Jim Shannon MP
Constituency Advice Centre
34a Frances Street
NEWTOWNARDS
BT23 7DN
Tel: 02891 827990
Fax: 02891 827990
Jim.shannon1@btopenworld.com

FCA/Consultation CP18/31

Consultation on SME access to the Financial Ombudsman Service and Feedback to CP18/31 : SMEs as Users of Financial Services - Response Thursday 6 December 2018

Submission by: Jim Shannon MP for Strangford (Democratic Unionist Party – DUP)

I confirm that this Response to the Consultation may be posted on your FCA website as one of the public responses to the Consultation shortly after 21 December 2018.

1. Background - can I provide two extracts from my / our DUP original submission to the CP18/3 Consultation on 20 April 2018.

"In short I believe we cannot allow the FCA to ignore past banking victims and that **SMEs should have the CHOICE of options in seeking redress within two parameters (in addition to commercial court) :-**

1. Within **FOS** with an expanded remit for claims / awards of up to £500,000 for businesses which are currently trading. This implemented after any further appropriate training and resourcing, management and governance reviews in FOS. I believe that the overall principle of providing a "fair and reasonable" solution is an appropriate ADR mechanism and it is a matter of implementation and culture – not more law.

OR

A "Financial Services Tribunal" as proposed by The APPG Fair Business Banking. We understand that this proposal is predicated on Employment Tribunal principles and I believe should be available for any claims of £10,000+ for those SMEs which continue to trade AND for those SMEs and Guarantors which have been the subject of insolvency or bankruptcy proceedings. This solution is quasi-judicial and is the most appropriate for the highest value complaints."

"Questions posed by the Consultation CP18/3

ADDITIONAL QUESTIONS/POINTS

(A) AWARD LIMITS: Although in para 4.17 the FCA state "We have powers to change the limit on the awards the Ombudsman can make within its compulsory jurisdiction. The current limit of £150,000 was increased from £100,000 in 2012" we do not see any question seeking our views on this subject although the FCA Consultation sets out some perspective from Paragraphs 4.17 to 4.33.

In the FOS FOI 2803 reply dated 26 September 2017 the FOS stated at page 3 "*In regards to questions 7, 8 and 9, our statutory involvement in a complaint ends once we've issued a final decision and so we do not monitor the degree to which a business pays compensation out to a consumer, or if they pay over our award limit. This means that we would only hold this information if the parties to the complaint got back in touch with us and manually reviewing this would exceed the appropriate limit. However, I would like to assure you that if the complainant gets in touch to say that they have not received the award, we would first raise this with the individual business and then with the FCA, which can use its regulatory powers to make a financial business pay the award up to our award limit.* "

We do believe that on balance it does make sense as the FCA say at paragraph 4.23 that the award limit available to the Ombudsman should be increased to £500,000 including direct consequential losses and that it remain within a "fair and reasonable basis" process . **In our view this should happen immediately for these cases and the FOS should have the task in the public interest of ensuring they follow up and know what the Banks actions have been.**

We did note with interest (FOS FOI 2383) that in the larger mis-selling complaints for fixed rate commercial loans and mortgages that out of the 21 cases at the FOS, that had an award of £75,000 or over, two were made by an Ombudsman while the rest were resolved informally between the parties without a formal Ruling. However I do believe that if the eligible complainant believes their claim is more than £500,000 including consequential losses then this should NOT be within the FOS process. Instead the complainant should pursue through the proposed Financial Services Tribunal process.

We believe that with the relevant powers of disclosure and appropriate training/number of competent resources within the FOS AND that the SMEs have the option of choosing to seek redress in the FOS OR via Financial Services Tribunal OR Court then the parties to the highest value complaints might properly expect the basis for decision making and the investigation process to more closely resemble those of a court – for example a Tribunal with hearings etc i.e. if their Claim is more than £500,000."

End of extract

I don't propose to answer the individual questions posed in the Consultation and simply want to relay in writing the evidence and policy position conveyed to your FCA Policy team in the Thursday 15 November 2018 meeting when we provided our formal feedback on the PS18/21 document issued by the FCA in October 2018.

Our response follows the release of reports into dispute resolution for businesses in the UK from the Treasury Select Committee (TSC), Simon Walker, the Financial Conduct Authority (FCA) Policy Statement PS18/21 and the APPG on Fair Business Banking's Fair Business Banking for All report.

To summarise we support the position of Simon Walker in his report dated 23 October 2018 recommending a compensation level of up to £600,000. That is also consistent with the APPG for Fair Business Banking in its Position Paper dated 14 November 2018. As recorded earlier in our April 2018 submission we now recommend that the paragraph should now read …….

"We do believe that on balance it does make sense as the FCA say at paragraph 4.23 that the award limit available to the Ombudsman should be increased to **£600,000** <*our April 2018 CP18/3 submission was £500,000*> including direct consequential losses and that it remain within a "fair and reasonable basis" process. **In our view this should happen immediately for these cases and the "Ombudsman" <was *FOS*> should have the task in the public interest of ensuring they follow up/ and know what the Bank actions have been."**

We also recognise that the minimum value for a Claim to Financial Services Tribunal should be raised from our initial submission of £10,000 to £25,000 in page 1 of my letter.

As you know from our prior Submission/ November briefing we believe that trading companies should have the choice of whether they proceed to Ombudsman or Financial Services Tribunal processes.

For completeness I have had the opportunity to review the UK Finance 18 page document dated 30 November 2018 last Friday and again over the weekend and have noted two specific points which I would like to comment on.

(1) On Pages 3 and 9 : Access to an appropriate Ombudsman scheme for SMEs with turnover between £6.5m and £10 Million and a balance sheet up to £7.5m. I note the increase from the £5m in the FCA PS18/21 to balance sheet of £7.5m in the UK Finance document.

(2) In relation to the Compensation Awards levels from the Ombudsman for historical cases it would seem that the UK Finance are proposing £350K for those in the compulsory jurisdiction (p6) whilst £600K (P.9) for those eligible complainants in their "proposed voluntary jurisdiction. I share Simon Walker's view (and the APPG – FBB proposal) that £600,000 should be the level for all historical and future complaints – subject to inflation going forward) as I can't see the logic or indeed ethics for any difference other than an effort to potentially reduce the Banks financial exposure.

I consider that the FCA should take the opportunity to amend their PS18/21 document when finally issued as complete for implementation to amend the turnover and balance sheet values upwards and the compensation award levels in the compulsory jurisdiction in their final document.

Indeed HMG will need to consider the Regulatory Perimeter very carefully, in its response to the TSC Select Committee report on SME Finance in October 2018, and its interaction and relationship / to FoS : Ombudsman solutions and the compulsory and voluntary jurisdictions.

I understand your CEO Mr Bailey also received directly from the APPG for Fair Business Banking their Position Statement 14.11.18 in advance of all MPs receiving same on 23 November 2018. It includes

- The APPG supports the FCA's proposals[1] to create a separate, ring-fenced, specialist unit to handle complaints from SME customers. Any specialist unit that is set up must not be staffed by the current staff from the FOS. (Annex P.8) A clean break and fresh start are required. The FCA should place this unit within its own remit, separate from the FOS.

Following all the research and analysis since I began this journey in August 2017 I want you have on the record my 100% support for this unit being within the FCA remit and given the "adjudication powers" to do so. Amongst other things this will reduce the confusion of many complainants between the FOS and FCA (such as my constituents the Armstrongs), the data collation / information exchanges would be within one organisation and crucially only 1 in 10 SME Banking cases – from the FOI evidence and this FCA Consultation point to less than 10% of cases being adjudicated. In the first instance it appears that the FOS look to avoid the case being eligible and then the balance of power – not evidence – between the parties in determining their actions /decisions. To propose to take on historical cases within the voluntary jurisdiction by FOS is ill-judged and certainly not in public interest/credible.

The TIMES correctly reported on Monday 3 December 2018 **part of my Statement** last Friday to them

'Although the UK Finance report represents a step forward in their Submissions on SME Finance to the TSC in March 2018 and the FCA Consultation on an expanded remit for FOS in April 2018 I would be concerned that the excellent points made by the TSC, in their SME Finance Report in October 2018, in relation to the past and future regulatory perimeter for SMEs **and the value of a complementary Tribunal process have been excluded from UK Finance considerations.**

This concern is compounded by the legitimate concerns of many SMEs about the independence of past bank-led redress processes, such as Griggs, Blackburn and dubious decisions by the FOS"

Jim Shannon

Jim SHANNON MP
Member of Parliament
Democratic Unionist Party
Strangford Constituency ***6 December 2018***

Circulation as per m y/ DUP Original Submission to the FCA CP18/3 Consultation

Copy Mr John Glen MP - Economic Secretary to the Treasury
Mrs Nikki Morgan - Chair and Members of the Treasury Select Committee

Mr Andrew Bailey - FCA Chief Executive
Ms Caroline Wayman - FOS Chief Executive and Chief Ombudsman

Mrs Heather Buchanan - APPG for Fair Business Banking

Additional Circulation

Mr Kevin Hollinrake MP - Vice Chair of the APPG – Fair Business Banking

Mr Stephen Jones - CEO UK Finance

Mr James Hurley – UK TIMES – as per my statement/quote – Friday 30th

(Also enclose copy of his TIMES article on Monday 3 December 2018)

Annex 1 - Relevant extracts from FCA CP18/31

1.20 In November 2018, the Oversight Committee will formally consider the ombudsman service's draft business plan and budget for 2019-20, ahead of the service's own public consultation. This will include looking at how the extension of the service to larger SMEs and others fits within the draft business plan and budget. The Oversight Committee will also consider the ombudsman service's progress towards meeting the recommendations made by Richard Lloyd's recent independent review (the 'Lloyd Review'). If, at that point, we are satisfied with the ombudsman service's preparations, we intend to make final rules on extending the service. We will most likely do this in December 2018.

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

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

2.4 The ombudsman service's awards are not made with reference to the award limit, but, as set out in FSMA, what the service 'considers fair compensation for loss or damage suffered by the com-

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

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

2.5 We last changed the award limit in 2012, when we increased it from £100,000. We said that, because the limit had not been changed since the ombudsman service was set up in 2001, the consumer protection provided by the service had declined in real terms. The increase to £150,000, effective from 1 January 2012, was based on general price inflation since 2001.

2.6 Our 2012 increase included an allowance for future price inflation to avoid the need for another review in the short term, as this could be costly for firms and confusing for complainants. While we were unable to say at the time how long the limit would be 'future-proofed' for, we have calculated that the value of the £150,000 award limit began to decline in real terms from 2015 onwards (using the CPI as the measure of inflation).

2.7 Of the 64 respondents to our consultation on the 2012 increase, around 80%, including most firms and trade associations who responded, accepted our argument for an increase in the award limit to maintain consumer protection in real terms.

2.8 We applied our 2012 increase to the award limit to all new complaints referred to the ombudsman service, including about acts or omissions by firms that occurred before the date the limit was increased. We did this because the increase was based solely on general price inflation and, as such, the award limit did not actually increase in real terms. Finally, we committed to reviewing the limit periodically, and adjusting it as necessary to ensure it kept pace with inflation.

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

Estimating the volume of high value complaints

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

2.17 Firstly, the most precise data we have on the amount of compensation recommended by the ombudsman service are for complaints determined by an ombudsman in a formal 'final decision'. Complaints decided by ombudsmen account for around 1 in 10 complaints resolved by the service, with the rest resolved informally at an earlier stage by adjudicators and investigators with the agreement of the parties. We have therefore assumed that complaints resolved by adjudicators and investigators have a similar distribution of agreed compensation payments as those resolved by ombudsmen (see Figure 2). The ombudsman service agrees this is likely to be a reasonable assumption.

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

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

2.21 Assuming firms currently only pay compensation for such complaints up to the current award limit then the shortfall for complainants with complaints with compensation between £150,000 and our proposed new limit of £350,000 – and, therefore, the aggregate financial harm – could be around £113 million per year. We have calculated this figure using the median of each money award range as the average money award in that range (see Figure 3).

Interest rate hedging products

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

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

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

Example: Interest rate hedging products

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

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

Wider effects and potential unintended consequences

Impact on the Financial Ombudsman Service

3.19 We recognise that if the ombudsman service has the power to require firms to pay substantially higher amounts of compensation, stakeholders may want to be confident it has the skills and expertise to decide such complaints fairly and reasonably.

3.20 However, there is currently no limit on the amount of compensation that the ombudsman service can recommend – and the grounds the service has for refusing to deal with a complaint are rather limited (DISP 3.3.4A). So, the award limit should not, in principle, have any bearing on the skills and expertise needed by the service. The ombudsman service should already be ensuring it has the skills and expertise necessary to determine any complaint from currently eligible complainants quickly, with minimum formality, and with reference to what, in its opinion, is fair and reasonable in all the circumstances of the case.

3.21 Further, it is not self-evident that the value of a complaint is strongly correlated with its complexity. For example, other things equal, a complaint about a rejected claim against a buildings insurance policy should be no more complex if the property was insured for £300,000 than if it was insured for £100,000. Similarly, the assured value of a critical illness policy should make no difference to the determination of a complaint about the grounds on which an insurer rejected a claim against that policy.

3.22 If the ombudsman service needs additional skills and expertise to meet its statutory obligations then it is the service's responsibility, as an independent body, to ensure it has the revenue (from the levy and case fees paid by firms) to fund these additional resources. Even if the ombudsman service did need further resources specifically because of our award limit proposals, we would not expect these to be significant. There are likely to be relatively few high value complaints, and around a third of these are within £50,000 of the current award limit (see Figure 3).

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

Note: As you know we / Mr Brian Little also provided additional relevant information from a number of FoI responses from the Financial Ombudsman Service from September 2017 to 3 December 2018 (FoI.3273)

6 December 2018