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Financial Services Authority and
Financial Ombudsman Service

Funding the Financial Ombudsman Service

A joint consultation paper

November 2000



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The Financial Services Authority and the Financial Ombudsman Service Limited invite comments on this consultation paper. Both the FSA and the Financial Ombudsman Service Limited will receive copies of all responses. Comments should reach us by 28 February 2001.

Comments may be sent by electronic submission using the form on the FSA's website (at www.fsa.gov.uk/pubs/cp/cp74_response.html).

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1 Executive summary

- 1.1 This paper sets out proposals for the funding of the new Financial Ombudsman Service (FOS) by the financial services industry. The funding arrangements will apply to firms authorised by the FSA which, under the Financial Services and Markets Act 2000 (FSMA), will be subject to the FOS on a compulsory basis, and to unauthorised financial services firms which choose to join the FOS on a voluntary basis. (However, firms which certify to the FSA that they do not do business or deal with customers eligible to use the FOS will be exempt.)
- 1.2 The proposed approach is governed by the fundamental objectives as set out in earlier consultation papers (CP4¹ and CP33²). In summary, the aim is to have funding arrangements that are fair, efficient and administratively simple to operate and collect, that provide the FOS with certainty and flexibility in budget planning and financial management and that provide firms with an incentive to resolve complaints at an early stage, but without deterring them from using the FOS where appropriate.
- 1.3 The proposals contained in this paper build on general agreement secured in response to CP33 that:
 - the FOS should be funded by a combination of a **general levy** to which all firms subject to the FOS's jurisdiction should contribute and a **user pays** element payable by firms in respect of individual complaints;
 - for the first year of the FOS's operation, the 50:50 split between general levy and user pays was a reasonable starting point but that the aim should be to increase the user pays element in the light of experience of the scheme; and
 - allocation of the general levy should be related to the budgeted costs of handling complaints in each industry sector in order to reflect the extent to which different sectors generate different levels of complaints.

1 *Consumer complaints.*

2 *Consumer Complaints and the new single ombudsman scheme.*

1.4 Taking this as a starting point, the proposals in this paper have been developed in the light of the FSA's proposals for its own post-N2 fee raising arrangements set out in CP56³ and in close consultation with an Industry Funding Group (IFG) established by the FSA and the FOS. The IFG comprises representatives from the main trade associations for the financial services industry.⁴ It has met regularly since its formation at the beginning of this year and we are most grateful to all those who have participated in it for their valuable assistance with this work.

1.5 In summary, the FOS's funding proposals are as follows:

- for the purposes of the general levy, firms should be grouped according to activity into a number of 'industry-blocks' and an agreed portion of the FOS's budget (ie 50% in the first year) should be allocated between those industry-blocks broadly on the basis of the number of complaints each sector is expected to generate. Firms will then be levied in accordance with the amount of business which they conduct in each industry-block;
- the remaining portion of the FOS's annual budget should be raised from case fees, payable by individual firms at a flat rate per case closed;
- the costs of establishing the FOS should be recovered over the first 3 full financial years after N2 via a supplementary levy on all firms which are subject to the FOS (including those in the Voluntary Jurisdiction) calculated in the same way as the general levy.

1.6 The proposals contained in this paper have been refined in two main ways from those contained in earlier consultation papers:

- (i) it is proposed that, for the purposes of the general levy, the approach proposed in CP56 by the FSA for its own fee-raising proposals should be adopted as far as possible, but modified as necessary to take account of the differences between the FSA and the FOS; and
- (ii) it is proposed that the user pays element should be raised via case fees payable during the year, rather than via a re-allocation of the general levy on a case-related basis at the end of the year.

The way in which the general levy and the case fees will operate is explained in more detail at 1.9–1.11 below.

1.7 The powers to make rules for funding the FOS contained in FISMA are shared between the FSA and the FOS. Under the proposals in this paper, the general

³ *The FSA's Post-N2 Fee Raising Arrangements.*

⁴ The IFG includes representatives from the Association of British Insurers; the Association of Friendly Societies; the Association of Independent Financial Advisers; Association of Private Client Investment Managers and Stockbrokers; Association of Unit Trusts and Investment Funds; the Banking Ombudsman Scheme; British Bankers Association; British Healthcare Association; the Building Societies Association; Financial Ombudsman Service; Fund Managers Association; the FSA; FSA Credit Union Project Team; the FSA Small Business Practitioner Panel; Insurance Ombudsman Bureau; the Investment Ombudsman Committee; Life Insurance Association; London Investment Banking Association.

levy would be raised from authorised firms under FSA's statutory powers (section 234 of FISMA), whilst case fees would be charged under FOS's statutory powers (paragraph 15 of Schedule 17 to FISMA). The Voluntary Jurisdiction will be funded (by contract) on a similar basis.

- 1.8 The FSA and the FOS propose to introduce the new funding arrangements in respect of the first full financial year following the date on which FISMA comes into force (N2) (i.e. 2002/03). This is likely to be during the summer of 2001. To avoid the need for a mid-year levy at N2, it is proposed that the whole of the financial year, 2001/02, should be financed under the existing ombudsman schemes' powers and mechanisms. This paper seeks views on whether it is necessary to adjust firms' levies at the end of that year in respect of the post-N2 part of the year, as FSA proposes to do.

General Levy

- 1.9 The FSA proposes to adopt a similar approach to raising the general levy for the FOS to the one which it proposes to adopt for its own fee-raising arrangements. The general levy will operate as follows:
- following consultation each year, the FSA and the FOS will agree a budget for the FOS for the year (including any audited variances between budgeted and actual income or expenditure for the previous year);
 - the amount to be raised by the general levy (i.e. 50% of the annual budget in the first full year) will be allocated between industry-blocks, in proportion to the workload which each industry-block is expected to generate;
 - the costs of each industry-block will then be allocated between the individual firms in that block, in accordance with the amount of business conducted by each firm as measured by the appropriate tariff-base for the relevant block;
 - in devising the industry-blocks for FOS funding purposes, the FSA has, as far as possible, adopted the 'fee-blocks' proposed in CP56 for its own funding purposes. However, in some instances, one or more of the proposed FSA fee-blocks has been combined to form a single FOS industry-block – and a single tariff-base is provided for these industry-blocks;
 - generally, we propose to apply the same tariff-base to an FOS industry-block as to the comparable FSA fee-block, except in one or two areas where there is a logical reason for adopting a different approach;
 - firms will be required to pay their general levies direct to the FOS either on an annual basis at the start of the financial year or on a quarterly basis (in advance) by direct debit agreement.

- 1.10 It should be noted that the FSA's own fee-raising arrangements are currently subject to further consultation. We shall want to take account of any changes where these are of relevance to the FOS funding proposals. The aim will be to align the FSA's fee-blocks and their relevant tariff-bases with the FOS's industry-blocks and tariff-bases as far as possible.

Case Fees

- 1.11 As part of the annual budget process, the FOS will estimate the number of complaints which it expects to close during the charging period (i.e. 'chargeable cases'). The FOS will set the case fee at the level necessary to raise the portion of the budget which is not raised by the general levy. The proposals relating to case fees are as follows:

- the portion of the annual budget to be raised by case fees will be consulted on annually and will be reviewed each year (in the first full year of the new arrangements, 50% will be raised by case fees);
- the standard case fee will be calculated by dividing the amount to be raised by case fees by the number of chargeable cases which the FOS expects to close in the year;
- unlike the calculation of the general levy, which is based on industry-blocks, it is proposed that the standard case fee will initially be a flat charge across the whole of the FOS constituency, although the FOS will need, in a few limited circumstances, to set 'special' case fees;
- going forward, the FOS intends to evaluate moving to 'tiered' case fees to take account of the stage at which a case is closed under the FOS's procedures and will also consider whether there is a case for differentiating between sectors;
- the intention is to charge case fees at the end of each quarter for cases closed in that quarter.

Other Issues

- 1.12 The following issues should also be noted:
- **Voluntary Jurisdiction.** Although FISMA requires that the annual budget should distinguish between the Compulsory and Voluntary Jurisdictions, it is proposed that the funding arrangements for firms joining the Voluntary Jurisdiction should, as far as possible, be the same as those for firms subject to the Compulsory Jurisdiction.
 - **Establishment costs.** It is proposed that the costs of setting up the FOS should be recovered via a supplementary levy on all firms which are subject to the jurisdiction of the FOS in the first 3 full financial years following N2.

These costs will, therefore, be capitalised and written off over the 3 years beginning April 2002;

- **Joiners.** It is proposed that firms which become authorised (and therefore subject to the FOS) part-way through the year should pay part of the general levy and, in the first 3 years, also part of that year's establishment costs (via a supplementary levy).
- **Leavers.** As with FSA, it is proposed that firms which cease to be authorised part way through the year would not receive a rebate in respect of the general levy. Exceptions may, however, be made, where a firm has given the FSA notice of its plans before the start of the financial year in question.
- **Collection.** The FSA proposes, subject to cost benefit considerations, to collect authorised firms' relevant business data for levy purposes, but to delegate to the FOS administrative responsibility for the invoicing and collection of levies from authorised firms which are subject to the Compulsory Jurisdiction.
- **Reserves.** In the interests of striking an appropriate balance between a prudent level of flexibility and avoiding imposing undue burdens on firms, the FOS proposes to build up reserves of 5% of its annual operating costs over a 3 year period.

Next Steps

- 1.13 This paper sets out and seeks views on the general structure of the proposed funding arrangements and the draft rules which will give effect to the proposals outlined. The draft rules are attached at Annex A. **We would welcome comments on the specific questions in the text and on the draft rules more generally. (A summary of these questions is at Annex H.)**
- 1.14 A further consultation paper, providing feedback on the responses to this paper, will be issued in the New Year. The FOS will be consulting on its annual budget for 2001/02 in January 2001, but as outlined in paragraph 1.8, this will be financed under the existing schemes' powers and mechanisms.

2 Introduction

- 2.1 In November 1999, the FSA and the FOS jointly published CP33 which sought views on detailed proposals relating to the arrangements which should apply for handling consumer complaints under the new system of financial services regulation, both within firms and within the new single ombudsman scheme.
- 2.2 Chapter 5 of CP33 set out initial proposals for funding the FOS. It explained that the FOS, like the FSA, would be funded by the financial services industry and that the costs would, therefore, be met by authorised firms subject to the Compulsory Jurisdiction and those firms which chose to join the Voluntary Jurisdiction. (There is no power in FISMA to charge complainants for using the FOS.)
- 2.3 As outlined in that paper, the key objectives in determining appropriate funding arrangements for the FOS are to ensure that they:
 - are as fair as possible as between firms;
 - are efficient and administratively simple to operate and collect;
 - provide the FOS with an appropriate degree of certainty and flexibility for budget planning and financial management purposes; and
 - provide firms with an incentive to resolve complaints, where possible, at an early stage, but avoid deterring them from using the FOS, where appropriate.
- 2.4 CP33 also indicated that the FSA and the FOS intended to set up an Industry Funding Group (IFG) to provide advice on how the proposals could be refined to achieve arrangements which were as fair as possible for all sectors of the industry. The IFG, which consists of representatives from the main trade associations for the financial services industry, has met regularly since it was set up at the beginning of this year and has provided valuable advice in developing the proposals now set out in this paper.

- 2.5 In May this year, the FSA and the FOS published Consultation Paper 49.⁵ This paper provided feedback on CP33 and contained the draft complaints handling rules for firms and the FOS. However, CP49 did not include detailed funding proposals or draft funding rules. This was because we felt that finalisation of these proposals should be delayed in order to enable us:
- to take account of the proposals for funding the FSA after N2, which were due to be published in June 2000; and
 - to provide the IFG with more time to develop its thinking in the light of those proposals and the responses to CP33.
- 2.6 Although CP49 did not contain draft funding rules, it did outline the broad principles on which CP33 respondents and the IFG were generally agreed. These principles are:
- that the FOS should be funded by a combination of:
 - (i) a **general levy** to which all firms subject to the jurisdiction of the FOS would contribute to reflect the reputational benefit conferred on the industry as a whole by the existence of an ombudsman scheme; and
 - (ii) a **user pays element** (ie case fees) so that those firms which generate complaints would pay for a greater (and proportionate) share of the costs of running the scheme.
 - that the proposal to fund 50% of the scheme's annual costs via the general levy and 50% on a 'user pays' basis is a reasonable starting point for the first full year of the scheme's operation, but that, in the light of experience of the scheme, the aim should be to raise a higher proportion of the overall costs via case fees, in a way which reflects the actual usage of the scheme, as distinct from its standing costs;
 - that the allocation of the general levy should be related to the budgeted case-handling costs for each industry sector in order to reflect the extent to which different sectors generate different levels of complaints; and
 - that firms should have the option of paying their general levy in quarterly instalments (in advance) rather than 100% in full at the start of the year.
- 2.7 The detailed proposals contained in this paper build on these foundations. First, the FSA has revised some of its earlier proposals for raising the general levy to take account of the FSA's own fee-raising proposals as set out in CP56. Second, the FOS has now decided to fund the 'user pays' part of the FOS's costs via case fees payable during the year, rather than by means of a case-related re-allocation of the general levy at the end of the year. This is a simpler approach and will enable firms to know in advance how much they will have to pay for each case.

5 *Complaints Handling Arrangements: feedback on CP33 and draft rules.*

Legislative Framework

- 2.8 The statutory framework for the FOS (including the fee-raising provisions) is set out in FISMA which received Royal Assent in June this year. As with other provisions relating to the FOS, the powers to make funding rules are shared between the FSA and the FOS.
- 2.9 **General Levy.** Section 234 of FISMA gives the FSA power to make rules relating to the funding of the Compulsory Jurisdiction. It enables the FSA to make rules requiring the payment to the FOS of general levies by all authorised firms subject to the Compulsory Jurisdiction in order to fund both the establishment costs and the ongoing operating costs of the FOS. These may be ‘specified amounts’ or ‘amounts calculated in a specified way’. The draft funding rules proposed in this paper in respect of the general levy on firms in the Compulsory Jurisdiction will therefore be made under the FSA’s powers.
- 2.10 **Case Fees.** Paragraph 15(1) of Schedule 17 to FISMA gives the FOS the power to charge firms in the Compulsory Jurisdiction specified case fees. The FOS proposes to exercise this power in order to fund a proportion of the annual operating costs, which will be agreed with the FSA. The draft rules relating to case fees will therefore be made under the FOS’s powers.
- 2.11 **Voluntary Jurisdiction.** Paragraph 18 of Schedule 17 to FISMA enables the FOS to require firms which choose to participate in the Voluntary Jurisdiction to pay fees to the FOS as part of the Standard Terms. (These are set by the FOS and form the contractual basis for participation in the Voluntary Jurisdiction.) In line with our previously agreed policy that the Compulsory Jurisdiction and the Voluntary Jurisdiction should operate in the same way as far as possible, the FOS proposes to apply the same funding arrangements to Voluntary Jurisdiction participants as for authorised firms in the Compulsory Jurisdiction.
- 2.12 **Annual Budget.** Paragraph 9 of Schedule 17 to FISMA requires the FOS to adopt, before the start of each financial year, an annual budget, which has been approved by the FSA. This annual budget must include an indication of the distribution of resources deployed in the operation of the scheme and the amounts of income which arise or are expected to arise from the operation of the scheme, distinguishing, in both cases, between the Compulsory Jurisdiction and Voluntary Jurisdiction.
- 2.13 The FOS will publish its annual budget for public consultation each year. Following consultation, the annual budget will be submitted to the FSA Board for approval before the start of each financial year on 1 April.
- 2.14 **Implementation of new funding arrangements.** The FSA and the FOS will have no power to raise fees to fund the new scheme before N2. There is, as yet, no

set date for N2, but HM Treasury announced in July this year that it was likely to be in about a year's time (ie during summer 2001). This means that N2 will occur after the start of the financial year 2001/02 and that funding for the first part of that year, at least, will have to be raised under the funding mechanisms of each of the existing schemes. Although the existing schemes are now operating under the day to day management of the FOS, under service level agreements with the FOS, they will retain their separate legal identities and terms of reference until N2 when the FOS receives its statutory powers.

- 2.15 Special arrangements will therefore be needed for funding the year in which N2 falls in order to avoid the need for firms to be levied separately in respect of the pre and post-N2 periods in this year. This issue is discussed in further detail in Chapter 3. **The proposed arrangement would mean that the draft funding rules set out in this paper would come into force for the first time in respect of the first complete financial year after N2 (i.e. 2002/03).**

Draft Rules

- 2.16 The draft rules set out in Annex A give effect to the proposals in this paper and provide the mechanism for raising the fees. They will apply to all authorised firms which are subject to the jurisdiction of the FOS. However, firms which certify to the FSA that they do not conduct business with customers eligible to use the FOS will be exempt from the rules.
- 2.17 The draft rules cannot, at this stage, include specific figures. These will depend on a number of different budget-related factors which will vary from year to year and which will be subject to annual consultation. The structure of the draft rules therefore reflects the fact that certain elements will be subject to change (and consultation) each year. It also distinguishes between the rules which will apply to firms and the administrative procedures relating to the allocation of the general levy and case fees.
- 2.18 At this stage, therefore, we are seeking views on the general structure of the proposed funding arrangements and on the draft rules. A further funding paper will be published early next year, the purpose of which will be to finalise the general framework of the rules. This will take account of the responses to this paper and, insofar as they are relevant, responses to the FSA's consultation on its fee-raising arrangements. It will also contain, for illustrative purposes, figures based on the FOS's budget for 2001/02, which will be published in January 2001. However, as noted above, we do not propose to implement these rules until the first complete financial year after N2 (ie 2002/03). We will consult on the figures for that year in January 2002, as part of the regular annual funding cycle described in Chapter 4.

The following chapters set out in detail how the proposed funding mechanism will operate. Draft rules are attached at Annex A. We would welcome comments on the specific questions in the text and on the draft rules more generally. (The questions are summarised at Annex H.)

3 Detailed funding proposals

- 3.1 This chapter sets out, the detailed proposals for funding the FOS. In particular, it covers:
- (i) how the FSA proposes to calculate and allocate the general levy;
 - (ii) how the FOS proposes to charge case fees (i.e. the ‘user pays’ element);
 - (iii) how the FSA and the FOS propose to recover establishment costs (i.e. the costs of setting up the FOS); and
 - (iv) how it is proposed that the year in which N2 falls should be funded.
- 3.2 The total sum to be raised in any one year will be the FOS’s Annual Budget (as approved by the FSA), which will take account of any audited variance from budgeted expenditure or income for the previous year. (The FOS also proposes to build up reserves of 5% of its annual operating costs over a 3 year period.) As noted above, we propose to raise these funds by a combination of a general levy and case fees.

I General Levy

- 3.3 In CP33 we set out our initial thoughts on how firms might be grouped together into comparable bands for general levy purposes, based on different ‘units of measure’. The proposals which follow represent a refinement of that approach, based on the FSA’s proposals (in CP56) for allocating regulatory fees between the different parts of its constituency, but adapted, where necessary, to suit the different needs and circumstances of the FOS.
- 3.4 We believe that it makes sense to take the FSA’s proposed fee-blocks as a starting point for the FOS general levy mechanism and to aim for as high a degree of consistency as possible. Whilst the fee-paying constituencies of the FSA and the FOS will not completely match, there will be a substantial amount of common ground, since the firms in the Compulsory Jurisdiction will all be authorised firms. The funding arrangements for the FOS must cater for the same diverse range of firms as the FSA in terms both of size and of activities.

- 3.5 The FSA's proposals group fee-payers together into fee-blocks according to business activity and define those fee-blocks in such a way that the fee-payers in each block offer broadly similar products and services. They are designed to apportion fees between fee-payers in a manner which is fair and economic and efficient to administer and which takes account of the diversity of the organisations which the FSA regulates and the risks posed by fee-payers to the FSA's statutory objectives.
- 3.6 The main benefit of this approach is that the grouping of firms is based on completely objective criteria and removes any element of uncertainty for firms. We believe that this is also the fairest and most transparent way of allocating the FOS general levy. A common approach will be simpler for firms (particularly in terms of the information which they will be required to provide) and easier and more cost-effective to administer, creating scope for the sharing of resources in some areas between the FSA and the FOS.
- 3.7 However, there are some significant differences between the FSA and the FOS, which the funding arrangements need to take into account. The most important of these, from a funding perspective, is the fact that the FSA, as a regulatory body, will have a wide range of different statutory functions, whereas the FOS will have a much more specific and limited focus. The FOS's statutory function is to provide a dispute resolution service. The extent to which different firms make 'use' of that service is clearly identifiable and objectively measurable and can therefore be charged for directly in the form of a case fee. This user pays element forms an important part of our proposals. It is also important to note that, unlike the FSA, the FOS will cover unregulated activities, undertaken by authorised firms, and also, in the Voluntary Jurisdiction, unauthorised firms.
- 3.8 For the purposes of the FOS general levy, we therefore propose to group firms into a number of blocks, which follow, wherever possible, the fee-blocks proposed for the FSA, with modifications where necessary to accommodate the factors noted above. To avoid confusion, the proposed FOS funding groups are described as industry-blocks, as distinct from the FSA's proposed fee-blocks.

Industry Blocks

- 3.9 The industry-blocks which we propose to adopt for the purposes of funding the Compulsory Jurisdiction of the FOS are summarised below. Firms will fall into one or more of these industry-blocks, depending on the activities which they conduct. (The activities covered by each of these industry-blocks are set out in more detail at Annex D.)

Proposed FOS Industry-Blocks	FSA Fee-blocks
1 Deposit-takers/lenders	FSA fee-block A1 and A2
2 Firms conducting general insurance activities	FSA fee-blocks A3,A5 and A6
3 Long term life insurers	FSA fee-block A4
4 Fund managers	FSA fee-block A7 and A8
5 Unit trust managers/OEIC corporate directors	FSA fee-block A9
6 Trustees of unit trusts and OEICs depositaries	FSA fee-block A10
7 Dealers (as principal)	FSA fee-block A11
8 Stockbrokers/corporate finance advisers	FSA fee-block A12, A13 and A15
9 Brokers (including Independent Financial Advisers)	FSA fee-block A14
10 Advisers only	FSA fee-block A16

3.10 There are 10 industry-blocks in total, as compared with the 22 fee-blocks proposed for FSA fee-raising purposes. This largely reflects the fact that only the Category A fee-blocks proposed by the FSA in CP56 are relevant in the FOS context. (The other fee-blocks relate to the FSA's wider range of functions and fee-payers.) However, it also represents a modest simplification through combining the proposed FSA fee-blocks in one or two areas.

3.11 The main differences between the proposed FOS industry-blocks and the FSA's proposed fee-blocks are as follows:

- **It is proposed that there should be a single FOS industry-block for deposit-taking and lending.** This represents a combination of FSA fee-blocks A1 and A2 and an extension to cover lending. We believe that it makes sense to combine credit unions with other deposit-takers (i.e. banks and building societies), in the first instance, at least. This is because the absence of any historical complaints data relating to credit unions makes it impossible to assess separately the likely costs of handling complaints about this particular type of firm.

We also believe that it makes sense, in the first instance, to include in this block unsecured lending, which will be covered by the Compulsory Jurisdiction from N2, since it is currently covered by the existing schemes. Unsecured lending is not a regulated activity and will therefore not be covered by any of the proposed FSA fee-blocks. We do not consider it practical to set up a separate industry-block for this activity and, since most deposit-takers will also be lenders, we believe that it makes sense to include unsecured lending within the deposit-taking block for FOS funding purposes at least initially.

The FOS industry-blocks will also need to cover mortgage lending. This is dealt with separately at paragraph 3.12 below.

- **It is proposed that there should be a single industry-block to cover insurance business (with the exception of life business).** This represents an amalgamation of FSA fee-blocks A3, (general insurers), A5 (Lloyd's Managing Agents) and A6 (the Society of Lloyd's). We do not believe that it is necessary to differentiate further between these fee-payers in the FOS context, given that the case fee will reflect the extent to which particular firms within the industry-block generate more complaints than others.
- **It is proposed that there should be 8 separate industry-blocks to cover investment business.** This represents a slight simplification of the FSA fee-blocks covering this area. We do not consider it necessary or practical, for FOS funding purposes, to differentiate between fund managers which hold client money and those which do not, or between stockbrokers on the basis of whether or not they do execution-only business or hold client money. Nor do we consider it appropriate to create a separate block for corporate finance advisers. We believe this to be justified in the FOS context, since the case fee creates a direct user pays element, which is not present in the FSA fees proposals.

A significant number of industry-blocks is, nonetheless, necessary to take account of the wide range of activities undertaken by firms in this sector. In practice, the industry-block for firms which deal as principal may prove to be an 'empty carriage' as it is possible that none of these firms is doing business with customers who would be eligible to use the FOS. However, we consider it prudent, at this stage, to make provision for all of the FSA Category A activity groupings to ensure that none is left out.

- 3.12 **Mortgage Lending.** The FSA currently expects to assume responsibility for regulating mortgage lending in January 2002. However, this activity will be covered by the Compulsory Jurisdiction of the FOS from N2, since it is currently covered by the existing schemes. The FSA has indicated, in its recently published consultation paper on 'Mortgage Regulation'⁶, that it is proposing to create a separate FSA fee-block for mortgage lenders and we believe that a separate industry-block for mortgage lenders may therefore also be appropriate in the FOS context. However, it should be noted that the FOS industry-block would go wider than the parallel FSA fee-block. This is because mortgage regulation will cover only first mortgages, whereas the Compulsory Jurisdiction of the FOS (like the existing schemes) will cover complaints about other kinds of mortgage lending, including second mortgages, which will remain unregulated. We will therefore be examining the implications of this

6 CP70: *Mortgage Regulation: The FSA's high-level approach* – November 2000.

with the IFG and will want to take careful account of responses to the Mortgage Regulation consultation paper before taking a final decision. **We should also welcome views from respondents on this point.**

- 3.13 **Voluntary Jurisdiction.** As previously noted, the intention is that similar general levy arrangements to those which apply under FSA rules to authorised firms in the Compulsory Jurisdiction will apply, via the FOS's Standard Terms, to firms which choose to participate in the FOS's Voluntary Jurisdiction. The overall costs of handling complaints against firms in the Voluntary Jurisdiction will have to be separately identified in the FOS budget and allocated to firms participating in the Voluntary Jurisdiction accordingly.
- 3.14 As the Voluntary Jurisdiction gradually expands, additional industry-blocks may, in due course, have to be created by the FOS. Where an authorised firm also chooses to join the Voluntary Jurisdiction, the FOS will allocate it, via its contract under the Standard Terms, to the appropriate industry-block or blocks.
- Q1 Do respondents agree with the proposed FOS industry-blocks set out in Annex D – and do they have any views on whether it is appropriate to create a separate mortgage lending block?

Allocating the FOS's Costs between Industry-Blocks

- 3.15 The FSA proposes to allocate the general levy between the various FOS industry-blocks in proportion to the anticipated cost of the resources needed to handle the number of complaints which the firms in each of those FOS industry-blocks are expected to generate. The costs to be allocated to each of the different industry-blocks will be determined each year by the FSA after consultation. These will be based on the FOS's budgeted costs and the number of case-handling staff required to deal with complaints relating to each industry-block.

Allocating costs to firms within Industry-Blocks: Tariff-Bases

- 3.16 The next stage of the process is to determine how the costs for each industry-block should be allocated to the individual firms within each industry-block. As explained at paragraph 3.26 below, the costs will be allocated on the basis of firms' 'relevant business'.
- 3.17 Again, we propose to follow a similar approach in respect of FOS funding to the one which the FSA proposes to adopt in relation to its own regulatory fees, by setting a tariff-base for each of the FOS industry-blocks. These tariff-bases are designed to produce a unit of measure common to the members of each industry-block in order to provide a fair basis for allocating costs between these firms. Wherever possible, we propose to use the same tariff-base as for the relevant FSA fee-block.

- 3.18 For most of the FOS industry-blocks, the proposed tariff-bases are the same as those proposed for FSA funding purposes. However, in some cases, we believe it is necessary to adopt a different tariff-base. This is either because the FOS industry-blocks combine FSA fee-blocks with different tariff-bases or because the tariff-base proposed for FSA fee purposes is inappropriate, given that the FOS industry-block also covers unregulated activities.
- 3.19 The proposed tariff-bases for each of the FOS industry-blocks are set out below. These are broadly in line with the ‘units of measure’ proposed in CP33, which received general support.

	Industry Block	Proposed FOS Tariff-base
1	Deposit-takers/lenders	No. of relevant accounts
2	General insurers	Relevant gross premium income
3	Long term life insurers	Relevant gross premium income
4	Fund managers	Relevant funds under management
5	Unit trust managers/ OEIC corporate directors	Relevant gross income from activity
6	Trustees of unit trusts/OEIC depositories	Relevant gross income from activity
7	Dealers (as Principal)	Relevant gross assets
8	Stockbrokers/Corporate finance advisers	Number of (relevant) Approved Persons OR Relevant commission and/or fee income from the activity
9	Brokers (including Independent Financial Advisers)	Number of (relevant) Approved Persons OR Relevant commission and/or fee income from the activity
10	Advisers only	Number of (relevant) Approved Persons OR Relevant commission and/or fee income from the activity

A comparison of the proposed FOS tariff-bases with those proposed for the FSA’s fee-blocks in CP56 is set out at Annex D.

- 3.20 The main area where we are proposing a different tariff-base from that proposed for the comparable FSA fee-block is in relation to deposit-takers and lenders (Industry-block 1). We propose that this tariff-base should be the number of accounts, rather than total deposits/assets. This is the measure currently used by the Banking Ombudsman and was favoured by respondents to previous consultations on the grounds that it provides a more sensitive measure of the amount of business transacted with consumers. This is, we

believe, particularly relevant in relation to unsecured lending, which will be covered by this block in the FOS context, but not by the parallel FSA fee-block, since it is not a regulated activity.

- 3.21 We have given thought, together with relevant members of the IFG, to the suggestion that the numbers of accounts should be weighted in some way to reflect the fact that different types of account generate different volumes of complaints. On balance, we do not consider this necessary since financing the scheme in part by case fees will ensure that those firms which generate the most complaints pay a greater proportion of the FOS's costs. **However, we should welcome views on this point.**
- 3.22 We are also seeking views on two possible options for Industry-blocks 8, 9 and 10, which relate to different types of broker and adviser, since no clear consensus has, as yet, emerged from previous consultations.
- 3.23 The choice here is between a tariff-base which uses the number of Approved Persons and one based on commission/fee income. A significant number of independent financial advisers have indicated a preference for the former. They do so on the grounds that it is similar to the unit of measure currently used for funding purposes in this sector (the number of Registered Individuals) and they believe that it provides a better reflection of the amount of business transacted with consumers. It also avoids the potential administrative difficulties, which the turnover test could pose for firms which have a significant number of appointed representatives. However, the concept of an 'approved person' is wider than that of a 'registered individual', since it also covers senior management and back office staff. It would therefore be necessary to restrict the tariff-base to those who are required to be approved persons because they deal with customers or customer assets (i.e. Approved Persons in respect of 'Controlled Functions' 20-28 as set out in CP53).⁷
- 3.24 The main drawback in using the Approved Persons measure is that it could not be used in relation to unauthorised firms or unregulated activities which may, in due course, be covered by the Voluntary Jurisdiction (e.g. mortgage or general insurance intermediaries). A separate tariff-base would have to be adopted in such circumstances. This could mean that independent financial advisers which were authorised and in the Compulsory Jurisdiction for their regulated activities but joined the Voluntary Jurisdiction for specified unregulated activities would have to provide data about their 'relevant business' according to a different tariff-base.

⁷ *The Regulation of Approved Persons: Controlled Functions* – June 2000.

3.25 The FSA also sought views on this point in the context of FSA funding and we will want to take account of the conclusions reached in that context. However, we are conscious that the drawback highlighted in the previous paragraph is specific to the FOS funding proposals, since the FSA covers only regulated activities. **We should therefore welcome further views on this point in the FOS context.**

Q2 Do respondents agree with the tariff-bases proposed in the table at 3.19 above?

Q3 In particular, do they have a view on:

- (i) whether the tariff-base for deposit-takers should be weighted in some way to take account of different types of account (paragraph 3.21); and
- (ii) whether the appropriate tariff-base for advisers and brokers should be the number of relevant approved persons or relevant commission/fee income (paragraphs 3.22–3.25).

Relevant Business

3.26 The tariff-base for FOS general levy purposes will apply to ‘relevant business’, rather than regulated activities. This means activities (whether regulated or not) which are covered by the FOS and which are conducted with consumers who could use the FOS.⁸ Firms will be required under the draft rules to provide details of the total amount of ‘relevant business’ which they conduct as at a specified date, distinguishing between each of the industry-blocks, as appropriate, using the relevant tariff-base.

3.27 We recognise, however, that it may be difficult for firms to identify the extent to which they do business with small businesses which will also be eligible to use the FOS, (as well as private individuals). We understand that this could be a particular problem for insurance companies since it will be the first time that small businesses have had access (as complainants) to an ombudsman scheme in this sector. We are also conscious that some firms which do no business at all with private individuals may not qualify for exemption from the funding requirement because they could very occasionally do business with a firm which has a turnover of under £1 million.

3.28 We therefore propose that a firm’s ‘relevant business’ for general levy purposes should be restricted to the business which it does with private individuals only. ‘Small business’ complaints handled by the FOS would be funded separately via a ‘special’ case fee (as distinct from the standard case fee). This special case fee would be set at a level which would broadly reflect the full unit cost of handling a case (see paragraphs 3.39 – 3.41 below). The FOS would levy the special case fee on the firm against which the small business complaint was lodged on closure of the case. **We would welcome views on this proposal.**

⁸ These are private individuals; firms with a turnover and registered charities with annual income of less than £1 million; and trusts with a net asset value of less than £1 million.

- Q4 Do respondents agree that, for FOS general levy purposes, 'relevant business' should be restricted to business done with private individuals only?
- Q5 Do respondents agree that small business complaints should be funded separately by a 'special' case fee (as described at paragraphs 3.27-3.28)?

Applying the Tariff-bases

- 3.29 The tariff-rate (i.e. £ per unit of measure) attaching to each tariff-base would be calculated by the FSA each year to produce the requisite sum for each particular industry-block (see paragraph 3.19 above). The FSA would make the necessary levy rules relating to each industry-block on an annual basis, following consultation. An illustrative industry-block graph is provided at Annex E.
- 3.30 In the light of previous consultation and discussions with the IFG, we are inclined to favour adoption of a 'straight-line' model in most areas whereby the tariff is applied so that levies increase on a continuous and uniform basis. This would mean that each firm's levy would be directly related, on a straight pro rata basis, to the amount of relevant business which it conducted.
- 3.31 However, we believe that there may be a case for adopting a logarithmic scale in some sectors where the range in the size of firms' business is particularly large – e.g. in respect of funds under management. This would mean that there would be some lightening of the levy at the upper end of the scale.
- Q6 Do respondents agree that a 'straight line' approach should be adopted for the FOS industry-blocks?
- Q7 Do respondents believe that the logarithmic approach described in 3.31 should be applied to the fund managers industry-block (or any of the other proposed industry-blocks)?

Minimum Levy

- 3.32 We propose that there should be a minimum levy for firms within each industry-block. This is because we believe that all firms which are subject to the FOS should contribute in some measure to its costs in view of the general benefit which its existence confers on them, but we recognise that for some firms, the amount of relevant business conducted will be very small. We also recognise that there is a minimum level below which it is not economic to collect a minimum levy, given the cost of collecting information on the tariff-bases, working out levies and collecting payment. We therefore propose that there should be a minimum levy for firms within each industry-block and we will consult on the appropriate sum at the same time as we consult on the tariff-bases.

Special Arrangements for Small Firms

3.33 We have noted in previous papers that special pooling arrangements may be needed for very small firms (e.g. credit unions, small friendly societies and cash plan health providers). However, we believe that the concept of a minimum levy offers a more satisfactory means of addressing these concerns. We therefore propose that firms which qualify for the minimum levy should not be subject to case fees. The minimum levy will, in effect, be a one-off payment. As noted above, it will have to be pitched at an appropriate level to ensure that it applies only to the smallest firms. Where a firm falls into more than one industry-block, it would not pay case fees in respect of any complaints falling into the block for which it paid the minimum levy.

Q8 Do respondents agree with the proposal for a minimum levy?

Q9 Do respondents agree with the proposal that those firms which qualify for the minimum levy should not be subject to case fees?

Maximum Levy

3.34 We consider that it would be inappropriate to set a maximum levy – for the same reasons outlined in CP56 in relation to FSA regulatory fees. The financial services industry has a tendency to consolidate into larger and larger organisations and setting maximum levies in a period of consolidation would benefit those firms which exceeded the threshold level.

Q10 Do respondents agree that there should be no maximum levy?

II Case Fees

3.35 Prior to the start of each financial year, the FOS will consult on the amount to be recovered through case fees and the proposed case fee required to achieve this. As noted above, the amount to be recovered by case fees, in the first full year of the FOS, will be 50% of the annual budget, but we believe that a move to a higher user pays element may be appropriate in the light of experience of the scheme.

Standard Case Fee

3.36 The standard case fee will apply to firms which are also subject to the general levy. For the year 2002/03, the standard case fee will be a flat fee for all chargeable cases across all sectors. It will be calculated by dividing the amount to be recovered by case fees by the total number of chargeable cases which the FOS expects to close in the relevant year. (A ‘chargeable case’ is defined in the rules and explained at paragraph 3.42 below.) Case fees will be collected quarterly, in arrears.

3.37 We have given careful thought to the question of whether or not case fees should be payable only where a complaint is upheld as ‘valid’. Whilst, on the face of it, this would appear to be a fairer approach, it is, in practice, problematic for reasons which we have explained in previous consultation papers.⁹ Approximately 75%-80% of cases (on average across the existing schemes) are currently resolved at the conciliation stage (i.e. through compromise and/or ex gratia payments etc) and we expect this to continue. It is therefore only at the determinative (i.e. final award) stage that ‘blame’ is attributed, and even then, the issue of the ‘validity’ of a complaint is not necessarily clear-cut. An Ombudsman might, for instance, simply award an increased level of redress where the firm has already accepted responsibility, or he might uphold the complaint only in part. We have therefore concluded that it is not practicable to charge case fees on this basis.

3.38 Going forward there will be a number of options which the FOS will want to evaluate:

- a) whether the case fee should take account of possible differentials between sectors. In practice, the harmonisation of FOS internal business processes should reduce a number of the differences.
- b) whether the case fee should be tiered (i.e. whether cases should attract a proportionately lower fee if closed at an earlier stage of FOS’s procedures). This would provide an incentive for the earlier closure of cases and has received support from some respondents to earlier consultations.
- c) whether there should be a small fee in respect of the enquiries the FOS deals with from consumers about individual firms.

Q11 Do respondents have any views on the issues relating to the possible future refinement of the approach to case fees outlined in paragraph 3.38?

Special Case Fees

3.39 In addition to the standard case fee described above, the FOS also proposes to exercise its power to include in the scheme rules provisions enabling it to charge firms special case fees on completion of a case in certain limited circumstances as follows:

- (i) Complaints from small businesses - see paragraph 3.28;
- (ii) Complaints about firms which were formerly authorised by the FSA;
- (iii) Complaints about post N2 business conducted by firms which were not members of one of the schemes currently operating under Service Level Agreements with the FOS¹⁰ (e.g. former RPB members,

⁹ CP4: *Consumer Complaints* – December 1997 (see pp113-114) and CP33: *Consumer complaints and the new single ombudsman scheme* – November 1999 (see paragraph 5.14).

¹⁰ Office of the Banking Ombudsman; Office of the Building Societies Ombudsman; Insurance Ombudsman Bureau; Office of the Investment Ombudsman; the SFA Complaints Bureau; and the PIA Ombudsman Bureau.

PIAS members etc) which are received and closed by the FOS before the end of 2001/02); and

- (iv) Complaints about former PIA members received by FOS between N2 and the end of 2001/02 financial year – see paragraph 3.50).

3.40 These provisions are designed to cater for situations where it is either impossible or impractical for firms to contribute to the general levy. The need for special case fees for small business complaints is explained at paragraph 3.28 above. The need for the FOS to be able to charge former firms special case fees arises because a complainant will be entitled to lodge a complaint with the FOS even after a firm has ceased to be authorised, provided the complaint relates to an event which occurred at a time when the firm was subject to the FOS's jurisdiction. The other two are essentially temporary measures which will be needed in respect of the remainder of the year in which N2 falls only – for reasons set out in paragraphs 3.48 – 3.50 below.

3.41 The FOS will set the case fees for these purposes and proposes to consult on this prior to the start of the first full financial year after N2 (i.e. 2002/03). However, for the purposes of the arrangements which will apply, between N2 and the end of the year in which N2 falls (ie 2001/02), to former PIA members and firms which were not members of one of the relevant existing schemes, the FOS will consult on the appropriate case fee at the time of its 2001/02 draft budget. (These fees are likely to be higher than the standard case fee in order to take account of the fact that the firm will not have contributed towards the general levy.)

Q12 Do respondents agree with the proposal for the FOS to charge special case fees in the circumstances outlined above?

Chargeable case

3.42 A chargeable case is defined in the draft rules as any complaint referred to the FOS, apart from those where the Ombudsman considers it apparent from the complaint, as received, and any final response which has been issued by the firm, that the complaint should not proceed because:

- the complainant is not an eligible complainant; or
- the complaint does not fall within the jurisdiction of the FOS (as described at DISP 2) or is outside the time limits set out in DISP 1.7; or
- the Ombudsman considers that the complaint should be dismissed without consideration of its merits in accordance with DISP 3.5; or
- the Ombudsman considers, at any stage, that the complaint should be dismissed under DISP 3.5.1 (2) on the grounds that it is frivolous or vexatious.

Firms will not be charged case fees in respect of complaints falling into the categories described above or in respect of enquiries. Cases will become chargeable on closure and firms will be invoiced for these quarterly in arrears.

Q13 Do respondents have any comments on the proposed definition of chargeable case?

III Establishment Costs

- 3.43 FISMA enables the FSA to recover the costs of setting up the FOS (including those incurred before N2) from the firms which the FSA will authorise at N2. These 'establishment costs' will include, amongst other things:
- employment costs of FOS Board and FOS staff prior to N2 (excluding the costs of FOS staff which were seconded under Service Level Agreements to the existing schemes from 1 April 2000);
 - costs of professional advisers (in particular, legal, tax, pensions and other employment advice); and
 - costs of moving the 8 schemes to one location, including all premises and infrastructure costs.
- 3.44 These costs have been funded initially by the FSA and more recently by an FOS line of credit, based on the prospective funding powers in the new legislation. A separate record is being kept of these expenses and they will be recovered after N2 when the relevant powers come into force. Establishment costs will be capitalised and written off over the 3 year period from April 2002.
- 3.45 The FSA and the FOS propose to recover these costs from all authorised firms which are subject to the Compulsory Jurisdiction (except those which are exempt), and from firms participating in the Voluntary Jurisdiction because all firms will benefit from the existence of the scheme.
- 3.46 We propose that these costs should be recovered by means of a supplementary levy over a period of three years from the first full financial year following the commencement of FISMA – raised on the same basis as the general levy. (This mirrors the approach which the FSA plans to adopt in recovering the costs of setting up the FSA.)
- Q14 Do respondents agree with this proposal for recovering the establishment costs of the new Scheme?

IV Funding for 2001 / 2002

- 3.47 HM Treasury announced in July this year that it expects N2 to be in the summer of 2001. This means that the powers relating to the funding of the FOS will not come into force until part way through the financial year. The current schemes will therefore need to raise funding through their existing mechanisms for the first part of the year.
- 3.48 In order to avoid the need for a mid-year levy by the FOS at N2 in respect of the second part of the year in which N2 falls, it is proposed that the total budget for 2001/02 should be funded by the existing schemes under their current powers and in accordance with their current funding mechanisms. The Service Level Agreements in place between the FOS and the existing schemes already provide for the remaining balance at N2 (subject to certain pre-agreed adjustments) to be passed across to the FOS to fund the new scheme's costs for the remainder of the financial year. The sums to be raised by each scheme will be determined in consultation with the Boards of the existing schemes and will reflect the estimated costs of handling the work in each of those sectors. The overall budget will be subject to FSA approval.
- 3.49 The FSA indicated, in CP56, that it proposed to adjust firms' regulatory fees in respect of the post N2 portion of the year to bring them into line with what they should have paid under the new funding arrangements. Any differences will be factored into the fees charged to firms on the new basis during the first full financial year after N2. However, we do not believe this approach is appropriate or necessary in the FOS context. The budget for the whole of the year in which N2 falls will be agreed with the existing schemes – and the costs of dealing with complaints relating to firms which are not already members of one of those schemes during the remainder of this year would be recovered via a special case fee.¹¹ As noted above, this will be higher than the standard case fee to take account of the fact that these firms will not be contributing towards the general levy. We do not therefore believe that adjustments are needed in the FOS context.
- 3.50 As explained above, former members of PIA (which already pay a case fee under the current arrangements) would continue, for the rest of the year, to pay case fees in respect of any complaints received by the FOS between N2 and the end of the year. From N2, these case fees would be payable direct to the FOS under FOS's case fee powers. The new funding arrangements described in this paper would come into force in respect of the first complete year of the Scheme (ie 2002/03).

Q15 Do respondents agree with the proposals for funding 2001/02 as set out in paragraphs 3.48 – 3.50 above?

11 This could include, for example, former members of the Personal Insurance Arbitration Service, which, unlike the other existing schemes, is continuing to run and be funded separately at present. It could also include former members of Recognised Professional Bodies (eg lawyers, accountants etc) who are not currently members of the existing schemes.

4 Draft rules, guidance and administrative matters

4.1 The draft rules and guidance at Annex A contain:

- requirements on firms to pay fees (including an Annex which will be amended each year after consultation); and
- details of how the FSA and the FOS propose to administer the fund-raising process.

(A statement of the FSA's reasons for believing that the rules and guidance which it proposes to make are compatible with its general duties under FISMA is at Annex B.)

Draft Rules and Guidance

4.2 The rules relating to the Compulsory Jurisdiction apply to all authorised firms, except those which certify to the FSA that they do not (and are not likely to) conduct business with consumers who would be eligible to use the FOS. The rules are made under the FSA and FOS fee-raising powers.

4.3 The rules require all firms subject to the Compulsory Jurisdiction:

- to pay to the FOS the amounts described in these rules to cover the cost of operating the Compulsory Jurisdiction (the 'general levy' and 'standard case fees');
- to pay to the FOS an amount described in these rules to cover the costs of establishing the FOS (the 'supplementary levy'); and
- to provide the FSA (on an annual basis) with a statement of the total amount of 'relevant business' which they conduct, as at a specified date, distinguishing between each of the industry-blocks in accordance with the appropriate tariff-base (i.e. number of accounts, gross premium income etc);

4.4 They require firms to pay the general levy on either an annual or a quarterly basis (in advance) and the case fees on a quarterly basis (in arrears). In addition, they contain a provision, made under FOS powers, enabling the FOS to charge a special case fee in certain limited circumstances.

- 4.5 Firms which consider that they qualify for exemption from the funding rules are required to notify the FSA of this fact no later than one month before the start of the financial year and must notify the FSA during the course of the year if they cease to meet the requirements for exemption.
- 4.6 As indicated in the guidance, the FOS proposes to apply these rules (with the exception of the ‘exemption’ provision) to participants in the Voluntary Jurisdiction via its Standard Terms (the contractual terms applying to firms participating in the Voluntary Jurisdiction of the Scheme).
- 4.7 The rules and guidance at Annex A also describe how the FSA and the FOS propose to administer the funding process. In particular, this covers:
- approval of the FOS budget by the FSA;
 - the structure for calculation and payment of the general levy by firms (including the industry-blocks and the tariff-bases); and
 - the setting of case fees.

Draft Annex to Rules

- 4.8 The Rules and Guidance set the framework of the funding arrangements. The actual figures will be contained in a separate annex to the rules. A new annex will be prepared and consulted on for each financial year in line with the budget figures. The FSA and the FOS will consult on this at the same time as the FOS consults on its budget (i.e. in January each year) and the new annex will be published following approval of the FOS’s own budget before the start of the next financial year. (The FOS will also publish details of the figures relating to Voluntary Jurisdiction participants at the same time.)
- 4.9 The annex to the rules will cover:
- the total sum to be raised via the general levy to fund the operating costs of the FOS;
 - the total sum to be raised (in the first 3 years) via a supplementary levy to fund the costs of establishing the FOS (‘establishment costs’);
 - the total sum to be raised from each of the industry-blocks;
 - the tariff-rate (i.e. £ per unit of measure) for each of the industry-blocks (e.g. £x per y number of accounts for deposit takers); and
 - the amount of the case fees.

Administrative Matters

- 4.10 Allocation of firms to industry-blocks will be determined by the activities which they conduct and should be a matter of objective fact. Firms should be able to identify for themselves the industry-blocks into which they fall.

However, in the event of any uncertainty, the FSA will determine this in respect of authorised firms in the Compulsory Jurisdiction. Firms participating in the Voluntary Jurisdiction will be allocated to the relevant industry-block (or blocks) by the FOS under the Standard Terms.

Collection of Data

4.11 Allocation of the general levy between the individual firms within each industry-block will depend on the provision of data relating to the amount of each firm's 'relevant business', as described in Chapter 3. This data will be collected from authorised firms under FSA powers (see DISP 5.5.1R in the draft rules) and from Voluntary Jurisdiction participants under the FOS's Standard Terms.

4.12 The FSA will require similar data from authorised firms in order to be able to calculate their regulatory fees, but this data will not always be identical. The information required for FSA regulatory fee purposes will relate to regulated activities only. The information required for FOS funding purposes will also need to take account of:

- unregulated activities (e.g. lending) which are subject to the scheme; and
- the extent to which business is done with customers who will be eligible to use the FOS if they have a complaint.

However, the use of similar industry-blocks and tariff-bases wherever possible for FOS and FSA funding purposes should help to minimise the administrative burden on firms.

4.13 In the interests of cost-effectiveness and simplicity, we believe in principle that it makes sense for authorised firms to be required to send both sets of data to the FSA but the FSA will take a final view on this in consultation with the FOS on the basis of what is most cost-effective. The draft rules (see DISP 5.5.1R) therefore require these firms to provide the FSA with the relevant data. FSA will then pass the FOS-related data on to the FOS so that it can send out invoices for the general levy each year (see below). Responsibility for collecting data about the 'relevant business' of unauthorised firms in the Voluntary Jurisdiction will rest with the FOS.

4.14 As far as timing is concerned, we propose to require firms to provide FSA/FOS, by the end of February each year, with details of their 'relevant business' as at 31 December each year, using the relevant tariff-base or tariff-bases, for each industry-blocks into which they fall. This would enable invoices to be based on actual data, rather than estimates and thus avoid the need for invoices to be adjusted later in the year. It would involve bringing draft rule DISP 5.5.1R relating to 'Information Requirement' into force in advance of the other rules. However, we are mindful of the need to co-ordinate the timing of this requirement with the requirement relating to the data needed

for FSA funding purposes as far as possible. The timing of the latter has not, as yet, been decided, but we will take this into account in finalising our requirements in this particular area.

Invoicing and Collection of Levies

- 4.15 The FSA and the FOS have also given careful thought to whether there is scope for the FOS to share FSA resources in other areas. In CP56, the FSA sought views on whether it might also act as invoicing and collecting agent for the new single Financial Services Compensation Scheme (FSCS) and for the FOS. However, we recognise that the arguments in favour of such an arrangement are less persuasive in the FOS context. Unlike the FSA and the FSCS, the FOS's scope goes beyond authorised firms and regulated activities. The FOS would, in any case, need to have a facility to collect levies from unauthorised firms in the Voluntary Jurisdiction and would also need to have arrangements for collecting case fees in respect of both jurisdictions.
- 4.16 We have therefore concluded, subject to cost benefit considerations, that it makes sense for the FSA to delegate to the FOS administrative responsibility for the invoicing and collection of levies from firms which are subject to the Compulsory Jurisdiction. FISMA enables the FSA to require that these firms pay their general and supplementary levies direct to the FOS and draft rules 5.4.6R and 5.7.5R exercise this power. It is important to note, however, that, in the case of authorised firms, this will be carried out by the FOS under the FSA's powers and in accordance with the relevant FSA rules, specifying how the levy in respect of the Compulsory Jurisdiction is to be allocated.
- 4.17 Firms subject to the FOS (Compulsory and Voluntary Jurisdiction) will receive an invoice from the FOS in April each year for their portion of the general levy for the year beginning 1 April, based on data relating to their relevant business. If accurate data is not available at this time (see paragraph 4.14 above), there will need to be an adjustment later in the year when this becomes available. The supplementary levy will be itemised separately but collected at the same time and on the same basis as the general levy during the first 3 full years of the Scheme.

Payment Terms

- 4.18 As noted above, the FOS will issue invoices on 1 April each year. Firms will have the option of either (i) paying the full amount of their general levy at the start of the year or (ii) paying the levy in quarterly instalments (in advance) by direct debit. Case fees will be payable quarterly in arrears. In order to achieve savings in administration costs for firms and for the FOS, where several individual firms belong to one group, it will be possible to arrange for invoices to be dealt with on a group basis if the group so wishes.

Credit Control

- 4.19 Firms will be required to pay any levy or case fees for which they are liable within one month of its falling due. Late payment by a minority of firms imposes increased costs on the majority who do pay by the due dates. We therefore propose to provide for interest to be charged in respect of overdue payments. Where the FOS considers, in relation to firms in the Compulsory Jurisdiction, that late payment might have a bearing on a firm's continuing fitness for authorisation, it will refer the matter to the FSA.

Joiners and Leavers

- 4.20 For firms which become subject to the Scheme part way through the financial year, their general levy (and supplementary levy) will be calculated on a pro rata basis and the invoice will be issued at the start of the quarter following the date when they become subject to the Scheme. The calculation will be based on the tariff-base for the relevant industry-block (or blocks) and the proportion payable will be as follows:

For Joiners In		Proportion Payable
First quarter	April – June	100%
Second quarter	July – September	75%
Third quarter	October – December	50%
Fourth quarter	January – March	25%

- 4.21 This will apply to firms in the Compulsory and Voluntary Jurisdiction of the Scheme.
- 4.22 It is not proposed to give refunds in respect of the general levy or the supplementary levy to firms which cease to be subject to the Scheme part way through the year. However, exceptions may be made if notification has been received prior to the year in question. (This is consistent with the policy proposed in the context of FSA regulatory fees in CP56.) Rule 4.2.9 of Annex A to CP49 details procedures for withdrawal from the Voluntary Jurisdiction and the date of leaving to be used for calculating any refund would be that defined in Rule 4.2.9 (3). Mid-year 'leavers' will remain liable for 'standard' case fees incurred up to the end of the relevant financial year and will also be liable to charges in respect of any eligible complaints received after that date (see paragraph 4.23).

- 4.23 Under FISMA, consumers will be entitled to bring to the FOS complaints about firms which are no longer subject to the Compulsory Jurisdiction of the Scheme, provided that the complaint relates to business done when the firm was subject to the Scheme. Where the FOS handles such complaints after the end of the year in which the firm ceased to be subject to the Scheme, the FOS proposes to charge the firm a 'special' case fee on closure of the case.
- 4.24 Annex F gives an indication of the way we see the funding process working, in terms of the timing of consultation on the budget, the annual replacement of the annex to the rules, the provision by firms of their 'relevant business' data, and invoicing for levies and case fees.
- Q16 Do respondents have comments on any of the administrative arrangements /requirements proposed in this chapter?

5 Draft Financial Ombudsman Service Funding Rules

5.1 Application

5.1.1 R This chapter applies to all *firms* which are subject to the *Compulsory Jurisdiction of the Financial Ombudsman Service*.

5.1.2 G *VJ participants* have agreed to be bound by the provisions of *DISP 5* under the *Standard Terms* (see *DISP 4*).

Exemption

5.1.3 R A *firm* which does not conduct business with *eligible complainants* and has no reasonable likelihood of doing so, is exempt from *DISP 5.2* to *DISP 5.10* to the extent that it notifies the *FSA* of this fact and that notice remains current.

5.1.4 R A notice under *DISP 5.1.3R* must be given:

- (1) within one month of the *commencement day*, in which case it will remain current until the end of the financial year in which it is given; or
- (2) at the time of its authorisation by the *FSA*, in which case it will remain current until the end of the financial year in which it is given; or
- (3) at the point when it ceases to conduct business with *eligible complainants*, in which case it will remain current until the end of the financial year in which it is given; or
- (4) no later than one month before the start of a financial year, in which case it will remain current until the end of the financial year after which it is given.

5.1.5 G A notice under *DISP 5.1.3R* will be renewable every 12 months.

5.1.6 R If, during the course of a financial year, a *firm* ceases to conduct business with *eligible complainants* and notifies the *FSA* of this under *DISP 5.1.4R(3)*, it will be treated as a *firm* to which *DISP 5.10* applies.

End of Exemptions

5.1.7 R A *firm* which is exempt under *DISP 5.1.3R* must notify the *FSA* if, during the course of the financial year, the conditions in *DISP 5.1.3R* no longer apply.

5.1.8 R A *firm* to which the conditions in *DISP 5.1.3R* no longer apply will become subject to *DISP 5* and will be treated, for the purposes of its contribution towards the *general levy*, as a *firm* to which *DISP 5.9* applies.

5.2 Purpose

- 5.2.1 G The purpose of this chapter is to set out the requirements on *firms* to pay annual fees (through a *general levy*) and case fees to the *scheme operator* in order to fund the operation of the *Financial Ombudsman Service*. This chapter also contains a requirement on *firms* to pay a *supplementary levy* towards the costs of establishing the *Financial Ombudsman Service*.

5.3 Introduction

- 5.3.1 G Paragraph 9 of Schedule 17 to the *Act* (The Ombudsman Scheme) requires the *scheme operator* to adopt an *annual budget* which has been approved by the FSA Board. The *annual budget* must distinguish between the costs of operating the *Compulsory Jurisdiction* and the *Voluntary Jurisdiction*.
- 5.3.2 G Section 234 of the *Act* (Industry Funding) enables the FSA to require the payment to it or to the *scheme operator*, by *firms* or any class of *firm* of specified amounts (or amounts calculated in a specified way) to cover the costs of:
- (1) establishing the *Financial Ombudsman Service*; and
 - (2) its operation in relation to the *Compulsory Jurisdiction*.
- 5.3.3 G Paragraph 15 of Schedule 17 to the *Act* enables the *scheme operator* to require *firms* subject to the *Compulsory Jurisdiction* to pay specified fees to it in respect of complaints handled under the *Financial Ombudsman Service*.
- 5.3.4 G Paragraph 18 of Schedule 17 to the *Act* enables the *scheme operator* to require *VJ participants* to pay to it such amounts at such times as it specifies in the Standard Terms.
- 5.3.5 G The provisions of these rules will be applied to *VJ participants* through the Standard Terms made by the *scheme operator* under paragraph 18 of schedule 17 to the *Act* (see *DISP 4*).
- 5.3.6 G This chapter sets out the framework for the funding arrangements of the *Financial Ombudsman Service*, including the method by which fees will be calculated. Details of the actual fees payable will vary from year to year, depending on the *annual budget*. These details will be set out in an annex to this chapter (*DISP 5 Ann 1R*). A new annex will be prepared and consulted on for each financial year.

5.4 The General Levy

- 5.4.1 G Each financial year, the FSA and the *Financial Ombudsman Service* will consult on the amount of the *annual budget* of the *Financial Ombudsman Service* which is to be raised by the *general levy*.
- 5.4.2 G For the purposes of the *general levy*, a *firm* will fall into one or more of the *industry blocks* set out in *DISP 5 Ann 1R* depending on the business activities which it conducts.
- 5.4.3 G The FSA will determine, following consultation, the amount to be raised from each *industry block*. This will be based on the budgeted costs and numbers of *Financial Ombudsman Service* staff required to deal with the volume of complaints which the *Financial Ombudsman Service* expects to receive about the *firms* in each *industry block*.
- 5.4.4 G Part 2 of *DISP 5 Ann 1R* sets out the fee tariffs for each *industry block*.
- 5.4.5 G The FSA will specify a *minimum levy* for *firms* in each *industry block*.

5.4.6 R **A firm must pay to the *scheme operator* a *general levy* as described in *DISP 5.4.8R* towards the costs of operating the *Compulsory Jurisdiction of the Financial Ombudsman Service*.**

5.4.7 G Under the *Standard Terms*, *VJ participants* will be required to pay an amount calculated on a similar basis towards the costs of operating the *Voluntary Jurisdiction of the Financial Ombudsman Service*.

5.4.8 R **A firm's *general levy* is calculated as follows:**

(1) identify each of the tariff bases set out in part 2 of *DISP 5 Ann 1R* which apply to the *relevant business* of the firm for the relevant year;

(2) for each of those tariff bases, calculate the sum payable in relation to the *relevant business* of the firm for that year;

(3) add together the amounts calculated under *DISP 5.4.8R(2)*.

5.5 Information Requirement

5.5.1 R **A firm must provide the [FSA] by the end of February each year with a statement of the total amount of *relevant business* (measured in accordance with the appropriate tariff base(s)) which it conducted, as at 31 December of the previous year, in relation to each of the *industry blocks* set out in *DISP 5 Ann 1R*.**

5.5.2 G The *FSA* will pass the statements provided by *firms* under *DISP 5.5.1R* to the *scheme operator* for the purposes of invoicing *firms* for their *general levy* payments in accordance with these rules.

5.6 Case Fees

Standard Case Fee

5.6.1 R **A firm must pay to the *scheme operator* the standard case fee specified in *DISP 5 Ann 1R* in respect of each *chargeable case* relating to that *firm* which is closed under the *Financial Ombudsman Service*, unless one of the categories described in *DISP 5.6.4R-DISP 5.6.8R* applies.**

5.6.2 G The standard case fee, which will be subject to consultation each year, will be calculated by dividing the *annual budget* for the *Compulsory Jurisdiction*, less the amount to be raised by the *general levy*, by the estimated number of *chargeable cases* which the *Financial Ombudsman Service* expects to close in the relevant financial year.

5.6.3 R **A firm which is subject to the *minimum levy* in an *industry block* is not required to pay standard case fees in respect of *chargeable cases* relating to that *industry block*.**

Special Case Fees: Complaints from small businesses

- 5.6.4 R A firm must pay to the *scheme operator* a special case fee, as specified in *DISP 5 Ann 1R*, in respect of each *chargeable case* relating to that *firm* closed under the *Financial Ombudsman Service* which was referred to the *Financial Ombudsman Service* by *eligible complainants* who fall within *DISP 2.4.3R(1)(b), (c) or (d)*.
- 5.6.5 R A firm which is subject to the *minimum levy* in an *industry block* is not required to pay special case fees under *DISP 5.6.4R* in respect of *chargeable cases* relating to that *industry block*.

Special Case Fees: Firms which cease to be authorised

- 5.6.6 R A firm which ceases to be authorised must pay to the *scheme operator* a special case fee, as specified in *DISP 5 Ann 1R*, in respect of each *chargeable case* relating to that firm closed under the *Financial Ombudsman Service* which concerned an act or omission occurring when the firm was authorised where the activity to which the complaint relates was subject to the *Compulsory Jurisdiction*.

Special case fees for 2000/01

- 5.6.7 R A firm which was a member of the *PIA* before the *commencement day* must pay to the *scheme operator* a special case fee, as specified in *DISP 5 Ann 1R*, in respect of each *chargeable case* relating to that *firm* received by the *Financial Ombudsman Service* after the *commencement day* and before the end of the financial year in which the *commencement day* falls.
- 5.6.8 R A firm which was not a member of a *predecessor scheme* before the *commencement day* must pay to the *scheme operator* a special case fee, as specified in *DISP 5 Ann 1R*, in respect of each *chargeable case* which relates to business conducted by the *firm* after the *commencement day* which the *Financial Ombudsman Service* closes before the end of the financial year in which the *commencement day* falls.
- 5.6.9 G The relevant provisions of *DISP 5.6* will be applied to *VJ participants* via the *Standard Terms*.

5.7 The Supplementary Levy

- 5.7.1 G For the purposes of calculating the *supplementary levy*, the *FSA* will apportion the *establishment costs* between the *industry blocks* in the same proportions as the operating costs for the purposes of the *general levy*. The *supplementary levy* will therefore be raised from *firms* on the same basis and at the same time as the *general levy* (see *DISP 5 Ann 1R*).
- 5.7.2 G The *establishment costs* will be recovered via the *supplementary levy* over the first three full financial years of the *Financial Ombudsman Service's* operation.
- 5.7.3 G The amount of *establishment costs* to be raised each year through the *supplementary levy* will be specified in *DISP 5 Ann 1R*.

- 5.7.4 G The *supplementary levy* will be identified separately from the *general levy* for the purposes of invoicing *firms*.
- 5.7.5 R **A firm must pay to the scheme operator a supplementary levy towards the costs of establishing the Financial Ombudsman Service ("the establishment costs").**
- 5.7.6 R **A firm's supplementary levy will be a sum payable in accordance with the fee tariffs set out in part 5 of DISP 5 Ann 1R.**
- 5.7.7 G Under the *Standard Terms*, *VJ participants* will also be required to pay an amount calculated on a similar basis towards the costs of establishing the *Voluntary Jurisdiction of the Financial Ombudsman Service*.
- 5.8 Payment**
- 5.8.1 R **A firm must pay the general levy and any supplementary levy to which it is subject to the scheme operator either:**
- (1) annually, in advance; or
 - (2) quarterly, in advance, by direct debit agreement.
- 5.8.2 R **A firm must pay any general levy or supplementary levy which is not subject to a direct debit agreement within 30 days of the date when the invoice is issued on [1 April] each year.**
- 5.8.3 R **A firm must pay to the scheme operator any standard case fee or special case fee which it is liable to pay under DISP 5.6.1R; DISP 5.6.4R; DISP 5.6.6R and DISP 5.6.8R, as appropriate, at the end of each quarter in respect of chargeable cases closed by the Financial Ombudsman Service during that quarter.**
- 5.8.4 R **A firm must pay any standard case fee or special case fee within 30 days of the date when the invoice is issued after the end of each quarter.**
- 5.8.5 G The *scheme operator* will issue invoices for the *general levy*, any *supplementary levy*, standard case fees and special case fees and the invoice will be payable within 30 days.
- 5.8.6 R **If a firm does not pay a levy or case fee in full within 30 days of the date when the invoice is issued, it must, thereafter, pay interest at [x]% per annum for each day the unpaid part remains outstanding.**
- 5.8.7 G If a *firm* fails to make payment under these *rules*, the *scheme operator* may:
- (1) take steps to recover any money owed; and
 - (2) refer the matter to the *FSA* so that the *FSA* may take whatever disciplinary action it considers necessary.
- 5.8.8 G The procedure in DISP 5.8.7G(2) will not be followed in relation to *VJ participants*.

5.9 Joining the Financial Ombudsman Service

5.9.1 R A *firm* which becomes subject to the *Financial Ombudsman Service* part way through a financial year must pay a rateable proportion of the *general levy* and the *supplementary levy* as indicated in Table *DISP 5.9.2R*.

5.9.2 R Table *DISP 5.9.2R*

Quarter in which the <i>firm</i> becomes subject to the <i>Financial Ombudsman Service</i>	Proportion payable
1 April to 30 June inclusive	100%
1 July to 30 September inclusive	75%
1 October to 31 December inclusive	50%
1 January to 31 March inclusive	25%

5.9.3 G A *firm* will not be required to contribute towards any levy relating to the quarters of the financial year that were completed before it became subject to the *Financial Ombudsman Service*.

5.10 Leaving the Financial Ombudsman Service

5.10.1 R Where a *firm* ceases to be authorised part way through a financial year:

- (1) it will remain liable to pay standard case fees in respect of *chargeable cases* against it closed under the *Financial Ombudsman Service* for the remainder of that financial year; and
- (2) thereafter, it must pay the special case fee specified under *DISP 5.6.6R* in respect of any other *chargeable cases* against it closed under the *Financial Ombudsman Service*.

5.10.2 G *Firms* which cease to be authorised and, therefore, subject to the *Compulsory Jurisdiction* part way through the year will not, normally, receive a refund of their *general levy* (or *supplementary levy*). However, exceptions may be made if *firms* have informed the *FSA* of their plans before the end of the previous financial year. *Firms* will continue to be liable for any case fees relating to *chargeable cases* closed under the *Financial Ombudsman Service* after they cease to be authorised. *Firms* will be charged the standard case fee where the complaint was closed under the *Financial Ombudsman Service* before the end of the year in which their authorisation ceased. The special case fee will apply to any complaint closed after the end of that year since the *firm* will no longer be contributing to the *general levy*.

DISP 5 Ann 1R: Illustrative Annual Fees Payable in Relation to [2002/03]

Introduction: Annual Budget

(1) The *annual budget* for [year] as approved by the FSA is £[x].

Part 1: General Levy

(2) The total amount of the *general levy* to be raised in [year] will be £[x].

Part 2: Fee tariffs for General Levy

(3) Table: fee tariffs for *industry blocks*

Industry Block	Tariff Base	Fee Payable by firm
1 <i>Deposit</i> takers and lenders, including credit unions	Relevant accounts	£[X] per [number] of relevant accounts subject to a minimum levy of £[x]
2 <i>Firms</i> that undertake insurance activities subject to prudential regulation only + Lloyds Managing Agents + Society of Lloyds	Relevant gross <i>premium</i> income	£[X] per £[X] of relevant gross <i>premium</i> income subject to a minimum levy of £[x]
3 <i>Firms</i> that undertake insurance activities subject to both prudential and conduct of business regulation (long term life business)	Relevant gross <i>premium</i> income	£[X] per £[X] of relevant gross <i>premium</i> income subject to a minimum levy of £[x]
4 Fund managers (including those holding <i>client money/assets</i> + not holding <i>client money/assets</i>)	Relevant funds under management	£[X] per £[X] of relevant funds under management subject to a minimum levy of £[x]
5 <i>Unit trust managers/OEIC authorised corporate directors</i>	Relevant gross income arising from the activity	£[X] per £[X] of relevant gross income from the activity subject to a minimum levy of £[x]
6 <i>Trustees of collective investment schemes/OEIC depositaries</i>	Relevant gross income arising from the activity	£[X] per £[X] of relevant gross income from the activity subject to a minimum levy of £[x]
7 <i>Firms</i> that deal as <i>principal</i>	Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity subject to a minimum levy of £[x]
8 Execution only brokers + brokers holding <i>client money/assets</i> + corporate finance advisers	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity subject to a minimum levy of £[x]

9 Brokers (excluding execution-only brokers and corporate finance advisers) not holding client money and/or assets	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity subject to a minimum levy of £[x]
10 Advisers only	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] relevant <i>commission</i> and/or <i>fee</i> income from the activity subject to a minimum levy of £[x]

G For the purposes of the tariff bases, references to 'relevant' relate to a *firm's relevant business*.

Part 3: Case Fees

(4) Standard Case Fees and Special Case Fees

Governing Provisions	Case Fee	Amount
<i>DISP 5.6.1R</i>	Standard	£[x]
<i>DISP 5.6.4R</i>	Special	£[x]
<i>DISP 5.6.6R</i>	Special	£[x]
<i>DISP 5.6.7R</i>	Special	£[x]
<i>DISP 5.6.8R</i>	Special	£[x]

Part 4: Supplementary Levy

(5) The total amount of *establishment costs* to be raised in [year] by the *supplementary levy* is £[x].

Part 5: Fee tariffs for Supplementary Levy

(6) Table: fee tariffs for *industry blocks*

Industry Block	Tariff Base	Fee Payable by firm
1 <i>Deposit</i> takers and lenders, including credit unions	Relevant accounts	£[X] per [number] of relevant accounts
2 <i>Firms</i> that undertake insurance activities subject to prudential regulation only + Lloyds Managing Agents + Society of Lloyds	Relevant gross <i>premium</i> income	£[X] per £[X] of relevant gross <i>premium</i> income

3 Firms that undertake insurance activities subject to both prudential and conduct of business regulation (long term life business)	Relevant gross <i>premium</i> income	£[X] per £[X] of relevant gross <i>premium</i> income
4 Fund managers (including holding <i>client money/assets</i> + not holding <i>client money/assets</i>)	Relevant funds under management	£[X] per £[X] of relevant funds under management
5 Unit trust managers/OEIC authorised corporate directors	Relevant gross income arising from the activity	£[X] per £[X] of relevant gross income from the activity
6 Trustees of collective investment schemes/OEIC depositaries	Relevant gross income arising from the activity	£[X] per £[X] of relevant gross income from the activity
7 Firms that deal as principal	Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity
8 Execution only brokers + brokers holding <i>client money/assets</i> + corporate finance advisers	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity
9 Brokers (excluding execution-only brokers and corporate finance advisers) not holding <i>client money</i> and/or assets	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] of relevant <i>commission</i> and/or <i>fee</i> income from the activity
10 Advisers only	Relevant approved persons OR Relevant <i>commission</i> and/or <i>fee</i> income from the activity	£[X] per approved person OR £[X] per £[X] relevant <i>commission</i> and/or <i>fee</i> income from the activity

DEFINITIONS

The preceding provisions make use of various terms, identified by *italics*, which have the meanings set out below. (Note: only the key definitions which are of immediate relevance to these provisions have been included here. And we have not repeated here those definitions which are well understood within the financial services industry. All defined terms will, however, be set out in the complete Handbook Glossary.)

<i>annual budget</i>	the annual budgeted costs of operating the <i>Financial Ombudsman Service</i> , taking account of any adjustments for the annual costs of the previous year, as approved by the <i>FSA</i> ;
<i>chargeable case</i>	any complaint referred to the <i>Financial Ombudsman Service</i> , apart from those where the <i>Ombudsman</i> considers it is apparent from the complaint as received, and any final response which has been issued by the <i>firm</i> , that the complaint should not proceed because: (1) the complainant is not an <i>eligible complainant</i> in accordance with <i>DISP 2</i> ; or (2) the complaint does not fall within the jurisdiction of the <i>Financial Ombudsman Service</i> (as described in <i>DISP 2</i>) or falls outside the time limits set out in <i>DISP 1.7 R</i> ; or (3) the <i>Ombudsman</i> considers that the complaint should be dismissed without consideration of its merits under <i>DISP 3.5</i> ; (4) the <i>Ombudsman</i> considers, at any stage, that the complaint should be dismissed under <i>DISP 3.5.1R(3)</i> on the grounds that it is frivolous or vexatious.
<i>commencement day</i>	the day specified in an order made by the Treasury under Section 431 of the <i>Act</i> (Commencement) for the purposes of commencing Part II of the <i>Act</i> ;
<i>Compulsory Jurisdiction</i>	the jurisdiction of the <i>Financial Ombudsman Service</i> to which <i>firms</i> are compulsorily subject;
<i>DISP</i>	the <i>FSA</i> rules on dispute-resolution and the ombudsman scheme rules which form part of Block 4 of the <i>Handbook</i> ;
<i>eligible complainant</i>	persons who may refer a complaint to the <i>Financial Ombudsman Service</i> as defined in <i>DISP 2.4</i> ;
<i>establishment costs</i> <i>Financial Ombudsman Service</i>	the costs of establishing <i>the Financial Ombudsman Service</i> ; the scheme which the <i>FSA</i> is required to set up for the resolution of disputes under Schedule 17 to the <i>Act</i> ;
<i>firm</i>	an authorised person;
<i>FSA, the</i>	the Financial Services Authority;
<i>general levy</i>	the annual fee raised from firms under <i>FSA</i> rules to fund an agreed part of the annual budget;
<i>industry block</i>	a grouping of <i>firms</i> by common business activity for the purposes of calculating the <i>general levy</i> ;
<i>minimum levy</i>	the fixed minimum <i>general levy</i> payable by a <i>firm</i> ;
<i>Ombudsman</i>	a person appointed by the <i>scheme operator</i> under paragraph 4 of Schedule 17 to <i>the Act</i> to the panel of persons maintained by the <i>scheme operator</i> to determine complaints, including the Chief

	Ombudsman;
<i>PIA</i>	the Personal Investment Authority Limited;
<i>relevant business</i>	that part of a <i>firm</i> business which it conducts with private individuals and which is subject to the jurisdiction of the <i>Financial Ombudsman Service</i> as provided for under <i>DISP 2.6</i> , measured by reference to the appropriate tariff base for each <i>industry block</i> ;
<i>Act, the</i>	the Financial Services and Markets Act 2000;
<i>scheme operator</i>	the Financial Ombudsman Service Limited;
<i>Standard Terms</i>	the contractual terms made under paragraph 18 of Schedule 17 to the <i>Act</i> by which <i>VJ participants</i> participate in the <i>Voluntary Jurisdiction</i> ;
<i>supplementary levy</i>	a levy, additional to the <i>general levy</i> , for the purposes of recovering the <i>establishment costs</i> ;
<i>Voluntary Jurisdiction</i>	the jurisdiction of the <i>Financial Ombudsman Service</i> in which persons (whether authorised or not) participate under contract;
<i>VJ participant.</i>	a person subject to the <i>Voluntary Jurisdiction</i> of the <i>Financial Ombudsman Service</i> by contract.

Factors to which the FSA has had regard in designing the proposed arrangements for funding the Financial Ombudsman Service ('the principles of good regulation')

The new single ombudsman scheme will play a key and complementary part in helping the FSA to achieve the appropriate degree of protection for consumers, by providing them with a free, accessible and user-friendly alternative to the courts. As noted in CP49, we believe that it will also help to promote the FSA's public awareness objective by promoting general awareness of the standards which consumers can expect of the firms with which they deal and informing our consumer education work. It should also help to increase consumer confidence in the financial services sector, provide the FSA and firms with valuable information about consumer problems and reduce the need for regulatory intervention.

The proposals contained in this paper aim to produce a result which is generally fair to all firms and which will be practical to operate. In designing them, we have had regard to the principles of good regulation set out in FISMA.

Efficiency and Economy

This relates to the use of resources. In designing the proposed arrangements for funding the Compulsory Jurisdiction of the FOS, the FSA has sought to make them efficient and economic to operate. For example, as with the proposals relating to the FSA's own fees (set out in CP56), we will need to collect data from firms about the size of their 'relevant business' for funding purposes. We have therefore sought to align the FOS tariff-bases and industry-blocks with the FSA's as far as possible in order to avoid unnecessary duplication of effort, both for firms and for the FSA – and the FOS proposes to apply the same funding mechanism to firms in the Voluntary Jurisdiction. We also aim to achieve economies of scale wherever possible by sharing resources when appropriate.

At a more general level, it is important to note that FISMA provides that the FOS budget is subject to FSA approval each year. In doing this, we will have careful regard to any burden which the funding obligation imposes on firms and the need to ensure that this is consistent with the benefits to be derived from the Scheme.

The responsibility of firms' management

A firm's management is responsible for its activities and for ensuring its business is compliant with regulatory requirements, including the funding requirements.

Proportionality

The burden of regulation on firms should be in proportion to the expected benefits for consumers and the industry. Our proposals for funding the FOS seek to achieve this in a number of ways:

- The combination of a general levy and case fees reflects the fact that all firms will derive a reputational benefit from the existence of the new FOS and should therefore contribute in some measure to the costs of the scheme, but ensures that those who give rise to complaints would bear a higher proportion of the costs – in proportion to the number of complaints which they generate.
- The decision to raise 50% of the FOS's operating costs through a general levy and 50% through case fees has been widely accepted by respondents to earlier consultation papers as a reasonable starting point for the first year of the scheme. However, we aim to increase the proportion of the scheme funded by case fees as soon as possible in the light of experience of operating the scheme.
- The general levy will be allocated between the different industry-blocks in proportion to the amount of each firm's 'relevant business' and the resources required to deal with the estimated caseload to which each of these industry-blocks will give rise. This will ensure that the general levy is raised on a basis which takes account both of the size of a firm's business and of the risks which the general nature of its business poses in terms of potential complaints to the FOS.
- The overall costs of the FOS reflect the fact that it has been designed in a way which takes account of the differing needs of different types of consumers. Access to the Scheme will be limited to private individuals and small businesses which are in a similar position to private individuals. Intermediate customers and market counterparties will not be able to use the Scheme and business conducted with such customers will not count towards a firm's relevant business for funding purposes.
- The proposals also distinguish between firms which could give rise to FOS complaints and those which could not. Firms which certify to the FSA that they do not do business with customers who would be eligible to use the FOS will not be subject to the proposed funding requirements. The proposal to base the general levy on business conducted with private

individuals only and to charge special case fees for small business complaints avoids imposing a disproportionate burden on firms which conduct only occasional business with small businesses which could be eligible to use the FOS.

- We propose to recover the costs of establishing the FOS on the same basis as the general levy. This is essentially the same as the method which the FSA proposes to adopt in recovering the costs of setting up the new regulatory regime as a whole (i.e. in proportion to the amount of relevant business conducted by each firm).

The desirability of facilitating innovation

We believe that the existence of consistent (and improved) complaints arrangements across the industry will increase consumer confidence in the financial services industry. FISMA enables the FSA (and the FOS) to amend their rules to change the coverage of the FOS's Compulsory and Voluntary Jurisdictions to reflect the development of new activities and products and the funding arrangements can be adapted to accommodate any such changes. The FOS should facilitate innovation by helping to generate the necessary level of consumer confidence to make the development of new products and services worthwhile.

The international character of financial services markets

We believe that the existence of an effective independent dispute resolution mechanism should add to consumer and market confidence, enhancing the competitive position of the UK. In particular, requiring overseas firms with a permanent place of business in the UK to be subject to the Compulsory Jurisdiction of the Scheme on the same basis as UK-based firms should help to maintain the confidence of all consumers using UK markets. Furthermore, we believe that the proposed arrangements will ensure the necessary protection for overseas consumers wishing to do business in the UK, since they will be available to all consumers of UK financial services, irrespective of where they live.

We do not think that the proposed arrangements will result in costs which will have an adverse impact on the attractiveness of the UK as a place to undertake financial services business. However, this is a matter to which we shall pay close regard in approving the FOS budget each year.

The need to minimise adverse effects on competition

The proposals relating to the funding of the Compulsory Jurisdiction and the Voluntary Jurisdiction take account of the need to avoid, as far as possible, creating adverse effects on competition between authorised and unauthorised firms which are conducting similar business. They do so by ensuring that the same funding arrangements will apply to both jurisdictions. Firms which conduct similar activities will therefore be treated in the same way, irrespective of whether they are authorised or unauthorised.

The proposed funding arrangements take account of the size and nature of a firm's business. They also seek to avoid imposing a disproportionate burden on very small firms. They do this by providing that firms which conduct very small amounts of relevant business will pay a minimum levy only, and will not be subject to case fees.

The desirability of facilitating competition between those regulated by the FSA.

The requirement to be subject to the new Scheme will apply to all authorised firms which do business with persons eligible to use the Scheme and the obligation to contribute to its funding will be allocated to firms in a way which reflects both their size and the nature of their business.

Our proposals take account of the desirability of facilitating competition between firms regulated by the FSA by defining different industry-blocks so that they will contain firms which offer similar products and services. The costs borne by each industry-block will reflect the cost of handling complaints in relation to that particular sector and the tariff-bases are designed to ensure that they are allocated fairly between the firms within each block. The case fee element ensures that those who give rise to complaints contribute more towards the costs of the Scheme, in proportion to the volume of complaints which they generate.

We therefore do not believe that these proposals will restrict firms' ability to compete with each other in providing financial services. On the contrary, the new Scheme should result in a greater degree of consistency of treatment for authorised firms in terms of complaints.

Proposed FSA fee-blocks and tariff-bases (as set out in Annex C to CP56)

Primary activity grouping	Secondary activity grouping	Legal basis for activities	Potential tariff base
	Category A	Authorised persons under section 31 of FSMA	
Deposit Taking	A. 1 Deposit-takers other than credit unions	<p>Regulated activity: Deposit Taking</p> <p>Limitation: None which could mean that firms in this fee-block could be identified as a Credit Union (i.e. an authorised person that satisfies the criteria that are defined in section 1 of the Credit Union Act 1979)</p>	Total assets of UK offices or total deposits or risk weighted assets or non-bank deposits or modified eligible
Deposit Taking	A. 2 Credit Unions	<p>Regulated activity: Deposit Taking</p> <p>Limitation: which would mean that firms within this fee-block could be identified as a Credit Union (i.e. an authorised person that satisfies the criteria that are defined in section 1 of the Credit Union Act 1979)</p>	Non-bank-deposits or total assets of UK offices or total deposits of UK offices
Insurance Business	A. 3 Insurance activities subject to prudential regulation only	<p>Regulated activities: EITHER: Effecting contracts of insurance AND/OR Carrying out contracts of insurance. AND</p> <p>Investment types: EITHER Rights under general insurance contracts (2(b)(i));OR Rights under long-term insurance contracts (2(b)(ii)) THAT ARE NOT contractually-based investments; OR THAT ARE Additional categories for friendly societies (2(b)(iii))</p>	Gross premium income or net premium income or gross assets

Primary activity grouping	Secondary activity grouping	Legal basis for activities	Potential tariff base
Insurance Business	A. 4 Insurance activities subject to both prudential and conduct of business regulation	<p>Regulated activities: EITHER effecting contracts of insurance; AND/OR carrying out contracts of insurance. AND</p> <p>Investment types: Rights under long-term insurance contracts (2(b)(ii)) THAT ARE contractually based investments</p>	Gross premium income, as currently defined in PIA tariff (as per ABI statistics) or life fund assets (to capture investment element)
Insurance Business	A. 5 The Lloyd's managing agents	<p>Regulated activity: Managing the underwriting capacity of Lloyd's syndicates as a managing agent at Lloyd's</p>	Gross premium income of the syndicates that they manage
Insurance Business	A. 6 The Society of Lloyd's	<p>Regulated activity: Arranging deals in contracts of insurance written at Lloyd's; AND arranging deals in participation in Lloyd's syndicates; AND Activity carried out in connection with, or for the purpose of, either of the above activities. (Authorised person by virtue of section 315 of the FSMA)</p>	N/a - only one organisation in this business category
Investment Business	A. 7 Fund managers - holding client money and/or assets	<p>Regulated activity: Managing investments AND Providing safekeeping and administration of investments</p> <p>Limitations: No limitation on holding client money</p>	Funds under Management ('FuM')
Investment Business	A. 8 Fund managers - not holding either client money and/or assets	<p>Regulated activity: Managing investments BUT NOT Providing safekeeping and administration of investments</p> <p>Limitations: Can not hold client money</p>	Funds under Management
Investment Business	A.9 Unit Trust Managers ('UTMs')/ OEIC Authorised Corporate Directors ('ACDs')	<p>Regulated Activities: Establishing, operating or winding up a regulated collective investment scheme; OR Establishing, operating or winding up an un-regulated collective investment scheme; OR Acting as the sole director of an OEIC</p>	Gross income from the activity

Primary activity grouping	Secondary activity grouping	Legal basis for activities	Potential tariff base
Investment Business	A.10 Trustees of collective investment schemes /OEIC Depositaries	Regulated activities: Acting as trustee or depositary of a regulated collective investment scheme; OR Acting as trustee or depositary of an un-regulated collective investment scheme	Gross income from the activity
Investment Business	A. 11 Dealing as principal	Any one (or combination) of the following: Regulated activity: <ul style="list-style-type: none"> • Making a market in securities; AND/OR • Buying securities with a view to selling; AND/OR • Regularly soliciting the public to deal in securities; AND/OR • Dealing as principal in contractually based investments (in so far as not related to the activities of effecting or carrying out contracts of insurance in A.4 above – limitation?) 	Gross assets related to the activity or total trading book capital charges.
Investment Business	A.12 Execution-only brokers	Regulated activity: Any one (or combination) of the following: <ul style="list-style-type: none"> • Dealing as agent; AND/OR • Arranging deals for another; AND/OR • Making arrangements enabling or facilitating deals BUT MUST NOT HAVE PERMISSION TO PROVIDE Investment advice	Commission income from the activity or number of approved persons.
Investment Business	A.13 Brokers (excluding execution-only brokers and corporate finance advisers) – holding client money and/or assets	Regulated activity: Any one (or combination) of the following: <ul style="list-style-type: none"> • Dealing as agent; AND/OR • Arranging deals for another; AND/OR • Making arrangements enabling or facilitating deals. AND MUST HAVE BOTH Investment advice AND Providing safekeeping and administration of investments Limitation: No limitation on holding client money AND NOT: a Corporate Finance Adviser (as defined by A.15 below)	Commission and/or fee income from the activity or number of approved persons

Primary activity grouping	Secondary activity grouping	Legal basis for activities	Potential tariff base
Investment Business	A.14 Brokers (excluding execution-only brokers and corporate finance advisers) – not holding either client money or assets	<p>Regulated activity: Any one (or combination) of the following:</p> <ul style="list-style-type: none"> • Dealing as agent; AND/OR • Arranging deals for another; AND/OR • Making arrangements enabling or facilitating deals. <p>AND MUST HAVE Investment advice BUT NOT Providing safekeeping and administration of investments.</p> <p>Limitation: Limitation on holding client money. AND NOT: a Corporate Finance Adviser (as defined by A.15 below).</p>	Commission and/or fee income from the activity or number of approved persons.
Investment Business	A.15 Corporate Finance Advisers	May not be definable through permissions alone, but there is a definition of corporate finance advisory firms in CP45 (draft COB sourcebook).	Commission and/or fee income from the activity or number of approved persons.
Investment Business	A.16 Advisory only	<p>Regulated activity: EITHER Investment advice OR Advising an underwriting member of the Society of Lloyd’s to become, continue or cease to be a member of a particular syndicate. BUT NONE of the dealing/arranging permissions used in defining A.12 to A.14 above, nor a Corporate Finance Adviser (as defined in A.15 above).</p>	Commission and/or fee income from the activity or number of approved persons.

Comparison of proposed FOS industry-blocks with FSA fee-blocks

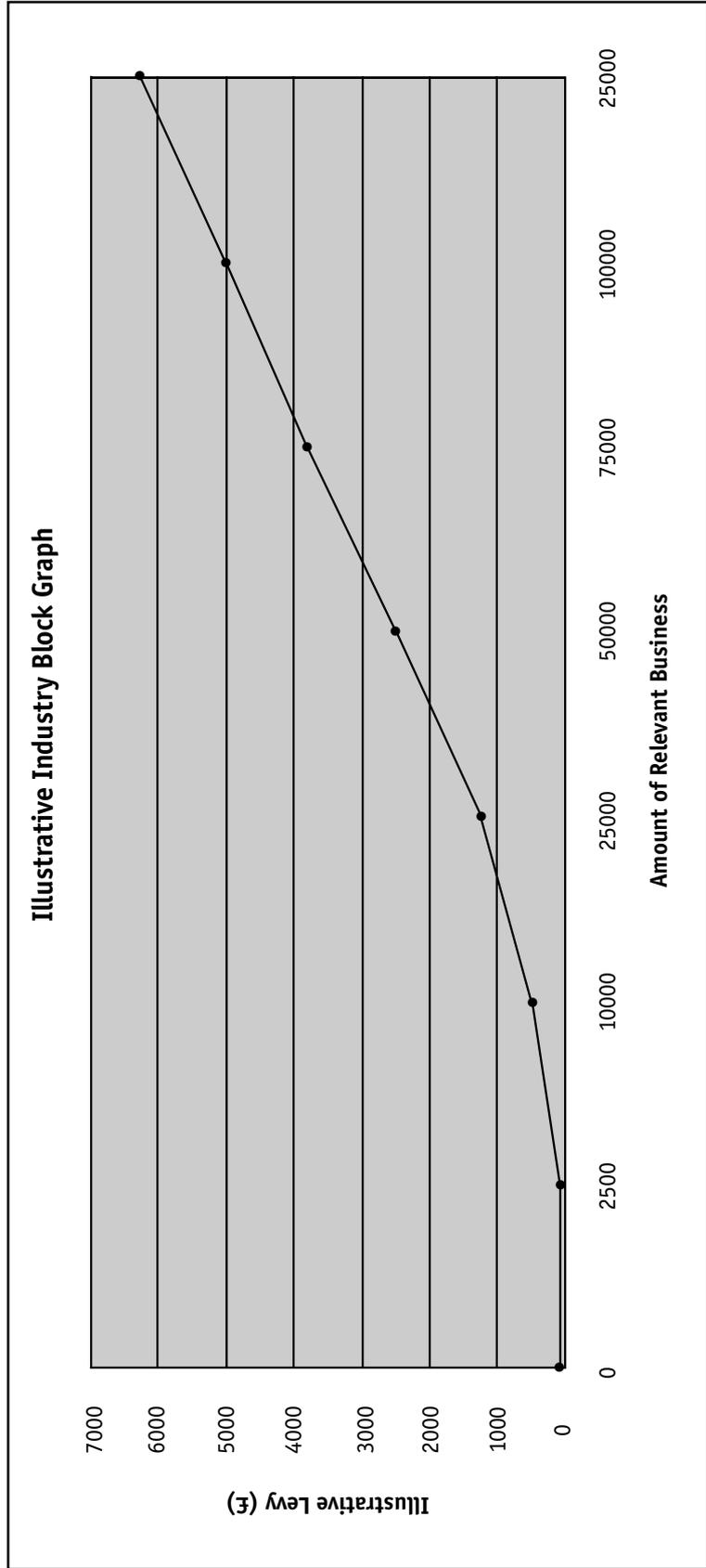
FOS Division	Proposed FOS Industry-Block + Business Activity	Proposed Tariff –base(s) for FOS	Proposed FSA Fee Block + Activity Grouping (subject to change following consultation)	Proposed Tariff Base(s) for FSA (subject to change following consultation)
Banking & Loans	1 – deposit-takers and lenders (including credit unions)	Relevant accounts	A1 – deposit takers other than credit unions	Total assets of UK offices or total deposits or risk weighted assets or non-bank deposits or modified eligible
			A2 – credit unions	Non-bank deposits or total assets of UK offices or total deposits of UK offices
Insurance	2 – insurance activities subject to prudential regulation only + Lloyd’s Managing Agents + Society of Lloyd’s	Relevant gross premium income	A3 – insurance activities subject to prudential regulation only	Gross premium income or net premium income or gross assets
			A5 – Lloyd’s Managing Agents	Gross premium income of the syndicates that they manage
			A6 – Society of Lloyd’s	N/A
Investments	3 – insurance activities subject to both prudential and conduct of business regulation (long term life insurers)	Relevant gross premium income	A4 – insurance activities subject to both prudential and conduct of business regulation	Gross premium income, as currently defined in PIA tariff (as per ABI statistics) or life fund assets (to capture investment element)
			A7 – Fund managers – holding client money and/or assets	Funds under management
	4 – Fund managers (including holding client money/assets and not holding client money/assets)	Relevant funds under management	A8 – Fund managers – not holding either client money and/or assets	Funds under management
			A9 – Unit Trust Managers/OEIC authorised corporate directors	Gross income from the activity
	5 – Unit trust managers/OEIC authorised corporate directors	Relevant gross income from the activity	A10 – Trustees of collective investment schemes/OEIC depositaries	Gross income from the activity
			A11 – Dealing as principal	Gross assets related to the activity or total trading book capital charges
	6 – Trustees of collective investment schemes/OEIC depositaries	Number of relevant approved persons OR Relevant commission and/or fee income from the activity	A12 – Execution-only brokers	Commission and/or fee income from the activity or number of approved persons
			A13 – Brokers (excluding execution-only brokers and corporate finance advisers) – holding client money and/or assets	Commission and/or fee income from the activity or number of approved persons
7 – Dealers as Principal	Number of relevant approved persons OR Relevant commission and/or fee income from the activity	A15 – Corporate Finance Advisers	Commission and/or fee income from the activity or number of approved persons	
8 – Stockbrokers and corporate finance advisers (FSA fee blocks A12, A13 and A15).				

FOS Division	Proposed FOS Industry-Block + Business Activity	Proposed Tariff-base(s) for FOS	Proposed FSA Fee Block + Activity Grouping (subject to change following consultation)	Proposed Tariff-base(s) for FSA (subject to change following consultation)
	9 – Brokers, including independent financial advisers (FSA fee block A14).	Number of relevant approved persons OR relevant commission and/or fee income from the activity	A14 – Brokers (excluding execution-only brokers and corporate finance advisers) – not holding either client money or assets	Commission and/or fee income from the activity or number of approved persons
	10 – Advisers only	Number of relevant approved persons OR relevant commission and/or fee income from the activity	A16 – Advisory only	Commission and/or fee income from the activity or number of approved persons

Illustrative Industry-Block Allocation Graph

Illustrative Data	
Annual Budget	£10,000,000
Allocation of Annual Budget to Industry-Block	5%
Annual Budget allocated to Industry-Block	£500,000
Total amount of Relevant Business as measured against Tariff-base	10,000,000
Fee Tariff	£50 per 1,000
Minimum Fee	£100

Firm	Amount of Business	Illustrative Levy
A	2,500	£125
B	10,000	£500
C	25,000	£1,250
D	50,000	£2,500
E	75,000	£3,750
F	100,000	£5,000
G	125,000	£6,250



Funding Process Time-table

JANUARY	<p>FOS consults on budget</p> <p>FSA/FOS consult on new annex to rules, including:</p> <ul style="list-style-type: none"> • Total amount to be raised by general levy and by case fees • Total amount to be raised from each industry-block • Tariff-rate (i.e. £ per unit) for each industry-block • The amount of the case fees • Total amount to be raised (in 1st 3 years) by a supplementary levy to recover 'establishment costs'
FEBRUARY (end)	'Relevant business' data (as at 31 December of previous year) sent to FSA/FOS.
MARCH	Budget approved by FSA. FSA/FOS annex to fees rules replaced.
1 APRIL	Invoices sent to firms
1 JULY	Quarterly case fee invoice sent out
1 OCTOBER	Quarterly case fee invoice sent out (plus mid-year adjustments to levy invoices if necessary).
1 JANUARY	Quarterly case fee invoice sent out.

Glossary

FOS	Financial Ombudsman Service
FSA	Financial Services Authority
FISMA	Financial Services and Markets Act 2000 (received Royal Assent 14 June 2000)
CP33	Joint FSA and FOS Consultation Paper 'Consumer complaints and the new single ombudsman scheme'
CP49	Joint FSA and FOS Consultation Paper 'Complaints handling arrangements: Feedback statement on CP33 and draft rules'
CP56	FSA Consultation Paper 'The Financial Services Authority's Post-N2 Fee-Raising Arrangements'
IFG	Industry Funding Group
PIAS	Personal Insurance Arbitration Service
RPB	Recognised Professional Body
Standard Terms	The contractual arrangements governing the Voluntary Jurisdiction
Scheme Rules	The arrangements governing the procedural operation of the Compulsory Jurisdiction
Scheme Operator	Financial Ombudsman Service Limited
N2	The date on which the FSA and the FOS will receive their statutory powers and functions under FISMA

Summary of questions

Question number	Ref.	Question
1	3.14	Do respondents agree with the proposed FOS industry-blocks set out in Annex D – and do they have any views on whether it is appropriate to create a separate mortgage lending block?
2	3.25	Do respondents agree with the tariff-bases proposed in the table at 3.19 above?
3	3.25	In particular, do they have a view on: <ul style="list-style-type: none"> (i) whether the tariff-base for deposit-takers should be weighted in some way to take account of different types of account (para 3.21); and (ii) whether the appropriate tariff-base for advisers and brokers should be the number of relevant approved persons or relevant commission/fee income (paragraphs 3.22–3.25).
4	3.28	Do respondents agree that, for FOS general levy purposes, ‘relevant business’ should be restricted to business done with private individuals only?
5	3.28	Do respondents agree that small business complaints should be funded separately by a ‘special’ case fee (as described at paragraphs 3.27–3.28)?
6	3.31	Do respondents agree that a ‘straight line’ approach should be adopted for the FOS industry-blocks?
7	3.31	Do respondents believe that the logarithmic approach described in 3.31 should be applied to the fund managers industry-block (or any of the other proposed industry-blocks)?
8	3.33	Do respondents agree with the proposal for a minimum levy?

- 9 3.33 Do respondents agree with the proposal that those firms which qualify for the minimum levy should not be subject to case fees.
- 10 3.34 Do respondents agree that there should be no maximum levy?
- 11 3.38 Do respondents have any views on the issues relating to the possible future refinement of the approach to case fees outlined in paragraph 3.38?
- 12 3.41 Do respondents agree with the proposal for the FOS to charge special case fees in the circumstances outlined above?
- 13 3.42 Do respondents have any comments on the proposed definition of chargeable case?
- 14 3.46 Do respondents agree with this proposal for recovering the establishment costs of the new Scheme?
- 15 3.50 Do respondents agree with the proposals for funding 2001/02 as set out in paragraphs 3.48 – 3.50 above?
- 16 4.24 Do respondents have comments on any of the administrative arrangements /requirements proposed in this chapter (i.e. chapter 4)?