurance advice and arranging – there is no compensation limit.



3.41 However, there is a key difference between the FSCS and the ombudsman service. The FSCS is a compensation scheme of last resort. It acts as a backstop and requires active firms to pay compensation for failed firms, whereas the Ombudsman requires active firms to pay compensation to their own customers for their own failings. It is therefore not obvious to us that the limits for the 2 schemes should be aligned.

Q18: Do you agree with our view that the award limits for the ombudsman service and the FSCS should not be aligned?

Annex 1

Questions in this paper

- Q1:** Do you agree with our estimate of the volume of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?
- Q2:** Do you agree with our estimate of the value of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?
- Q3:** Do you agree with our assumptions about the volume and value of high value complaints that might be referred to the ombudsman service by newly-eligible SMEs? If not, are you able to provide any data to support your view?
- Q4:** Do you agree with us that, for the reasons given, the number of high value complaints that are not currently made to the ombudsman service because of the award limit is unlikely to be significant? If not, are you able to provide any data to support your view?
- Q5:** Do you agree with our proposal to increase the ombudsman service's award limit to £350,000 for complaints about acts or omissions by firms on or after 1 April 2019?
- Q6:** Do you agree with our proposal to automatically adjust, in line with general price inflation, the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 every year from 2020 onwards?
- Q7:** Do you agree that the measure of general price inflation used to automatically adjust the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?
- Q8:** Do you agree with our proposal for a one-off adjustment, reflecting general price inflation between 2015 and 2019, to the ombudsman service's award for complaints about acts or omissions by firms before 1 April 2019?
- Q9:** Do you agree with our proposal to automatically adjust every year from 2020 onwards, in line with general price inflation, the ombudsman service's award limit for complaints about acts or omissions before 1 April 2019?



- Q10:** Do you agree that the measure of general price inflation used for both the proposed one-off and automatic adjustments to the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?
- Q11:** Do you agree with our assessment of the impact of our award limit proposals on the ombudsman service?
- Q12:** Do you agree with our assessment of the impact of our award limit proposals on the professional indemnity insurance market?
- Q13:** Do you have any analysis or evidence to present in relation to how the costs of professional indemnity insurance (PII) might change if the ombudsman service's award limit is raised to £350,000?
- Q14:** Do you agree with our assessment of the impact of our award limit proposals on individual firms?
- Q15:** Do you agree with our assessment of the impact of our award limit proposals on the Financial Services Compensation Scheme?
- Q16:** Do you agree with our decision to rule out having different award limits for different types of complaint or complainant? If not, why do you think there should be different limits?
- Q17:** Do you agree with our view that there should be a limit to the amount of compensation the ombudsman service can require firms to pay to complainants? If not, how – if at all – would the ombudsman service's approach to dispute resolution need to change for it to be able to require firms to pay any amount of compensation?
- Q18:** Do you agree with our view that the award limits for the ombudsman service and the FSCS should not be aligned?
- Q19:** Do you agree with the costs, benefits and transfers we have identified? If not, please explain why.

Annex 2

Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.
2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about the appropriate level of consumer protection, taking into account all the other impacts we foresee.

Problem and rationale for intervention

3. As set out in Chapter 2, being able to complain to the ombudsman service reduces the risk of harm to financial services users, both individually and in aggregate. As a basic matter of fairness, people who have suffered a financial or non-financial loss, such as distress or inconvenience, need to be directly compensated by firms for those losses. If it is not easy for individual consumers and businesses to get redress, firms' incentives to maintain high standards of behaviour, culture and product governance will be undermined. Potentially, this may affect even larger numbers of consumers. Further, inability to gain full redress may lower confidence in using specific financial products and reduce the wider trust in the sector.
4. The individual and aggregate benefits of consumers having access to the Ombudsman will, however, not be fully realised if the ombudsman service's award limit means that complaining to the ombudsman service does not result in payment of all – or at least a substantial portion – of the compensation the service believes is due. According to the analysis presented in Chapter 2, a non-negligible number of complaints – around 2,000 – are made to the ombudsman service each year that result in compensation above the award limit. Such complaints account for just over 1% of all complaints made to the ombudsman service that result in money awards. Accordingly, we estimate that, if we did not increase the ombudsman service's award limit to £350,000, more than £113 million of compensation recommended by the service may currently be voluntary for firms.

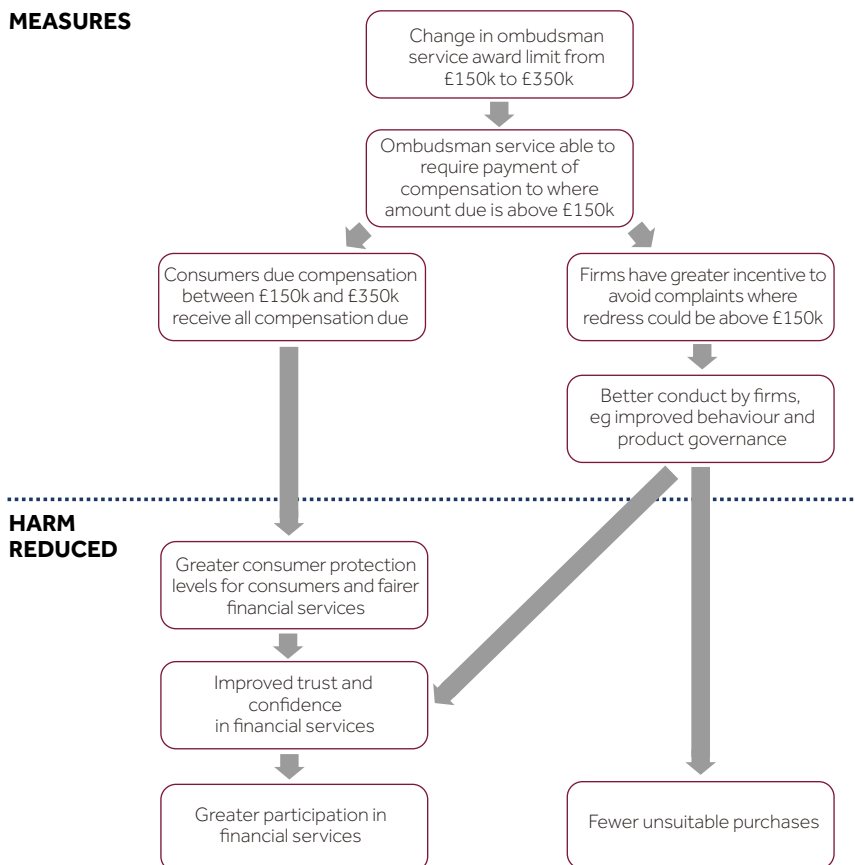


Our intervention

5. We propose that, on 1 April 2019, the ombudsman service's £150,000 award limit should change to:
 - £350,000 for complaints about acts or omissions by firms on or after 1 April 2019.
 - £160,000 for complaints about acts or omissions before 1 April 2019. This is so that the limit for these complaints reflects changes in inflation since the £150,000 limit was put in place, as measured by the Consumer Prices Index (CPI).
6. We also propose that both award limits should be automatically adjusted on 1 April from 2020 onwards, using the CPI, with the adjusted figure rounded down to the nearest £5,000. We explain how this will work in Chapter 3.
7. For any complaints referred to the ombudsman service before 1 April 2019 the limit will remain at £150,000.

Causal chain

MEASURES



Baseline

8. We believe the current observed number of claims is the appropriate baseline to use in this CBA. While markets are likely to change and this will affect instances where compensation is due we do not believe these will change significantly in the near future.

Costs

Redress awarded to complainants with money awards above £150,000

9. We consider the impact on firms of additional redress payments due to a higher award limit – a cost to firms but a benefit to consumers – in paragraphs 17-21, below.

Administrative complaints handling costs for firms

10. We believe that the familiarisation (ie one-off) costs of our proposals will be negligible for firms. This is because the amount of additional information to be considered to understand the change in the rules regarding the ombudsman service's award limit is minimal.
11. There will be no change to the way firms are required to deal with complaints from eligible complainants. So, we do not expect firms' ongoing complaint handling costs to change because of our proposals.

Costs to the Financial Ombudsman Service

12. For the reasons set out in Chapter 2 (paragraphs 2.23-2.24), we do not expect our proposals to significantly increase the number of complaints made to the ombudsman service, only the amount of compensation it can award. So, we do not expect the ombudsman service to experience significantly higher costs through an increase in the number of complaints.
13. Even if the number of complaints does not increase, our proposals could increase costs for firms if a higher award limit requires the ombudsman service to bring in additional skills or expertise. However, as we explain in paragraphs 3.20-3.22, the ombudsman service should already have the skills and expertise in place to deal with complaints of any value. Even if additional skills or resources were required, the relatively small number of complaints affected by our proposals mean it is unlikely this investment by the ombudsman service would have a significant impact on its cost base.

Costs of insuring against an increase in Financial Ombudsman Service money awards

14. As we set out in paragraph 3.24, there is a possibility that professional indemnity insurance (PII) premiums paid by firms required to hold PII to firms providing PII will increase as the amount of compensation that the Ombudsman can require firms to pay rises.
15. We would expect most of the increase in premiums would be offset by the reduction in compensation directly borne by the firms. However, we would expect additional costs to firms that purchase insurance, as increasing the level of claims on insurance would lead to higher premiums. If we assume premiums increase proportionately with claims and, given the claims ratio (the percentage of claims costs incurred in relation to the premiums earned) for professional indemnity insurance is 63%⁷, then premiums would increase by an additional £77m over and above the additional compensation costs to firms that we accounted for above (see paragraph 2.21).⁸ We would expect this to be an overestimate of the increase in insurance costs. This is because not all claims will be insured or fully insured.

7 Source: Association of British Insurers (2018), Liability Insurance Income & Outgo, claims ratio for professional indemnity insurance in 2017

8 We calculate this by estimating the additional cost of insurance premiums (over and above compensation payments) on these additional claims by the following calculation: (£113,000,000/63%) - £113,000,000 = £77m.



16. Further, claims ratios will include fixed costs of providing insurance which will not increase proportionately with the size of claim. Finally, we would not expect many additional insurance claims to arise as a result of increasing the amount that might be awarded, and therefore no new costs to insurers of administering claims.

Benefits

Redress awarded to complainants with money awards above £150,000

17. Based on our estimates of the number and value of complaints with money awards above £150,000 (see paragraphs 2.16 and 2.19), we estimate that increasing the award limit to £350,000 would result in additional financial compensation of £113m being paid to complainants. We note that this is a benefit to consumers but a cost to financial services firms.
18. The primary benefits arise from consumers being adequately compensated for financial and non-financial loss. We think there is an additional benefit from consumers being appropriately compensated for their loss, over and above the value of the transfer from firms to consumers. We do not think it is reasonably practicable to monetise these additional benefits. This is because it is not clear how we would value restitutive justice.
19. A higher award limit would give firms greater incentives to assess and, if required, improve their conduct and product governance. We do not believe it is reasonably practicable to estimate this benefit. This is because we are unable to determine how firms might respond to a higher limit.
20. Our CBA for our proposals to extend the ombudsman service's remit to larger SMEs highlighted survey data that may be relevant. These appeared to show that the incidence of problems experienced by businesses that have access to the ombudsman service was around 30% lower than that for businesses that did not, although we did not attribute all this difference to access to the ombudsman service. Providing access to the ombudsman service for new complainants, however, may have a greater impact on firms' incentives than increasing the award limit for complainants who already have access.
21. A higher award limit would lower the cost of getting redress for any eligible complainants who, due to the current limit, may be forced to take firms to court to be fairly compensated. This impact is likely to be small, as, generally speaking, eligible complainants already lack the means to take court action.

Q19: Do you agree with the costs, benefits and transfers we have identified? If not, please explain why.

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).
2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.
5. This Annex includes our assessment of the equality and diversity implications of these proposals.
6. Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of protecting consumers, as set out in paragraphs 2.9-2.13. They are also relevant to the FCA's operational objectives to promote effective competition



in the interests of consumers (as set out in paragraph 2.14), and to ensure market integrity (as set out in paragraph 2.11).

8. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they seek to address the harm experienced by consumers who, because of the ombudsman services's award limit, are unable to obtain fair compensation due to the acts or omissions of firms. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.

9. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

10. Our proposals should improve incentives for firms to maintain high standards of behaviour, culture and product governance. The alternative could be more intensive supervision, which is likely to be less efficient.

The principle that a burden or restriction should be proportionate to the benefits

11. We consider our proposals impose burdens or restrictions that are proportionate to the benefits we expect to see, as set out in the CBA. The impact on firms is primarily driven by transfers of wealth from firms to eligible complainants. These costs are, therefore, equal to the resulting benefits. Relevant consumers should see benefits as a result of changes in conduct that should eventually reduce the number of complaints.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

12. Our proposals should improve outcomes for the sector, as a result of increased consumer confidence and market integrity.

The general principle that consumers should take responsibility for their decisions

13. When considering complaints from consumers, the ombudsman service will have regard to relevant law and regulations, rules, guidance, standards, codes of practice when determining what is fair and reasonable when determining the outcome for complaints.

The responsibilities of senior management

14. We have had regard to this principle in developing our proposals. Senior managers should ensure their business has adequate systems and controls and handles complaints in accordance with DISP.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

15. We have had regard to this principle and do not believe our proposals, which seek to ensure consumers receive fair compensation when they have been harmed by the acts or omissions of any type of firm, undermine it.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

16. This principle is not relevant to our proposals as they do not involve any requirements imposed under FSMA, nor do we require persons subject to such requirements to publish information.

The principle that we should exercise of our functions as transparently as possible

- 17.** We believe that by consulting on our proposals, and committing to publish the award limits going forward, we are acting in accordance with this principle. We have also discussed our proposals with the Ombudsman, and considered its views when developing our proposals.
- 18.** In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). A higher limit should improve incentives for firms to maintain systems and controls that minimise the loss of money by their consumers due to fraud and other financial crime.

Expected effect on mutual societies

- 19.** The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies compared to any other type of firm responding to a complaint from an eligible complainant.

Equality and diversity

- 20.** We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.
- 21.** The outcome of the assessment in this case is stated in paragraphs 1.22-1.26 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRRA)

- 22.** The LRRRA principles and Regulators' Code do not apply when we are making rules. So, they do not apply to this Consultation Paper, which proposes only amended rules not guidance or other policies or principles.



Annex 4

Abbreviations in this document

BII	Business interruption insurance
CBA	Cost benefit analysis
CFA	Conditional fee arrangement
CJ	Compulsory Jurisdiction
CJC	Civil Justice Council
CP	Consultation Paper
CPI	Consumer Prices Index
CPIH	Consumer Prices Index including owner occupiers' housing costs
DISP	Dispute resolution: complaints
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
IRHP	Interest rate hedging product
LRRA	The Legislative and Regulatory Reform Act 2006
PII	Professional indemnity insurance
PS	Policy Statement
SME	Small and medium-sized enterprise
TPLF	Third-party litigation funding
VJ	Voluntary Jurisdiction

We have developed the policy in this Consultation Paper 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.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from 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 or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN



Appendix 1

Draft Handbook text

FINANCIAL OMBUDSMAN SERVICE (AWARD LIMIT) INSTRUMENT 2019

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 Annex 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 the Annex below apply equally to the Voluntary Jurisdiction of the Financial Ombudsman Service Limited 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 137T (General supplementary powers); and
 - (2) section 229 (Awards).
- 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 made and amended and the standard terms for Voluntary Jurisdiction participants 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 Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with the Annex to this instrument.

Notes

- I. In the Annex 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

- J. This instrument may be cited as the Financial Ombudsman Service (Award Limit) Instrument 2019.

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

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

[*Editor’s note:* The text in this Annex takes account of the changes proposed in PS18/21 ‘SME access to the Financial Ombudsman Service – near-final rules’ (October 2018) as if they were made.]

Annex

Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

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

3 Complaint handling procedures of the Financial Ombudsman Service

...

3.7 Awards by the Ombudsman

...

Money awards

...

- 3.7.4 R (1) The maximum money award which the *Ombudsman* may make is:
~~£150,000.~~
- (a) £350,000 for a *complaint* concerning an act or omission which occurred on or after 1 April 2019; and
 - (b) £[160,000] for a *complaint* concerning an act or omission which occurred before 1 April 2019.
- (2) On 1 April each year, for *complaints* referred to the *Financial Ombudsman Service* on or after this date up to and including 31 March in the following year, the amounts in (1)(a) and (b) are adjusted by:
- (a) applying the percentage increase in *CPI* between January 2019 and January of that year; and
 - (b) rounding down to the nearest £5,000.

[Note: The maximum money award which the *Ombudsman* may make is set out in the table below. This Note will be updated before any new limit takes effect.]

date of act or omission	before 1 April 2019	on or after 1 April 2019
date complaint referred		

before 1 January 2012	£100,000	n/a
before 1 April 2019 but on or after 1 January 2012	£150,000	n/a
on or after 1 April 2019	£[160,000]	£350,000

...

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
...					
[47]	<u>DISP 3.7.4</u>	<u>R</u>	<u>For a complaint referred to the Financial Ombudsman Service before 1 April 2019 but on or after 1 January 2012 the maximum money award which the Ombudsman may make is £150,000.</u>	<u>From 1 April 2019</u>	<u>1 April 2019</u>

...

