

Financial Ombudsman Service: Our future funding

Response by the Building Societies Association

August 2019



 Building
Societies
Association

Introduction and summary

The BSA is pleased to respond to the Financial Ombudsman Service's consultation on its future funding proposals. The key points in our response are as follows –

1. The BSA opposes the proposal to move from 85/15% (**case fee/levy**) split to a 50/50 position. We believe that such a change is unnecessary, disproportionate for smaller and medium-sized firms, and would create a moral hazard (by providing a financial shield to future large-scale 'polluters' at the expense of firms that had treated their customers fairly) - please see page 4 below.

We find it very surprising that the Service should make such a proposal. It would also come on top of this year's **87% increase** in the levy.

2. The BSA also opposes the planned reductions in the number of '**free cases**', which are again unnecessary and detrimental to small firms that treat their customers well (page 8).
3. We set out some **practical suggestions** to help the Service deal with funding issues; in particular, the Service could address relevant matters by flexing its very large **contractor workforce** at the appropriate time, in line with its previous statements (page 10).
4. Especially in the light of the levy/case fee split proposals and the big increase in consumer credit claims, the BSA is not convinced that the **funding model**, in terms of allocation among sectors, is fair. We recognise that this is not directly a matter for the Service, but it is important background to the Service's proposals and we are now examining the issue with our members (page 12).
5. We also have serious concerns about the **timing and process** for this consultation (page 14).
6. The BSA's responses to the **questions in the consultation paper** are set out on pages 17 - 19, although our response covers much of the substance earlier on (see above).
7. We list a number of **questions for the Service** on page 20. We would much appreciate the Service's comments and feedback on them.

The Proposals

1. Case fee/levy split – 50/50 proposal

We recognise that the Service seeks stability in its funding arrangements. However, the reality is that the Service, as a complaints adjudicator, faces more peaks and troughs in terms of funding needs than most other organisations – such volatility is in the nature of the service that it provides.

For example, the current and recent period - with new complaints jurisdictions and the PPI complaints/pre-deadline 'spike' - is a particular peak (with total 2019/20 expenditure provisionally set at £332.2million) whereas, say, the early 2000s, before endowment complaints and when the Service adjudicated fewer complaints areas, represented a trough (when total annual expenditure was in the £20millions).

If the Service had entirely stable funding it would probably be, at any given time, either over-resourced or under-resourced, depending on the scale and pattern of complaints. Sensibly, the Service has built a large contractor workforce and, as we explain below, that arrangement provides the Service with the ability to cope fully with changes in funding need.

Turning first to the substance of the current proposal, we have significant concern that the proposal to move to a 50/50 split on case fees/levy, from the current 85/15 split, would represent a serious departure from the 'polluter pays' principle.

We recognise that this principle has never been taken to its *full* extent (for example, payment of fees based entirely on outcomes, which the Hunt Report in 2007 rejected). However, it is important to maintain a position where those firms receiving the large majority of complaints should take the major share of the Service's funding costs, through the case fee – otherwise, moral hazard arises.

Firms responsible for the largest number of complaints, and usually most upholds, would appear to be financially sheltered by the proposed significantly reduced reliance on case fees – which firms that had treated their customers fairly would subsidise (ultimately paid for by their own customers; ie the public).

One of our members expressed the point like this –

“Raising more from the levy and less from the case fees penalises the “good” firms that resolve customer complaints before they go to the ombudsman meaning that the “good” firms subsidise the firms that do not resolve cases before going to ombudsman”.

Another BSA member stated that it –

“very much supports the BSA call for the FOS fee structure in any year to reflect the volume of complaints generated by an institution in the previous year. This approach is more equitable and would recognise the customer culture and approach to complaint administration and redress by firms. Those firms which create the lowest workload for FOS, which we know to include building societies, should have this acknowledged through lower fees.”

A further comment from a BSA member was as follows –

“The Society completely disagrees with the proposal for a 50/50 split of levy income and case fees. It appears profoundly unfair to seemingly water down the principle of polluter pays by ‘re-balancing the levy and case fee’ by placing greater emphasis on levies (the potential to pollute) rather than actual FOS referrals (a tangible cost to polluting firms).

FOS’s proposals will have significant impact on firms such as the Society that will be inevitably required to pay substantially higher levies, whilst having comparatively low levels of FOS referrals. Firms such as the Society would in effect be subsidising polluters through paying a higher proportion of FOS’s running costs.”

With so much focus in financial services on behavioural psychology, it is disappointing that such considerations appear to be absent in the proposal.

Given that total levies are currently £45million while total fees are £250.7 million (page 11 of the consultation), a move to 50/50 would be very significant indeed. The Service forecasts that its total income will average just over £200m over the four financial years after this one [Source: Chart, Page 12, *Our Future Funding*]. If the 50/50 split was applied, this would mean case fees of around £100m a year paid *by firms subject to complaints*, about £70m a year *lower* than if the current 15/85 split was applied.

This £70 million would instead be paid by all levy-paying firms regardless of the number of complaints the Service received relating to them. It is therefore very clear that, under the proposal, future large-scale polluters would benefit most, subsidised regarding the Service’s funding by firms that treated their customers fairly.

It is also important to bear in mind that the levy has *already* nearly doubled since last year (£24million to £45million, an 87.5% increase – please see page 35 of the Service’s Annual Report 2018/19).

Our point is one of important principle; it is non-sectoral. However, as a trade body representing a particular sector, we have tried to ascertain, from the information in the consultation, how the proposals – if introduced – would be likely to affect our members.

Some have provided in confidence estimates of the likely financial impact. It is difficult to ascertain precise figures, not least because future complaints numbers are impossible to calculate, but we believe that the overall costs across the sector could be in the millions of pounds annually. As mutuals, which do not pay dividends to external shareholders, this would mean that our members’ own members and customers would indirectly foot the bill.

Regrettably, the Service no longer provides complaints data by way of sector (banks, building societies, insurers, investment firms etc), which makes it difficult to compile precise data per sector. However, if we look at our sector’s core business, mortgages, our sector accounts for 23% of all outstanding mortgages, but - as far as we can ascertain from Service data - for only 10% of new mortgage and home finance complaints received by Service in H2 2018.

Our members are part of the deposit acceptors/home finance fee block I001 ¹, which provides 39% of the levy in 2019/2020. Of course, this includes other firms, such as banks, but

nonetheless this block is by far the major levy contributor; the next highest being general insurance mediation (I017) at 14.9% and general insurers (I002) at 12.0%.

To illustrate our point about costs, we have created a relevant table, similar to those included for the different options in the December 2018 consultation paper, but absent from the current consultation –

Case fee		FCA levy	
50%		50%	
what are the advantages?	what are the disadvantages?	what's the impact?	
<ul style="list-style-type: none"> Income is received when the Service closes the number of complaints from non-group fee firms, so it can respond more quickly to increased demand. The Service's work resolving complaints at an earlier stage, before they become 'chargeable', is better funded. Firms, especially large ones, have a clearer idea of financial impact. <p><i>But, all these issues could be addressed by flexing the contractor workforce</i></p>	<ul style="list-style-type: none"> Potentially significant reduction of the principle that a firm pays relative to the amount of complaints it is responsible for. Diminished incentive for firms to reduce complaints, because of expansion of the levy. Also a potentially significant reduction in the arrangement's proportionality to the costs and complaints generated by each firm. 	type of firm large firm medium-sized firm small firm	possible impact pays less than before in comparison to other firms, despite (due to scale) having a much higher number of complaints pays more than before compared to large firms, due to operating in one industry block (despite generating lower volumes of complaints) pays more on the general levy and has reduced 'free' cases (10 down from 25).

Based on the proposals and the information provided in the chart on page 12, we believe that the levy payment would increase to nearly four times the amount over five years (from £24m in 2018/19 to £93m in 2022/23) despite the expected decline in cases, as follows in the chart on the next page.

Year	Estimated from Chart on page 12				Assuming 50% reached in 3 years	
	Cases	Income (£000s)	% change in cases	% change in income	Income from levies	...as % of total income
2018/19	392,000	249			24	10%
2019/20	460,000	297	17%	19%	45	15%
2020/21	280,000	275	-39%	-7%	74	27%
2021/22	205,000	200	-27%	-27%	76	38%
2022/23	175,000	185	-15%	-8%	93	50%
2023/24	175,000	185	0%	0%	93	50%

Year	Estimated from Chart on page 12				Assuming 50% reached in 2 years	
	Cases	Income (£000s)	% change in cases	% change in income	Income from levies	...as % of total income
2018/19	392,000	249			24	10%
2019/20	460,000	297	17%	19%	45	15%
2020/21	280,000	275	-39%	-7%	102	37%
2021/22	205,000	200	-27%	-27%	100	50%
2022/23	175,000	185	-15%	-8%	93	50%
2023/24	175,000	185	0%	0%	93	50%

Year	Estimated from Chart on page 12				Assuming 50% reached in 1 year	
	Cases	Income (£000s)	% change in cases	% change in income	Income from levies	...as % of total income
2018/19	392,000	249			24	10%
2019/20	460,000	297	17%	19%	45	15%
2020/21	280,000	275	-39%	-7%	138	50%
2021/22	205,000	200	-27%	-27%	100	50%
2022/23	175,000	185	-15%	-8%	93	50%
2023/24	175,000	185	0%	0%	93	50%

For the reasons set out above, we believe that the 50/50 proposal would contravene the following Service principles for funding; ie that it should –

- be fair
- be broadly proportionate – that is, the cost to firms broadly relates to the workload they generate for the Service, and
- create no perverse behavioural incentives.

Indeed, in his report on the Service (page 25) Mr Lloyd said that the principles for funding should not only be fair but also “*broadly proportionate (costs relate to the workload users generate for the FOS)*”. Mr Lloyd also said -

“Based on this analysis, the FOS and FCA should consider consulting on a levy funding structure for the FOS that is based on the risk that firms bring to the market through their unfair treatment of consumers as presented by complaints that are not resolved before they reach the FOS. This would more strongly incentivise firms to change their behaviour and remove any perception that case fees inappropriately influence decision making at the FOS.”

It appears that the Service’s proposals are seriously out of alignment with these aspects of the Lloyd Report.

We presume that the Service would have prepared an impact statement on its proposal. If so, the Service should make this available. We believe that any impact statement should –

- consider costs to different sectors on current claims projections.
- examine projections based on a future mass claims episode. Alternatively, given that no one can predict the future, the Service could examine the impact of the 50/50 proposal had it been in effect over the last 5 years or so (ie the peak of PPI claims). *What impact would that have had on the five firms with the largest number of PPI complaints to the Service in respect of Service funding over that timeframe?*

While we appreciate that this is not a direct matter for the Service, we repeat for background completeness the relevant comments from BSA’s response in May 2019 to the FCA’s consultation on regulated fees and levies 2019/20 (CP19/16) -

“The FOS general levy is paid by all firms authorised or registered by the FCA, including those that have not had any cases referred to the Financial Ombudsman Service. The levy is calculated using industry blocks, which are similar (but not identical) to the FCA fee blocks. Building societies are covered by the 1001 industry block, deposit acceptors, home finance lenders and administrators. In 2019/ 2020, 39% of the levy comes from this block. This high percentage explains our interest in the levy.

The general levy for 2019/2020 is £44.5 million, a steep rise of 82% from £24.5 million in 2018/ 2019. Reasons given for the £20 million increase include: recovery of previous year’s overspend, two new areas of complaints - SMEs and CMCs - and a “scale up” to meet increasing demand and change in product mix.

We did question the increased budget in our response to FOS’s strategic plans and budget for 2019/ 2020. We pointed out that many firms did not have SME customers. This is certainly the case for most building societies.

Not wholly clear is why £11.3 million is needed for a “scale up”. Our understanding of the current model is that, aside from every firm’s 25 “free” cases, the “polluter pays” principle applies ie above the 25th case, the firm pays a case fee, currently £550. We have always supported that principle. But the proposed use of the levy for the “scale up” seems to suggest this principle has been watered down, or even abandoned. If so, this would be a matter of considerable concern.”

While we recognise that the fee blocks are a matter for the regulators, rather than the Service, it is relevant to point out that the BSA has stated the following to the PRA and the FCA -

“The tariff basis for the A.1 deposit takers class is modified eligible liabilities, roughly UK deposits. The A.1 category includes building societies and banks. While we understand the PRA requires an expedient and clear metric, modified eligible liabilities is an indiscriminate and blunt measure of risk or impact. It has a disproportionate effect on domestic deposit takers such as building societies, which by their nature tend to have high levels of MELs

While the very largest societies’ size and customer base mean they are systemically important, they operate a lower risk business model, compared to many banks. In part, this is due to restrictions imposed by the Building Societies Act 1986 and to the PRA’s supervisory statement on building societies’ treasury and lending activities . But in the main, this lower risk model is a result of societies’ – in common with all mutuals - desire to serve their members with straightforward, well-designed, low cost products.”

The BSA’s view is that it could be appropriate to decouple building societies from big banks and consider a more proportionate tariff for them, one that reflects their lower risks and domestic focus.

2. ‘Free’ cases

‘Free cases’ are important to smaller firms, which because of their scale, receive small numbers of complaints and which sometimes benefit from the level of free cases. They contribute to the levy, of course, so this is by no means a ‘free ride’. However, like all firms, they are increasingly subject to ‘speculative’, ill thought-out (and sometimes large-scale) claims by some CMCs, solicitors, representative bodies etc.

The savings to the Service by reducing the number of ‘free’ cases for non-Group firms are small (£4.5 million – page 20 of the consultation paper) compared to the potential costs savings that could be made, at an appropriate point in future, by releasing contractors (at least £60 million – please see below).

Many firms, including the BSA’s members, work hard to resolve complaints so that they do not have to go to the Service. This is very much in the best interests of customers. One of our members explained the point as follows –

“We have very few cases which ever reach FOS as we spend time in researching and responding appropriately to avoid them going to the next level. Unlike other firms, we are taking the cost hit internally already in defending earlier in the process to prevent things escalating. We therefore feel that being asked to contribute more for a service which we make an effort to prevent unnecessary referrals to, is disappointing.

We are aware that a number of the larger organisations put very little effort into their earlier defence and have much deeper pockets, therefore allowing a greater % to refer to FOS and action at that point. They should therefore be paying the larger share of the overhead costs for the caseworkers required by FOS to handle their compliant volumes.”

Other members have made essentially the same point.

We strongly urge the Service to drop this proposal, which is (a) unnecessary and (b) would adversely affect the firms that generate the fewest complaints, while helping those that generate the most.

Practical suggestions

- **Timing**

The Service has made it clear that the next few years are likely to be uncertain for a number of reasons. These include the PPI deadline (but with a potentially lengthy pipeline ‘tail’) and lack of clarity about precisely what types of complaints will arise in future and their complexity.

In view of such uncertainty, it would surely be better not to make fundamental changes to the funding arrangements until a clearer picture had emerged. There are certain shorter-term mitigants that the Service could put in place to help its funding (please see below).

- **Case fee collection**

Page 14 of the consultation notes the operational problem in collecting case fees after the case is closed. In particular, the arrangement makes it hard for the Service to scale-up and respond to increases in the demands placed upon it. Therefore, it would surely be much better from a cash flow perspective to collect the fee when the complainant refers the case to the Service.

- **Levy changes**

One of our members suggested the possibility of a funding model that charged a ‘management levy’ for non-volume related overheads, with a charge of 100% for case-driven expenses to case fees.

Another member has floated the possibility of tiered case fees or tiered levy multiples based on the number of referrals to the Service. These options might involve predetermined thresholds for referrals to the Service that, once exceeded, would attract a higher cost per relevant account or unit of income.

We have not had time to consider such options in detail, or to canvass other BSA members about them, but we may now do so as part of our wider examination of the funding model (please see below)

- **Contractors**

Apart from a brief mention of contractors on page 16, the paper is silent on the matter. What plans does the Service have for laying-off contractors once the PPI deadline has passed and the pipeline cases have diminished? Would these not be capable of fully addressing the Service’s concerns about future funding? Presumably what the Service’s Chief Executive suggests in her introduction as a “*smaller organisation in future*” does not require large numbers of PPI complaints contractors?

Indeed, the Service’s most recent Annual Plan and Budget (2019/20) made it clear that it planned to use its contractor workforce to respond flexibly to demand. The consultation paper states that “*We’ve also continued our strategy to increasingly use a contractor workforce to manage our PPI workload and volatility in demand for our service more generally.*”

The theme continues in the Service’s Annual Report 2018/19, which states that –

- *“Our current approach - which we will continue into 2019/20 – is to use our contractor workforce to ensure we can respond flexibly to demand . . .”* and
- *“we’ve continued our policy of increasing the use of our contractor workforce, rather than recruiting permanent headcount.”*

The Annual Report also states that *“As at 31 March, 60% of our case-handlers in our areas of mass claims were contractors (51% in 2017/18).”*

We note from the Service’s Accounts that the costs to the Service of contractors increased from £41million in 2018 to £62million in 2019. The Service plans further significant increases (more than double in two years - see table below). **Surely this can work the other way when complaints fall? Otherwise what is the point of utilising contractors?**

Does the Service consider ‘flexibility’, in relation to contractors to be a one-way street – *ie recruitment only?* If not, why is it not ready to use the considerable flexibility in this area to address its funding issues, instead of moving to an arrangement that seems to be based on the principle of the polluter paying much less?

It might be argued that it is not necessarily easy to recruit large numbers of contractors at very short notice should the need arise in future due, say, to some new mass mis-selling episode. However, complaints concerning mass claims tend to have a fairly gradual gestation before reaching a peak; for example, as we saw from mortgage endowments and PPI.

Indeed, the fact that the Service has recently increased its recruitment of contractors considerably and has plans to continue doing so (see paragraph above), despite already having a very large contractor workforce, proves the proposition that it is perfectly possible logistically to recruit large numbers of contractors.

We understand that many contractors recently moved to the separate premises in Coventry referred to on page 16 of the consultation. While we appreciate the cost savings resulting from this relocation from more costly London premises, this is presumably only a temporary measure given the impending PPI deadline and the eventual tailing off of PPI cases (which we recognise will take some time). This leads to certain questions -

- how many contractors are based in Coventry?
- how long is the lease on the Coventry premises?

The Service’s 2019/20 Strategic Plans and Budget (page 32), largely consistent with the Service’s recently published Annual Accounts, disclosed the following –

Expenditure	2017/18: actual (£m)	2018/19: latest forecast (£m)	2019/20: provisional budget (£m)
Staff and staff-related costs	156.0	169.2	175.7
Contractor staff	41.6	62.5	101.1

As the Service's data makes clear, its expectation is that costs on contractor staff, who as we understand it mainly work on PPI, will have more than doubled between 2017/18 and 2019/20. On current calculations, the cost of contractors for 2019/20 would be about 57% compared to established staff costs **and more than 30% of the Service's total expenditure (of £332.2 million)**.

This position can surely be accounted for only by the PPI pre-deadline 'spike' and subsequent 'tail'. Following this, even if contractor costs and levels went back only to the 2017/18 level (and one would expect them to be much *lower* than that given the end of the unprecedented PPI complaints), the Service would save at the very least £60 million.

In view of these figures, the ability to lay off contractors should provide the Service with considerable flexibility in terms of its costs – something that, as noted above, the Service has alluded to a number of times and presumably will become a significant reality post PPI.

- **Claims firms**

We have previously advocated that claims firms, as businesses making a profit out of claims, just as all regulated firms are businesses that make a profit out of the activities that sometimes lead to complaints, should pay case fees.

Over several years, various regulators have had to provide numerous warnings or reminders to claims firms about their approaches to making complaints and their conduct (for example, there were several communications from the Ministry of Justice, and more recently from the FCA [here](#) and Solicitors Regulation Authority [here](#) and [here](#)). The Financial Ombudsman Service itself has issued similar notifications, for example [here](#).

The fact that such warnings have continued to be made over a lengthy time suggests that something more needs to be done. The prospect of paying a case fee would concentrate the minds of the less scrupulous claims firms. We recognise that this is not a matter that the Service could decide but, if the relevant change were made, this would also help with the Service's funding.

Funding model

Especially in the light of the 50/50 proposal, we are not convinced that the current model for allocation of fees is fair and proportionate. We refer to some issues above.

It is interesting to note that complaints about consumer credit products now represent one in three of all non-PPI complaints referred to the Service. Indeed, the Chief Ombudsman states in her foreword to the Service's Annual Report 2018/19 that such complaints have risen by 89%. Most of our members do not offer consumer credit products. It is early days and, at this stage, we are simply flagging up that we need to consider the impact of the Service's proposals, among other things, against the distribution of compulsory jurisdiction (CJ) levy for relevant businesses.

Again, we appreciate that this is not directly a matter for the Service. However, the CJ levy is based on the Financial Ombudsman Service's forecasts for the proportion of resources that it expects to devote to cases from firms in each sector over the next financial year. Therefore, it

is very relevant background to the consultation. It may be that there needs to be a radical re-alignment and we are taking views from our members.

FOOTNOTE

- 1 The Financial Ombudsman Service general levy is paid by all firms authorised or registered by the FCA, including those that have not had any cases referred to the Service. The levy is calculated using industry blocks, which are similar (but not identical) to the FCA fee blocks. Each industry block has a minimum levy and, in most cases, the levy then increases in proportion to the amount of "relevant business".

Building societies are covered by the I001 industry block include deposit acceptors, home finance lenders and administrators and dormant account fund operators. In 2019/20, 39% of the levy comes from this block. For I001, the proposed rate is £0.07095 per relevant account, up from £0.04388, subject to a minimum levy of £100. The definition of "per relevant account" is number of accounts relevant to the activities in [DISP 2.6.1R](#) as at 31 December.

The Process

In its *strategic plans and budget* paper, published on 17 December 2018, the Service set out a number of options for its future funding to which the BSA responded on 30 January 2019.

The Service’s December 2018 consultation was a detailed paper that examined three separate time horizons and then, in respect of future funding, set out examples of four separate possible options (a control option and options 1, 2 and 3 – see below). The consultation carefully provided a note of suggested advantages and disadvantages of each possible option, together with a further note of the possible impact on different types of firm.

The BSA welcomed the attention to detail in the December paper and the logical consideration of the different alternatives. The FCA, from the point of view of its own responsibilities regarding funding, published further relevant information in PS19/19 in April 2019 (chapter 6) in respect of which the BSA had also responded.

It is therefore very disappointing that the July 2019 paper provides limited information about the Service’s process in arriving at some of its key conclusions/proposals, including more detailed information about the feedback it received, especially as the paper rejects all the options canvassed in the earlier consultation and recommends an entirely new one; ie –

Funding options examined in December 2018 paper	Funding option recommended in 2019 paper
Control option (current position) – Case fee: 85% / Levy: 15%	Case fee: 50% / Levy: 50%
Option one – 100% via the levy	
Option two – Case fee: 45% / Levy: 15% / new risk-based levy: 40%	
Option three – Case fee: 50% / new risk-based levy: 50%	

We recognise that page 19 explains why the Service has decided not to move towards a risk-based levy model – indeed, our response explicitly recognised the practical difficulties in developing an explicit risk-based approach. Having said that, insurers are well used to risk-based models in making their actuarial calculations and they tend to work effectively.

In principle, a risk-based model for the Service’s funding should not be impossible; for example, based on an extension of the ‘polluter pays’ concept, ie the number of complaints and upholds per firm in the previous year. Naturally, a firm’s contribution could be adjusted as a firm’s complaints profile reduced or increased. Therefore, we do not believe that the possibility of a risk-based approach should be taken off the table permanently.

We also appreciate that page 16 provides a little more information about the Service's Horizons programme, although it does not set out the feedback that the Service received on it. We also note that the Service's Annual Report 2018/19 contains further information on the Horizons programme.

However, while pages 17 - 18 of the consultation briefly outline general feedback at very high-level, the paper provides little real insight into the representations that helped persuade the Service to move away from the proposals in the December 2018 paper and, instead, introduce a brand new option.

In its *code of practice on consultation* [here](#), the Government set out seven consultation criteria including the following –

- *“Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible”,*
- *“Consultation documents should be clear about ... the expected costs and benefits of the proposals” and*
- *“Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.”*

We believe that this consultation fails to meet each of these criteria and, accordingly, is seriously deficient from a process perspective in terms of timescale, cost-benefit analysis, and feedback. We summarise key concerns and questions as follows –

1. Why was 50/50 case fees/levy not considered in the earlier paper?
2. Why does the paper give us almost no insight into different groups of respondents' comments about the options (as would typically appear, say, in FCA feedback)? The consultation papers says *“We've carefully considered the options, and the feedback we've received”*. Can we please have some information about that feedback and how it influenced the Service's considerations? For example, does the 50/50 proposal align with representations from the big banks? What did others say about funding proposals?
3. We believe that it would have been appropriate for the July 2019 consultation to have set out, for the 50/50 (case fees/levy) funding proposal, the kind of notes of potential advantages and disadvantages, and possible impact on different kinds of firms, that the earlier consultation contained in respect of the four options it identified. In its absence, the BSA has prepared such a note – please see above.
4. In addition, it would have been very helpful if the paper could have –
 - (a) contained information about the likely increased costs or savings to individual sectors if the proposals were carried forward, even if only in broad terms, and
 - (b) to have explicitly considered the potential moral hazard in moving away from majority funding by case fee.

5. Furthermore, better explanation of how the Service is using the extra £11.3million on the levy for 'scaling up' would have helpfully informed the consultation. (Page 23 of FCA PS19/19 provided high-level information, but it would have been useful if the Service had provided a more detailed update.) This is, of course, in addition to the costs of adjudicating complaints by SMEs (£5 million) and CMCs (£2.2 million), and under-collection of the previous year's levy (£1.5 million). Such information is important background in view of the 50/50 proposal. Could we now have information on what the £11.3million scale-up costs comprise please?
6. We do not understand why the consultation does not explain clearly whether, and how, the Service plans to leverage the considerable costs flexibility that its large contractor PPI workforce provides it. We commented on this point in detail above.
7. As already noted, we have an observation about the timing of the consultation; ie 6 weeks, from 2 July to 13 August. Especially when set against the lack of detailed explanation (see above), we believe that it is poor practice to consult - over a 6 week period some of which overlaps Summer holidays - on a brand new option that could have adverse financial consequences for many firms and could carry moral hazard.

In view of the time that the Service has had to prepare the paper (the deadline for responses to the previous consultation was 31 January), and the long-term implications of its main proposal, we believe that it should have contained much more detailed explanatory material and allowed consultees a full three months to respond. We believe that this represents poor process.

8. We respectfully urge the Service to be much more explicit on the above points in its feedback on the current consultation than it was in respect of the previous one, and going forward to permit more time for the firms that fund the Service to consider radical funding proposals. Will the Service agree to this?
9. We are left with the impression that the key consideration underlying the consultation is the operational benefit of the Service, possibly aligned with the interests of large firms, rather than the interests of the majority of the firms funding it and, most important, the moral hazard (ultimately harmful to consumers) potentially created.
10. As we explained above, our concerns about poor process are not mere points of procedure. Indeed, in addition to the overriding moral hazard point above, the proposals if implemented, could lead to a situation where – in effect – our members' customers and members (and customers in some other sectors comprising small and/or medium-sized firms) subsidise –
 - (a) the big banks, that are responsible for the large majority of complaints,
 - (b) an over-resourced* Financial Ombudsman Service, and
 - (c) claims companies that earn large profits from complaints but do not pay case fees.

*assuming that it does not significantly reduce its contractor workforce at an appropriate time.

Questions from the Service

Question 1

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

BSA response – We provided some information in response to a similar question in the December consultation (please see pages 4-5 and 8-9 of our response [here](#)).

PPI remediation currently stands at £35.7 billion (details [here](#)). This level is unprecedented and dwarfs all previous mis-selling redress. Our sector had limited exposure to this matter - most PPI sold by BSA members having been, generally cleanly sold, mortgage PPI. While no one has a crystal ball, it is difficult to envisage anything comparable to PPI complaints in the near future.

We are seeing quite large numbers of pre-deadline PPI complaints from organisations representing, or claiming to represent, insolvent and deceased individuals – these last minute interventions are adding to the pre-29 August 2019 ‘spike’. Some appear to be highly speculative and subject to poor, or no, due diligence. Some members have received increased numbers of complaints in relation to investments, and we are also seeing numerous DSAR requests relevant to other areas (please see our response to Question 2, below)

Question 2

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

BSA response – We know that some claims firms are submitting large numbers of speculative DSARs in order to try to find some way to buoy up their profits in the absence of PPI. Many appear to be in the context of mortgage sales or contracts. In some cases, these firms trail a range of legal arguments, many of which are complex, unsubstantiated, dubious or make no sense at all. The SRA has struck off at least one solicitor engaged in mortgage claims, and the ASA has recently banned a relevant TV advertisement from a claims management company.

The DSARs will undoubtedly lead to complaints (however dubious some may be) in the near future, and we do not seek to underestimate the potential workload for firms and the Service, but we doubt if many of those complaints will be sustainable long-term.

As we have stated before, new complaints could accompany Open Banking as it develops. Clearly, there is as also much public attention on investments, wealth management etc. However, our sector mainly provides individuals with mortgages and savings products, so that is where the BSA has relevant experience. Unless there is a major source of mass complaints in a sector that we are not familiar with, we believe it likely that the Service should, broadly speaking, be able to return to business as usual over the next few years – ie once PPI complaints end and speculative attempts by claims firms to replace that source of income diminish.

Question 3

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

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

BSA response – The BSA has always been a strong supporter of the Service and the work that it does, including many of its wider activities – see, for example, page 9 of our response to the December consultation. Like any other organisation funded by third parties, the Service should be mindful to act within the reasonable limits of its purpose (in the case of the Service, as an independent adjudicator of complaints).

In terms of wider work to prevent complaints, some of our members have remarked that they undertake this kind of work themselves as a matter of TCF, without needing to involve the Service.

Although not directly related to complaints, we also note the worthwhile initiatives set out in the Annual Report concerning the environment, equality, corporate social responsibility and other matters.

We have nothing further to add at this stage.

Question 4

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

BSA response – We have made a number of comments in the section headed 'Practical suggestions' above. The key point for us is for the Service to utilise the flexibility provided by its large contractor workforce, when appropriate in a *downward* direction – just as in recent years it has moved, and continues to move, in an upward direction where the need exists. However, collection of case fee upfront would also provide greater stability/foreseeability.

A BSA member commented as follows –

"We would welcome any improvement in the management of workflow at FOS which would prevent us receiving chases for information that we have already provided.

We would also welcome notification of a complaint referred to the Service at the time it is referred to them rather than when they have everything they need from the customer (which can sometimes take a number of months). This would enable us to prepare our case file in readiness for a FOS request."

Another BSA member made the following comments –

"[The Society] would appreciate more detailed guidance from FOS on its expectations in regard to trouble and upset/distress and inconvenience payments and some thresholds around what is a material difference in payment from what the firm considers and what FOS considers. We understand the subjective nature of this assessment but believe that by aligning as far as possible our approach with FOS expectations this will not only reduce the number of overturns, but potentially reduce the level of work required on each case. We believe these thresholds should begin at a difference of over £100.

[The Society] deals with complaints in a prompt and courteous manner and whilst we continue to believe that the service FOS provides should be free for the customer we are aware that some CMC's may use this to elevate groundless complaints. We would therefore appreciate greater co-operation in dealing with those organisations that use the service in this way and don't have consumer's best interests at heart."

Question 5

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

BSA response – For reasons set out above, we strongly oppose this retrograde suggestion. The proposal, if implemented, would lead to moral hazard and – in effect – to our members' customers and members (and customers of other sectors comprising small and/or medium-sized firms) subsidising –

- the big banks, that are responsible for the large majority of complaints,
- an over-resourced* Financial Ombudsman Service (* ie if contractors levels remain unchanged even when complaint numbers fall significantly), and

- claims companies that earn big profits from complaints but do not pay case fees.

Question 6

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

BSA response – As explained above, evidence of the Service’s careful consideration of certain key aspects was absent from the latest consultation paper. The BSA believes that there are strong reasons to retain the *status quo* for the time being. However, as noted, we have made a number of practical suggestions in the section headed ‘Practical suggestions’ above intended to mitigate cost pressures on the Service.

Question 7

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

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

BSA response – For reasons set out above, we disagree with (a) – it is unnecessary.

(b) will be relevant to few BSA members but, to be consistent with (a), we do not support it.

Question 8

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

BSA response – It seems sensible in principle to work towards this position provided it does not have a significantly adverse effect on the firms that fund the Service. However, it should be borne in mind that, as we pointed out above, mass claims are usually slow to gestate towards their peak and the Service has great costs flexibility because of its large contractor workforce.

Question 9

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

BSA response – We have very serious concerns about the Service’s timing and processes on this matter – all set out above. We believe that the Service should maintain the *status quo* until the post-PPI picture becomes clear.

Question 10

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

BSA response – As noted, we are not convinced that the current model for allocation of fees is fair and proportionate. We refer to some issues above. It is interesting to note that complaints about consumer credit products now represent one in three of all non-PPI complaints referred to the Service. Most of our members do not offer consumer credit products.

It may be that there needs to be a radical re-alignment – indeed, the 50/50 proposal in the consultation has prompted us to take views from our members and give consideration to the possibility of making formal representations to the FCA.

It may well be that building societies should be uncoupled from the big banks in terms of the funding model. This is among the possibilities that we have been prompted by the consultation proposals to explore further.

Questions to the Service

For completeness, these are the key questions in this response that we have asked the Service. We would appreciate a response from the Service on each of the questions –

1. Why was 50/50 case fees/levy not considered in the earlier paper?
2. Why does the paper give us almost no insight into different groups of respondees' comments about the options (as would typically appear, say, in FCA feedback)?
3. The consultation papers says *"We've carefully considered the options, and the feedback we've received"*. Can we please have some information about that feedback?
4. For example, does the 50/50 proposal align with representations from, or on behalf of, the big banks?
5. What did others say about funding proposals?
6. We presume that the Service would have prepared an impact statement on its proposal. If so, could the Service make this available?
7. We believe that any impact statement should consider costs to different sectors on current claims projections, and examine projections based on a future mass claims episode. Given that no one can predict the future, why not examine the impact of the 50/50 proposal had it been in effect over the last 5 years or so (ie the peak of PPI claims). What impact would that have had on the five firms with the largest number of PPI complaints to the Service in respect of Service funding over that timeframe?
8. We respectfully urge the Service to be much more explicit on the above points in its feedback on the current consultation than it was in respect of the previous one, and going forward to permit more time for the firms that fund the Service to consider radical funding proposals (thus, aligning with good practice). Will the Service agree to this?
9. Could we now have information on what the £11.3million scale-up costs comprise please?
10. Apart from a brief mention of contractors on page 16, the paper is silent on the matter. What plans does the Service have for laying-off contractors once the PPI deadline has passed and the pipeline cases have diminished?
11. Would these not be capable of fully addressing the Service's concerns about future funding?
12. Does the Service consider 'flexibility', in relation to contractors to be a one-way street – *ie recruitment only*?
13. If not, why is it not ready to use the considerable flexibility in this area to address its funding issues?
14. Presumably what the Service's Chief Executive suggests in her introduction as a *"smaller organisation in future"* does not require large numbers of PPI complaints contractors?
15. How many contractors are based in Coventry
16. How long is the lease on the Coventry premises?

By Chris Lawrenson MBE
Head of Legal Services
chris.lawrenson@bsa.org.uk
020 7520 5915

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

BSA EU Transparency Register No: 924933110421-64

www.bsa.org.uk

The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £400 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.