

10/1

Financial Ombudsman Service,
Financial Services Authority &
Office of Fair Trading

Consumer complaints (emerging risks and mass claims)

OFFICE OF FAIR TRADING

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Financial Services Authority

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The Financial Services Authority, Financial Ombudsman Service and Office of Fair Trading invite comments on this Discussion Paper. Please send us your comments to reach us by 10 June 2010.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/Pages/Library/Policy/DP/2010/dp10_01_response.shtml).

Alternatively, please send comments in writing to:

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A confidential response may be requested from us 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 Tribunal.

Copies of this Discussion Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1 Overview

Introduction

1.1 This Discussion Paper considers the current position for redress and complaints handling in the financial services industry and any potential changes. It is a joint publication by the Financial Services Authority (FSA), the Office of Fair Trading (OFT) and the Financial Ombudsman Service ('the ombudsman service').

Structure of this Paper

- 1.2 Chapter 2 of this Discussion Paper sets out the background on complaints handling in the financial services industry, and outlines the roles of firms, the regulators and the ombudsman service.
- 1.3 Chapter 3 deals with encouraging fair complaint handling by firms. It covers:
- the responsibility of firms' senior management;
 - the role of the regulators in ensuring better complaints handling;
 - the publication of complaints data;
 - ombudsman guidance; and
 - cooperation between the FSA, OFT and the ombudsman service.
- 1.4 Chapter 4 deals with the identification and handling of 'new and emerging risks' and how they can be dealt with by firms, the FSA, the OFT and the ombudsman service.
- 1.5 Chapter 5 deals with 'mass claims'. It covers:
- the wider implications process;
 - a proposed new co-ordination committee; and
 - redress proposals in the Financial Services Bill.

Why is the paper being issued now?

- 1.6 Two main factors contribute to publishing this paper now. First, it includes some issues outstanding from HM Treasury's July 2009 White Paper *Reforming Financial Markets* about identifying and managing emerging risks. Second, the timing allows for a consultation paper in the third quarter of 2010 on any rule changes arising from responses to this paper and other work, including the Financial Services Bill, subject to its Parliamentary progress.

Responses invited

- 1.7 This paper contains a number of specific questions, but comments on any of the matters raised in the paper are welcomed.
- 1.8 Please provide your comments to dp10_01@fsa.gov.uk by 10 June 2010.

2 Fair consumer redress

- 2.1 A key element in rebuilding consumer confidence in financial services is that firms carrying out activities regulated by the FSA and/or licensed by the OFT should treat complainants fairly. This means firms should:
 - handle consumer complaints fairly and promptly, so that consumers with products or services that have gone wrong receive swift and effective redress;
 - identify and remedy any recurring or systemic problems brought to light by complaints; and
 - consider whether they should act on their own initiative to review the position of consumers in a similar position, but who have not yet complained.
- 2.2 Consumer detriment from inadequate complaint handling and systemic problems remains a major issue. Overall:
 - firms are currently recording, and reporting to the FSA, around 3 million consumer complaints per year. This number excludes complaints resolved by the close of the next business day, which the FSA does not require firms to report;¹
 - the financial services industry remains the subject of widespread complaints about mis-selling and other issues. The latest instance of 'mass claims' relates to payment protection insurance (PPI). For 2009, it is estimated that firms received 260,000 complaints about the sale of PPI products, while 41,000 new PPI complaints were referred to the ombudsman service;
 - the total number of complaints referred to the ombudsman service by consumers who are dissatisfied with the way in which the firm has handled their complaint has grown from around 31,000 in the 2000/01 financial year to more than 150,000 in 2009/10;²
 - around half of all the cases referred to the ombudsman service relate to firms in just four or five large groups; and

1 <http://fsahandbook.info/FSA/html/handbook/DISP/1/5>

2 The scope of the ombudsman service has also increased over this time.

- the ombudsman service upheld 56% of complaints in favour of the consumer it resolved during the 2009 calendar year. This indicates that some firms may not be handling consumer complaints fairly.
- 2.3 The FSA, in its *Financial Risk Outlook* for 2010, has also identified poor quality complaints handling as a key conduct risk and will be maintaining complaints handling as a key area of focus.³
- 2.4 The primary responsibility for complaint handling and putting right systemic problems sits with firms' senior management. However, it is helpful for firms and consumers to understand the roles, powers and objectives Parliament has given the FSA, the OFT and the ombudsman service in this area:
- the FSA is the UK's main regulator for financial services. Its role includes setting and overseeing the rules about how firms handle complaints;⁴
 - the OFT is the UK's consumer and competition authority working across the whole of the economy. Its Consumer Credit Group is responsible for overseeing consumer credit licensing;⁵
 - resolving individual consumer complaints is the responsibility of firms in the first instance. But if consumers remain dissatisfied, they can refer their complaint to the ombudsman service or go to court; and
 - the ombudsman service is an informal alternative to the civil courts for resolving individual disputes between consumers and firms. It is not a regulator. Like the courts, it is operationally independent.⁶
- 2.5 The FSA and OFT are not directly involved with the resolution of individual consumer complaints. Nor can they intervene with how the ombudsman service or a court handles individual complaints.

Jurisdiction and terminology

Complaint handling standards are set out in Chapter 1 of the FSA's Dispute Resolution: Complaints (DISP) sourcebook. They apply to the ombudsman service's:

- compulsory jurisdiction – firms carrying out activities regulated by the FSA and payment service providers;
- consumer credit jurisdiction – persons licensed by the OFT who are not regulated by the FSA; and
- voluntary jurisdiction – persons who have chosen to opt in to the service provided by the ombudsman.

In practice, 98% of the complaints to the ombudsman service currently come from firms that fall within the compulsory jurisdiction – which includes consumer credit licensees who are also FSA authorised firms. Therefore, for the

³ *Financial Risk Outlook 2010*, FSA, March 2010 (page 69)

⁴ See www.fsa.gov.uk/Pages/About/Who/index.shtml for more information about the FSA.

⁵ See www.oft.gov.uk/about for more information about the OFT.

⁶ See www.financial-ombudsman.org.uk/about/index.html for more information about the ombudsman service.

purposes of this paper, ‘firm’ is used to refer to persons in the compulsory or consumer credit jurisdictions.

Micro-enterprises, some charities and some trustees are eligible to take their complaints to the ombudsman service. But the overwhelming majority of complaints are from consumers. Therefore, this paper uses the term ‘consumer’ throughout.

3 Encouraging fair complaint handling by firms

- 3.1 This chapter sets out the complaint handling framework and the responsibilities of firms to handle complaints promptly and fairly. It also sets out actions that are underway to improve firms' complaints handling. Finally, it discusses how the ombudsman service, the OFT and the FSA cooperate within the regulatory framework to ensure its effective operation.

Responsibility of firms' senior management

- 3.2 The primary responsibility for ensuring that consumer complaints are handled promptly and fairly lies with firms' senior management. Firms' obligations to treat dissatisfied consumers fairly should coincide with the long-term reputational and commercial advantages that arise from this.
- 3.3 Recent research by The Leadership Factor into the commercial impact of complaint handling in financial services firms has shown that customer satisfaction rates are almost as high among customers who have complained about a problem and had it satisfactorily resolved, as they are among customers who have not experienced a problem at all. Also, actual insurance renewal rates were higher (85% for customers who complained and were satisfied with the outcome of their complaint, compared to an average renewal rate of 68% for customers who experienced no problem).⁷
- Q1. What more can be done to encourage firms to recognise that it is in their long-term interests to handle consumer complaints promptly and fairly?

Regulatory responsibilities of the FSA and OFT

- 3.4 Firms under the ombudsman service's compulsory and consumer credit jurisdictions are subject to similar complaint handling rules.

⁷ The Leadership Factor, Association of British Insurers Complaint Management Seminar, 1 December 2009.

8 DP10/1: Consumer complaints (March 2010)

- 3.5 The FSA is responsible for supervising complaints handling for all firms in the ombudsman's compulsory jurisdiction. This jurisdiction includes a substantial number of businesses selling consumer credit products and services.
- 3.6 However, responsibility for dealing with the underlying activity that is giving rise to complaints depends on the regulator. The OFT is responsible for any regulatory action relating to consumer credit activities and the FSA is responsible for action relating to regulated activities under the Financial Services and Markets Act 2000 (FSMA).

FSA regulation of complaints handling

Complaint handling rules

- 3.7 Principle 6 of the FSA's Principles for Businesses requires firms to treat customers fairly. This applies throughout the product lifecycle, including where a product or service has (or may have) gone wrong.
- 3.8 The obligations placed on firms' complaint handling include:
 - having an accessible process for handling complaints (so that dissatisfied consumers are not discouraged from pursuing their concerns);
 - assessing complaints promptly and fairly (to resolve the concerns of those consumers who have complained);
 - identifying and putting right the underlying causes of complaints (to reduce the number of future complaints); and
 - considering other affected consumers who have not yet complained (to put things right without all the affected consumers having to make individual complaints).
- 3.9 Chapter 1 of DISP sets out the minimum standards for firms' complaint handling. In 2007 these rules were updated, with the aim of making them more effective, by removing some of the prescriptive detail and focusing on the following key outcomes:⁸
 - dealing with complaints fairly and promptly;
 - informing complainants appropriately of their rights; and
 - seeking to minimise the number of complainants who turn to the ombudsman service because they have not received a substantive response from the firm.
- 3.10 The FSA continues to believe that the complaint handling rules should focus on the outcomes that matter. It intends publishing a consultation paper on the ombudsman service's awards limit in the third quarter of this year. If the ongoing review of complaints handling by major banks (see paragraph 3.18), finds that any elements of Chapter 1 of DISP require amendment or strengthening in light of the practices found, the FSA will consult on any proposed changes in the forthcoming consultation paper.

⁸ www.fsa.gov.uk/pages/Library/Policy/Policy/2007/07_09.shtml

3.11 Any changes to Chapter 1 of DISP will be subject to the outcomes of consultation and cost benefit analysis. Responses to this paper will inform the consultation paper.

Q2. Do you have any analysis or evidence which suggests that the effectiveness of Chapter 1 of DISP could be improved? If so, which elements might be reviewed?

Supervision and enforcement

- 3.12 The FSA is changing its approach to how it supervises firms – to deliver more intensive and intrusive supervision coupled with credible deterrence. This involves an increased focus on firms' conduct of business, including the extent to which they treat complainants fairly.
- 3.13 This intensive approach to supervision is underpinned by the new organisational structure that the FSA adopted in October 2009. There is a single integrated business unit to deal with risk, which includes a new division (with specialist resources) to target conduct risk.
- 3.14 In this new structure, supervisors receive specialist support from dedicated teams – for example, from teams with particular expertise in financial promotions or the Unfair Terms in Consumer Contracts Regulations 1999.
- 3.15 It also provides FSA-wide support for assessing whether firms are treating customers fairly (including in relation to complaint handling), which is now embedded in the FSA's core supervisory work.
- 3.16 Credible deterrence involves the FSA taking a more proactive approach to enforcement and using all of its powers to deliver its mandate. During 2009 the FSA:
- took enforcement action against four firms, which led them to proactively contact around 400,000 consumers and offer full redress (with the redress payable by one firm alone exceeding £7.7 million);
 - imposed fines of nearly £3.6 million on three firms for failing to treat their customers fairly and for inadequate complaint handling; and
 - withdrew approval of two persons for complaint handling failures.
- 3.17 So far in 2010, the FSA has:
- censured one firm for, among other things, complaint handling failures. The firm is now in the process of winding down; and
 - taken action against two firms to facilitate redress. One has been fined £101,000 and is required to contact consumers and pay redress where appropriate. Funding of between £5m and £7.8m has been secured from the other firm to pay redress.

Review of how major banks handle complaints

- 3.18 The FSA is undertaking intensive work to review complaint handling in major banking groups, which account for a very high proportion of all the complaints firms receive. The review will be completed in the second quarter of this year. The

FSA will publish a report outlining the review's findings, including examples of good and poor practice, which will be relevant to all firms.

OFT and complaints handling

- 3.19 Like most regulatory bodies, the OFT adopts a risk-based approach – prioritising its work and the use of its resources on the basis of an assessment of known and potential consumer detriment. As part of this approach, the OFT has identified a number of consumer credit activities which it considers have the potential to cause significant consumer detriment.
- 3.20 With the introduction of the Consumer Credit Act 2006 reforms, the OFT has been able to assess the competence of licensees, enabling it to consider the skills, knowledge and experience of businesses wishing to undertake consumer credit activities. A significant element of this assessment is considering how a firm approaches complaint handling. In assessing competence, particularly in those areas identified as high risk, the OFT is looking for clear evidence that firms have effective complaint handling systems in place including suitable monitoring processes.
- 3.21 The OFT views effective complaint handling processes and, where appropriate, compliance with ombudsman decisions as an important element of a firm's overall fitness to hold a consumer credit licence. Proper complaints handling is important across the board, but is particularly significant in markets where consumers are vulnerable and/or face significant detriment.
- 3.22 Evidence of poor or non-existent complaints handling can result in OFT enforcement activity where the concerns are significant enough to warrant this. OFT action has included:
 - refusing a firm a consumer credit licence to undertake debt management activities where, among other matters, it was unable to demonstrate satisfactorily that it could deal properly with consumer complaints; and
 - placing a formal requirement (breach of which may lead to a financial penalty) on a licensee to establish effective procedures for dealing with complaints fairly and promptly, and ensuring that it informed customers of their right to pursue a complaint with the ombudsman service.

Publication of complaints data

- 3.23 Publishing more information (including firm-specific information) exposes the significant differences in the quality of complaint handling by different firms, and will provide a further reason for firms to improve their complaint handling.

Financial Ombudsman Service

- 3.24 Since it was established, the ombudsman service has published information about complaints the service has handled. This now includes: the number of complaints

about all the different financial products; the twenty financial products which give rise to most complaints and the proportion of complaints upheld in relation to the most complained about products. Until recently, individual firms were not named.⁹

- 3.25 In September 2009, the ombudsman service started to publish half-yearly figures on the complaints it has handled about individual, named, firms that had at least 30 new and 30 resolved cases during the period.¹⁰ The figures show the number of new cases and the percentage of closed cases in which the ombudsman service changed the outcome in favour of the consumer.

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- 3.26 Also in September 2009, the FSA began publishing regular reports of the overall number of complaints reported by all firms,¹¹ broken down by type of firm, the products and services complained about and the cause of the complaints, as well as overall figures on the number of complaints closed within eight weeks and the proportion of complaints upheld or rejected by firms.¹²
- 3.27 From this year, the FSA will require firms receiving 500 or more reportable complaints in any six-month period to publish details of the complaints received in the period as well as details of all the complaints closed in the same period. By the end of September 2010, the figures for the first half of the year will be available from the FSA's website.
- 3.28 The vast majority of financial services businesses are covered by the arrangements to report complaints. But there are some exceptions. Firms in the consumer credit jurisdiction are not required to report complaints numbers nor, in accordance with the European Directive on payment services, are payment service providers if they are not authorised for any other FSA-regulated activities.

Ombudsman guidance

- 3.29 The FSA expects firms to analyse and reconsider their approach to handling complaints in light of the decisions that the ombudsman service has given them on similar previous cases. It is not acceptable behaviour for firms to reject complaints they receive, despite knowing that these would be upheld if referred to the ombudsman service, as consumers would be treated unfairly.
- 3.30 The primary role of the ombudsman service is to resolve the complaints that are referred to it. However, the ombudsman service also provides feedback to firms and consumers and, in particular, regulators about the lessons learned from the cases it deals with. This helps firms and consumers resolve cases themselves and encourages the elimination of the sources of complaint.

9 www.financial-ombudsman.org.uk/publications/complaints-data.html

10 www.ombudsman-complaints-data.org.uk

11 Note that the figures which firms report do not include the complaints which have been resolved to the satisfaction of the complainant by the close of the next business day.

12 www.fsa.gov.uk/Pages/Library/Other_publications/complaints_data/index.shtml

3.31 In addition to the publication of complaints data, actions the ombudsman service is taking in this area include:

- expanding the already extensive information it publishes about its approach to particular issues and the lessons learned from its cases, including through the regular ombudsman news, and its developing online digest; and
- outreach activities, including:
 - a technical helpline for firms, consumer bodies, seminars and training sessions (for complaint-handlers in firms and consumer advisers); and
 - recently updated arrangements for liaison and strategic discussion with industry and consumer bodies.

Cooperation between FSA, OFT and the ombudsman service

- 3.32 The FSA, the OFT and the ombudsman service cooperate – so far as this is consistent with the different roles, powers and objectives given to them by Parliament – and exchange information that enables them to fulfil their respective functions.¹³ They have published details of their arrangements to exchange information and cooperate with one another.¹⁴ The three organisations will review their information sharing arrangements to ensure that they are helping to deliver their statutory functions effectively and efficiently in support of the overall operation of the regulatory framework.
- 3.33 Regular meetings between them support the identification of issues that may have a significant impact and promote a consistent and coordinated approach. This includes discussing potential overlaps that may arise between the ombudsman service and the regulators, which are brought to either the ombudsman service's or the regulators' attention by firms or others through a range of channels (see paragraph 4.11).
- 3.34 The potential for overlaps arises from the fact that the ombudsman service must, under FSMA, decide cases on the basis of what is 'fair and reasonable' in the individual circumstances of each case. This involves taking into account the relevant law, regulations, regulators' rules and guidance and good industry practice at the relevant time. But ombudsman decisions in individual cases have the potential to influence market wide practices, which are the responsibility of the regulators.
- 3.35 The ombudsman service provides the FSA and OFT with monthly updates on its caseload. It also informs the FSA or OFT (as appropriate) of any systemic issue it identifies. This includes notifying them of any indications that there may be a systemic problem with a particular firm's complaint handling. The regulators will then investigate and (if appropriate) take supervisory and/or enforcement action based on the evidence they have collected and their analysis of the risks.

13 The ombudsman service may provide information about complaints to the FSA and the OFT, subject to the parties' rights of privacy. Disclosure of confidential information by the FSA to the OFT and ombudsman service is subject to the Financial Services and Markets Act 2000 (Disclosure of Confidential Information) Regulations 2001.

14 See:
FSA and OFT – www.fsa.gov.uk/pubs/other/concordat_fsa_oft.pdf
FSA and the ombudsman service – www.fsa.gov.uk/pubs/mou/fsafos.pdf
OFT and the ombudsman service – www.financial-ombudsman.org.uk/about/FOS-OFT_MoU.pdf

- 3.36 As part of its more intensive approach to supervision, the FSA is working to ensure that complaint handling data consistently informs its supervision of firms' conduct. The FSA is able to develop an overview from the data that it requires firms to report six-monthly,¹⁵ as well as information from the ombudsman service, of:
- the total number of complaints received by the firm;
 - how long the firm takes to resolve them;
 - the proportion of complaints that the firm upholds or rejects;
 - the proportion of complaints about the firm referred to the ombudsman service; and
 - the extent to which the ombudsman service has upheld complaints against the firm.
- 3.37 The FSA considers that complaints data does not, by itself, necessarily provide evidence that an individual firm is treating complainants unfairly. But it does provide a basis for the FSA to challenge and make judgements about individual firms. For example, patterns of high ombudsman service uphold rates could be evidence that there might be problems with the complaint handling procedures in some firms. This can lead to further work, including in-depth assessments of firms' complaint handling.
- 3.38 It is challenging to use complaints data to identify areas of emerging risk. But trends in complaints data (for example, a rapid increase in overall complaints about a particular issue) can help reveal common failings in firms' conduct. Where these are identified early, and the evidence is robust, the FSA and the OFT have an opportunity to head-off issues before they become widespread.

Q3. Do you consider that improvements could be made to how information is exchanged and used between the regulators and the ombudsman?

¹⁵ In compliance with the European directive on payment services, this does not apply to payment service providers.

4 Emerging risks

- 4.1 Change in firms' business models, products and services can cause complaints about the same (or a similar) issue. Prompt action may head off a problem before it becomes a significant cause of complaints and consumer detriment. This requires:
- early identification of new and emerging risks;
 - encouraging firms to proactively take action themselves to close down the risks; and
 - where appropriate, regulatory action to force firms to close down the risks.

Identifying risks

Financial Services Authority

- 4.2 The FSA's new operating structure includes additional specialist resource dedicated to spotting potential risks to consumers from firms' misconduct at an early stage and working with firms to stop those risks from emerging. Risks are identified both within each sector (e.g. insurance risks, banking risks) and across sectors (e.g. risks affecting insurance products distributed by banks).
- 4.3 The FSA uses a range of information and intelligence to provide an integrated picture of where potential risks may arise and how emerging risks may evolve. This enables the FSA to analyse emerging risks and, where these are significant, take mitigating action.

Identifying and analysing emerging conduct risks

First, the FSA collects intelligence about emerging conduct risks in particular sectors through the work of its sector teams.

Second, conduct risks that affect more than one sector are identified and analysed through a dedicated 'horizon-scanning' function. This looks at the main environmental drivers of firms' and consumers' behaviour, including:

- the macroeconomic environment and its effect on consumer demand for financial products and services and for firms' strategies;

- the competitive environment, particularly its effect on the relative profitability of different products and services; and
- the regulatory and market environment and its effect on the way firms decide to respond to other drivers.

This analysis of the operating environment is combined with more ‘micro’ intelligence on firms’ business models, products and incentives to identify where future conduct risks are more likely to emerge.

Third, the FSA regularly receives intelligence on emerging risks from a variety of sources across the organisation including from dialogue with the Financial Services Consumer Panel, the Financial Services Practitioner Panel, the Smaller Businesses Panels, as well as the FSA’s Consumer Affairs Team, Consumer Contact Centre and sector teams. This information assists the FSA in identifying new and emerging issues. In identifying emerging risks it also draws on information available from firms’ complaint handling data returns and information from the ombudsman service.

Finally, FSA specialists analyse the business models of high-impact firms with the potential to cause significant detriment to consumers. This involves looking in detail at their business model, product offering and strategies, to identify potential conduct risks, and extends to supporting supervisors in discussions with firms to explore potential risk areas. During such discussions firms are questioned about trends and future developments in their strategies.

Office of Fair Trading

- 4.4 The OFT has a range of processes to identify new and emerging risks, using a variety of intelligence from a number of sources, both internal and external. Because of the OFT’s broader remit in overseeing competition and consumer matters across the economy generally, rather than just financial services, these cover both the wider economy and financial services.

Complaints and enquiries from consumers

One source of intelligence for the OFT is complaints and enquiries, primarily from consumers but also from traders, to its:

- Enquiries and Reporting Centre; and
- Consumer Direct.

The Enquiries and Reporting Centre has a dedicated team which deals specifically with consumer credit related enquiries.

Consumer Direct has been part of the OFT since April 2006. It is a telephone and online consumer advice service, available to the entire population of Great Britain. (Consumers in Northern Ireland have access to Consumerline.) It provides clear, practical, impartial advice to help consumers to resolve problems and disagreements they may be having with suppliers of goods or services including financial services products.

Although many consumers seeking advice may be referred to other organisations for more specialised advice, Consumer Direct captures data on the number and nature of these issues which then feeds into some of the processes discussed below. In 2008-09, Consumer Direct received 1.6 million calls and emails and recorded more than 850,000 complaints against traders, so the potential value of this data is significant.

In addition the OFT receives direct intelligence about credit-related risks from a number of other sources. Of particular importance are:

- complaints and other data provided by the Local Authority Trading Standards Service relating primarily to the activities of consumer credit licensees, but with the potential to indicate more widespread practices; and
- information from stakeholders, including industry and consumer groups through the OFT's Stakeholder Relationship Programme and ad hoc contacts.

Economy-wide issues

- 4.5 The OFT has internal processes looking at both financial services-specific and economy-wide issues that may merit further investigation because of the potential concerns they raise. These involve cross-office working on preliminary investigations which explore the scope for, and value in, progressing particular issues. These processes draw on information received from complaints and enquiries and all other available relevant material (including, for example, that gathered through the OFT's competition and market study related analyses of markets).
- 4.6 The OFT is currently reviewing how it identifies and uses intelligence, including: how it can enhance the value and impact of the intelligence it gathers; and establishing an intelligence management database – to capture intelligence from the Local Authority Trading Standards Service, Consumer Direct and other sources and ensure that it is available to be shared across the wider enforcement community.
- 4.7 The OFT's Consumer Credit Group has its own discrete intelligence function, which is responsible for drawing together information that is directly relevant to the OFT's administration of the consumer credit licensing regime. It captures and deploys information which promotes the OFT's understanding of existing problems and informs an appropriate response, as well as preparing for potential future problems at the micro and macro level. This includes: information on specific firms; concerns about business practices and behaviours; and data about trends and new risks which may warrant further work.
- 4.8 The OFT makes clear those consumer credit activities that it considers to be high-risk, including any changes to its risk model. It also outlines its key objectives for the forthcoming year in its annual planning process, which includes a full consultation. More specifically, the OFT has published its Financial Services Plan which sets out its strategic objectives in the financial services sector, including promoting fairness and responsibility in the relationship between the credit industry and its customers.¹⁶

16 OFT (2009) Financial Services Plan – www.oft.gov.uk/shared_oft/reports/financial_products/oft1106.pdf

Financial Ombudsman Service

- 4.9 The ombudsman service provides the FSA and the OFT with monthly data on the numbers and types of cases it receives, and their outcomes – as a contribution to the information available to the FSA and OFT in identifying new and emerging risks. And through its regular dialogue with the FSA and OFT, the ombudsman service draws to their attention any new and emerging risks that it may have identified.
- 4.10 Where the ombudsman service identifies new or emerging risks from its casework it will raise these with the firms concerned to enable them to comment and take appropriate action. The ombudsman service will also raise the issue with the relevant regulator to allow it to consider what action it should take.

Firms and consumers: identifying new and emerging risks

- 4.11 The FSA's and OFT's risk identification involves extensive engagement with firms and consumers through a range of channels – for example:
- industry and consumer-wide perspectives from the practitioner and consumer panels and from the industry and consumer groups involved in the OFT's Stakeholder Relationship Programme;
 - directly from consumers through telephone and online services; and
 - directly from firms through 'on the ground' activity such as firm visits and/or the Local Authority Trading Standards Service.
- 4.12 Both the FSA and OFT are working to integrate the data gathered from these channels with market and economy-wide analysis, to form a holistic picture of emerging risks.
- 4.13 Firms themselves (in some cases working with their trade association) are well placed to identify new and emerging risks and are encouraged to raise them with the FSA or OFT.
- Q4. Are there additional cost-effective steps that the FSA, OFT or the ombudsman service could take in order to identify new and emerging risks?
 - Q5. What more could be done to encourage firms to identify new and emerging risks to the FSA and OFT?
 - Q6. What further role might consumers play in identifying new and emerging risks?

Dealing with new and emerging risks

- 4.14 Once new and emerging risks have been identified, proactive action should be taken to mitigate those risks before they cause significant consumer detriment.

Firms

- 4.15 It is in a firm's own interests to identify and close down emerging issues early. The regulatory regime makes firms primarily responsible for putting things right. Where an issue becomes widespread, the cost for relevant firms of putting things right can be significant. This gives individual firms a reason to identify and mitigate new and emerging risks, before they turn into widespread issues.
- 4.16 In addition, firms can already proactively notify the FSA or OFT of concerns about a particular aspect of a product or service (and are often under an obligation to do so). For example, where a firm's managers become concerned that a competitor's or the market's practices are evolving in a way that may not be in the interests of consumers or other firms, they can discuss this with the relevant regulator. This may be before a breach has occurred and is particularly straightforward where the firm has established a frank relationship with its supervisors.
- 4.17 Where firms voluntarily disclose an issue that involves a breach of a regulatory requirement, their openness will be taken into account in any enforcement action (for example, in assessing the extent of financial penalties). This ought to provide a further reason for firms to be pro-active in notifying the FSA or OFT of issues.
- 4.18 But, in a competitive environment, firms can face incentives to continue selling a product, even though they know about the risks that it may go wrong. This is because the costs of being the first firm to proactively close down a risk may outweigh the commercial benefits of just carrying on. This is where the threat of regulatory action (including effective redress) needs to be brought to bear.
- 4.19 H M Treasury's July 2009 White Paper *Reforming Financial Markets* asked the Retail Financial Services Forum (RFSF) to consider processes that would incentivise firms to close down new and emerging issues proactively – with little or no need for regulatory action – so that fewer risks go on to become mass claims.¹⁷ The Forum supported the Government's aim. It made a number of suggestions, but did not reach a consensus on the processes that would be required.
- 4.20 The FSA and OFT believe that a combination of deterrence and 'reward for good behaviour' provides firms with appropriate incentives. But the FSA and OFT are both interested in proposals that would encourage firms and consumer groups to identify issues and for firms to proactively close them down – provided they add value to existing processes for identifying risks and do not restrict regulators' decisions on whether and how to take action.

Financial Services Authority

- 4.21 The FSA is putting an increased focus on, and resources into, dealing with new and emerging risks that it has identified and analysed – so that they can be 'nipped in the bud'. This means making judgements about the risks inherent in a firm's products

¹⁷ The Retail Financial Services Forum is a high-level group, sponsored by H M Treasury, where representatives of industry, consumers, regulators and the ombudsman service can discuss strategic issues concerning retail financial services.

and services, and intervening when the FSA believes it is necessary to provide consumers with an appropriate degree of protection.

Tracker mortgages

One example of the FSA's approach in action concerns firms that intended to introduce a collar on tracker mortgages when the collar had not been disclosed at the point of sale. One firm had included a contract term allowing it to vary the up-front tracker margin under certain conditions, while another intended to rely on a term permitting it to increase charges. In these particular cases, the FSA considered these terms not to have been adequately disclosed and, in relation to the former term, considered that it was unfair. Following FSA discussions with the relevant firms they agreed not to rely on them.

Mortgage payment protection insurance (MPPI)

Another example is the FSA's response to concerns about recent increases in MPPI premiums and reductions in what customers are covered for under their policy. In October 2009, the FSA orchestrated an industry-wide package of measures for consumers, including firms proactively refunding increases of premiums of around £60 million.¹⁸ The package also included: reversing any reductions in cover for customers whose policies had changed in 2009; offering to reinstate policies where customers had cancelled them within two months of an increase in premium or reduction in cover during 2009; and freezing premiums and cover for existing customers for at least the remainder of that year.

Office of Fair Trading

4.22 Similarly, the OFT aims to pre-empt new and emerging risks that have been identified.

Sale and rent back

Following a market study into the emerging sale and rent back sector, the OFT found that consumers were facing a number of serious problems including the possibility that their tenancy was only guaranteed for a short period and/or they faced substantial rent increases, contrary to their expectations.

As a result, OFT recommended statutory regulation of the sector which would ensure much greater consumer protection. The FSA has been operating an interim regime for this sector to address the most immediate problems facing consumers, with the full regime scheduled for launch later this year.

Second charge lending

A cross-governmental review of arrears and repossession policies in the second charge market suggested there was scope for improvement in order to ensure that

18 www.fsa.gov.uk/pages/Library/Communication/PR/2009/135.shtml

poor practice did not become widespread and result in considerable consumer detriment. Second charge lending is considered a high-risk activity by the OFT, given the risk that borrowers could end up losing their homes if they default on payments. As a result, the OFT undertook to produce guidance for the sector.

The resulting guidance sets out the minimum standards the OFT expects from businesses engaged in second charge lending if they are to be considered fit to hold a licence. It covers the entire lending process including selling techniques, customer care, and practices around the management of arrears. Breaches of the guidance may trigger enforcement action in appropriate cases.

- Q7. What more could be done to encourage firms themselves to proactively deal with new and emerging risks before they turn into widespread issues?

5 Dealing with mass claims

- 5.1 Fair and prompt complaint handling by firms, and focussing on effective identification and mitigation of emerging risks, should work to help prevent 'mass claims' – a large number of the same (or similar) complaints about the same issue.
- 5.2 However, as evidenced by the current concerns about the handling of complaints about PPI, the financial services industry continues to be the subject of mass claims about mis-selling and other issues.
- 5.3 More than half of the cases ever referred to the ombudsman service, since it was formed, have related to just six financial products. These mass claims have had a disproportionate impact on consumer confidence in financial services and played an important part in increasing the number of complaints referred to the ombudsman service by consumers from around 31,000 in the 2000/01 financial year to over 150,000 in 2009/10.
- 5.4 Mass claims complaints can also grow quickly, in part due to the role of claims management companies in bringing issues to the attention of some consumers and assisting them to make a complaint.
- 5.5 However, claims management companies are generally a symptom of mass claims, not the cause of them. Though they have a significant role, they are far from the only channel for mass-claim complaints. Most of the mass claim complaints received by the ombudsman service have not involved a claims-management company.
- 5.6 The ombudsman service, the FSA and the OFT liaise with the Claims Management Regulation Unit, part of the Ministry of Justice, if they see indications that there may be systemic problems in this market or with individual claims management companies.

Co-ordinated handling of mass claims

- 5.7 Mass claims typically hinge on widespread or common sales practices or contracts that are alleged to amount to mis-selling or an unfair contract term. It is primarily the responsibility of regulators to resolve these. In this context:

- the FSA and the OFT can consider action to address the underlying issues (whether or not affected customers have made an individual complaint); but
 - the ombudsman service can only consider the cases of affected consumers who have complained to the firm and then gone on to refer their complaint to the ombudsman.
- 5.8 The impact of mass claims can be significant, both in terms of consumer detriment and the costs to industry of remedying an issue. This can result in fixed positions and delays before complex issues can be resolved.
- 5.9 While regulators are working to investigate and evidence the potential mis-selling, contractual terms or other matters underlying mass claims (or the courts consider some aspect of them), consumers can continue to take forward complaints about the same issue to firms, the ombudsman service or the courts. In these situations it is particularly important that firms handle the complaints they receive promptly and fairly.
- 5.10 In September 2009, the FSA published a consultation paper making proposals to improve firms' handling of PPI complaints.¹⁹ It responds to the FSA's serious concerns about the fairness with which firms have assessed consumer complaints about past PPI sales, including evidence that the ombudsman service has felt it appropriate to overturn, in favour of the complainant, firms' decisions in over 80% of the cases reaching it.

Wider Implications Process

- 5.11 The Wider Implications Process aims to encourage effective co-operation and co-ordination between the ombudsman service and the regulators. The Process was created in order to:
- publicly confirm how the three bodies cooperate in identifying and handling complaints issues that raise wider implications; and
 - give firms, industry bodies and consumer bodies a clear mechanism through which they can raise potential wider-implications issues, including where firms are concerned about the standards they should rely on when assessing some complaints.
- 5.12 In practice, issues that have been taken forward as having wider implications have been identified by the FSA, OFT and ombudsman service; consumer bodies have only raised one issue that has been taken forward, while firms and industry bodies have raised none.
- 5.13 Feedback from the RFSF suggests that both firms and consumers recognise that the arrangements need to be updated. And the FSA, OFT and ombudsman service agree that the current process does not add value to what is already achieved through their liaison and intelligence-gathering arrangements and ongoing dialogue with firms.

19 www.fsa.gov.uk/pubs/cp/cp09_23.pdf

Co-ordination committee

- 5.14 The FSA, OFT and ombudsman service propose that there should be a co-ordination committee, meeting regularly and drawing together members of their executive teams.
- 5.15 They envisage that the committee will be a key part of wider information sharing and co-ordination among the three bodies, supporting a proactive and forward looking approach to identifying and dealing with emerging risks and mass claims.
- 5.16 However, there will always be a degree of subjective judgement depending on the characteristics of each issue. Also, each body must ultimately be responsible for exercising its own powers and functions.
- 5.17 The committee's role will be to coordinate consideration of:
- whether new and emerging risks that have been identified are likely to result in mass claims if mitigation is not put in place; and
 - the relative merits of dealing with particular issues by regulatory action or by means of individual complaints.
- 5.18 In its work, the committee will take a view as to whether:
- it would be assisted by seeking views from both firms (or industry bodies) and consumer bodies;
 - to set a clear timetable for regulatory action and whether this would enable the ombudsman service to place a hold, or 'stay', on complaints; and
 - regulatory action, once taken, would enable the ombudsman service to dismiss complaints.
- 5.19 In undertaking its work, the committee will also consider the extent to which regulatory action may still leave the ombudsman service dealing with some complaints about the issue, because firms may have failed to follow the regulator's requirements. A regulatory solution to a mass claim may require firms to consider the facts of individual cases, in which event consumers will need a means to challenge firms' judgements. Regulators do not have the facilities to consider individual cases, so this role would continue to fall to the ombudsman service or the courts.
- 5.20 The committee will have regard to the differences between the statutory powers and responsibilities of the regulators and of the ombudsman service. In particular:
- regulators may seek a widespread and proportionate solution that provides redress for a large number of consumers; but
 - where the ombudsman service decides the merits of a case, the law requires it to do so on the basis of "... what is, in the opinion of the ombudsman, fair and reasonable in all of the circumstances of the case".²⁰

20 Financial Services and Markets Act 2000, Section 228 (2).

- 5.21 Subject to FSMA and the Enterprise Act 2002, it is proposed that the issues the committee will consider and its outputs will be made transparent by posting material on the OFT, FSA and/or ombudsman service's websites.
- 5.22 A useful guide to whether an issue should be treated as being potentially widespread is whether it involves (or is likely to involve):
- a number of firms;
 - 5,000 or more complaints referred (or likely to be referred) to the ombudsman service;²¹ and
 - the underlying cause of complaints is very similar.
- 5.23 The FSA, OFT and ombudsman service believe that this proposal will provide firms and consumers with greater certainty and transparency about identifying and handling issues.
- 5.24 In practice, firms and consumers would still be able to bring potential overlaps to the attention of the ombudsman service or regulators through the range of channels discussed in Chapter 4.
- 5.25 The outputs of the committee would be subject to existing checks and balances, including:
- where the solution involves new regulatory rules or guidance, the FSA and OFT will follow their existing approaches – including consultation and cost-benefit analysis as appropriate; and
 - where FSA or OFT enforcement action is contemplated, existing procedures will apply – including appeal to the relevant tribunal.
- Q8. Would such a committee process improve the handling of emerging issues and mass claims?
- Q9. What are the factors that should be taken into account when identifying mass claims?

Regulatory tools

- 5.26 The FSA does not deal with individual complaints, but it can take regulatory action to require individual firms to provide redress in certain circumstances. The FSA also has a tool to facilitate industry wide reviews which, subject to how it is applied, can remove the need for consumers to complain individually. This is covered by section 404 of FSMA.
- 5.27 The FSA has not used the powers in section 404 of the FSMA for several reasons, including concerns about its scope, procedure and operation. Whether section 404 should be streamlined or new powers conferred on the FSA is for Parliament to decide. Parliament is currently considering Clause 26 of the Financial Services Bill

²¹ Or detriment of a similar magnitude to adversely affected consumers who have not yet complained.

(as introduced) which proposes to update the FSA's power in section 404 to require a group of firms to undertake a review of their past business.

- 5.28 The Bill also proposes to insert a new section 404B, which would remove the potential difference in approach between the ombudsman service and the FSA when the regulatory solution is a section 404 past business review.

Other avenues for redress

- 5.29 In some instances, only the courts can provide an authoritative answer on the legal effect of a contractual term underlying a mass claim, for example when the law is unclear. The ombudsman service's rules allow a firm to propose a test case in court, provided it pays the consumer's costs, but no firm has ever taken up this option. The ombudsman service does not have the power to impose it.
- 5.30 The recent decision by the Supreme Court in proceedings brought by the OFT provided an authoritative answer to certain complex legal questions concerning current account unauthorised overdraft charges.²² But this did not automatically resolve the cases of individual consumers. These complaints still need to be considered individually by the firm and the ombudsman service.
- 5.31 Whether the court should be able to deal with consumer claims collectively is a matter for Parliament, which is currently considering Clause 18-25 of the Financial Services Bill (as introduced) which proposes the introduction of collective actions in the financial services sector. A collective action would enable a representative to pursue an action through the courts on behalf of a group of consumers who have similar claims. Firms and consumers would benefit from a more effective way to settle mass claims through the courts in this way.
- 5.32 If implemented, the proposed new FSA powers to secure consumer redress, a new collective action procedure in the courts, and proactive action by firms and the regulators to identify and close down new and emerging risks set out in this paper would be a significant change in addressing the risks identified in this consultation.

22 See <http://www.supremecourt.gov.uk/decided-cases>

List of questions

- Q1. What more can be done to encourage firms to recognise that it is in their long-term interests to handle consumer complaints promptly and fairly?
- Q2. Do you have any analysis or evidence which suggests that the effectiveness of Chapter 1 of DISP could be improved? If so, which elements might be reviewed?
- Q3. Do you consider that improvements could be made to how information is exchanged and used between the regulators and the ombudsman?
- Q4. Are there additional cost-effective steps that the FSA, OFT or the ombudsman service could take in order to identify new and emerging risks?
- Q5. What more could be done to encourage firms to identify new and emerging risks to the FSA and OFT?
- Q6. What further role might consumers play in identifying new and emerging risks?
- Q7. What more could be done to encourage firms themselves to proactively deal with new and emerging risks before they turn into widespread issues?
- Q8. Would such a committee process improve the handling of emerging issues and mass claims?
- Q9. What are the factors that should be taken into account when identifying mass claims?

List of acronyms

A list of acronyms used in this paper is set out below.

DISP	FSA's Dispute Resolution Complaints Sourcebook
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
MPPI	Mortgage payment protection insurance
OFT	Office of Fair Trading
PPI	Payment protection insurance
RFSF	Retail Financial Services Forum

The ombudsman service

Financial Ombudsman Service

PUB REF: 001961

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