Financial Ombudsman Service

Our future funding

Our response to feedback and next steps

November 2019

Contents

This summary and feedback statement reflects our current thinking on our future funding. We'll give more detail about our proposed 2020/21 plans and budget in December 2019, when they will be subject to public consultation.

The FCA has responsibility for confirming the levy it will collect from regulated firms each year, and approving proposals we make about our case fees.

About us

We were set up by Parliament under the *Financial Services and Markets Act 2000* to resolve individual complaints between financial businesses and their customers – fairly and reasonably, quickly, and with minimal formality. On 1 April 2019, our remit was extended to complaints made by more small businesses about financial services, and to complaints made by customers of claims management companies.

If a business and their customer can't resolve a problem themselves, we can step in to sort things out. Independent and unbiased, we'll get to the heart of what's happened and reach an answer that helps both sides move on. And if someone's been treated unfairly, we'll use our powers to make sure things are put right. This could mean telling the business to apologise, to take action or to pay compensation – in a way that reflects the particular circumstances. For complaints about events that happened after 1 April 2019, we can tell a business to pay up to £350,000.

In resolving hundreds of thousands of complaints every year, we see the impact on people from all sorts of backgrounds and livelihoods. We're committed to sharing our insight and experience to encourage fairness and confidence in the different sectors we cover.

About our consultation

The context for change

Our service tripled in size in response to the unprecedented payment protection insurance (PPI) mis-selling scandal. Assuming something on that scale doesn't happen again, we're planning on the basis we'll be a smaller organisation in future. So, in combination with our focus on finding efficiencies and smarter ways of working, we expect the overall cost of our service to fall in the coming years.

However, as PPI reaches a conclusion, we expect to see a changing mix of complaints, and a continued trend toward complexity in our casework. Looking ahead, we know we'll need to account for the potential for volatility in demand for our help. And we also want to maintain, and build on, the wider value of our service – sharing our insight and experience to prevent complaints arising in the first place.

Conversations about our funding

Against this backdrop, we've been talking to our stakeholders about the most effective way of collecting the funds we'll need in the years ahead.

In 2018 and 2019, we've used our regular engagement with financial businesses, trade bodies and consumer organisations to generate discussion about both the principles and practicalities of our funding. This included a series of roundtable meetings focused specifically on these issues.

These conversations informed our 2019/20 plans and budget consultation, published in December 2018. As well as considering the next financial year, we also looked further ahead – illustrating some features that potential future funding models might have, to generate discussion about their pros and cons. Although there was tentative interest in exploring a new type of 'risk-based' levy, many stakeholders reflected on the strengths of our existing FCA levy-plus-case fee model.

Having considered this feedback, in July 2019 we formally consulted on three proposals aimed at generating greater stability and certainty for us and for firms that contribute to our funding.

The summary from pages 4 to 7 gives an overview of these proposals, the key points stakeholders made in response to our consultation, as well as our response. The rest of this feedback statement looks at individual consultation questions in greater detail.

2015 - 2017

- Our plans and budget consultations highlighted the need to think differently about our funding, in view of our changing ways of working, an uncertain future workload and pressures on costs.

Spring/ summer 2018

- We ran roundtables focused on our future funding.
- We engaged with businesses, trade bodies and consumer organisations one-to-one and at industry steering group and consumer liaison group meetings.

Autumn/ winter 2018

- We continued to engage with businesses, trade bodies and consumer organisations one-to-one and at industry steering group and consumer liaison group meetings.
- We promoted discussion about our future funding and strategy in our 2019/20 plans and budget consultation.

Spring/ summer 2019

- We continued to engage with businesses, trade bodies and consumer organisations at industry steering group and consumer liaison group meetings.
- We opened formal consultation on our funding proposals.

Autumn/ winter 2019

- **We publish our funding consultation feedback statement.** 54 organisations responded to our July 2019 consultation (see page 21 for a list).
- We'll engage with businesses, trade bodies and consumer organisations one-to-one and at industry steering group and consumer liaison group meetings.
- We'll publish our 2020/21 strategic plans and budget consultation, including future funding and strategy proposals.

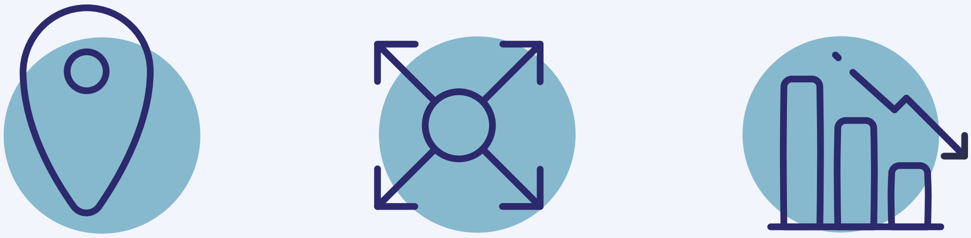
Spring 2020

- We'll publish our final strategic plans and budget for 2020/21. Our budget is subject to approval by the Financial Conduct Authority (FCA).

Summary

The context for change

In our consultation, we reviewed how our service has been funded in the years since we were established. We then looked ahead, explaining how we expect the overall cost of our service to fall significantly after PPI reaches its conclusion. We also highlighted the continued trend toward complexity and potential for volatility in complaints, our complaint prevention work and the wider value of our service as factors that have a bearing on our future funding.



Feedback

- There was widespread support for our established funding principles, and most respondents acknowledged the need for change in our funding.
- The majority of respondents expressed strong support for our wider work to help prevent complaints and encourage fairness.
- We received suggestions about areas where we could share more of our insight, as well as how we might make efficiencies as we develop our service.

Our response

We're reassured by respondents' general agreement with our assessment of the challenges we're facing, as well as their recognition of the wider value of our service.

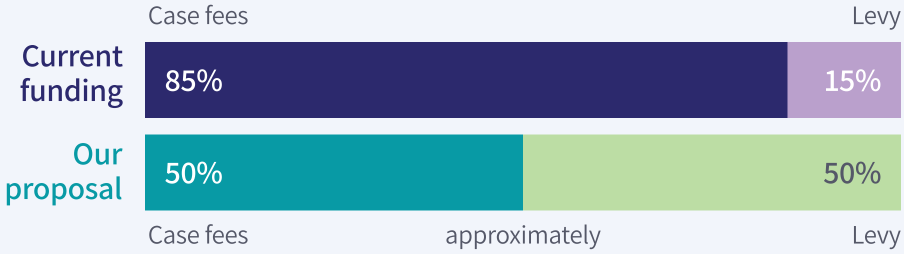
We'll build on the examples we shared in our consultation about ways we'll look to improve our efficiency while enhancing the service we provide.

We'll consider the ideas and insights people shared with us as we set our plans and budget for the next financial year and our strategy for the future.

There's more detail about this area of our consultation from page 8 to page 10 of this feedback statement.

Rebalancing the proportion of income we get from our levy compared with case fees

In our consultation, we set out our proposals to rebalance the proportion of our income we get from our levy compared with case fees. We set out our position on the alternative arrangements we'd considered, concluding that our proposal struck the right balance between linking businesses' contribution to our service to the casework they generate for us, while achieving greater certainty and stability in our funding.



Feedback

- We received a mixed response from businesses. Representatives of smaller businesses (in terms of complaints volumes) said they felt they would be subsidising larger firms, and vice versa. Many businesses and trade bodies asked for more detail about the projected impact on firms in their sectors.
- Some respondents offered alternative suggestions – including collecting case fees at the point we receive complaints, varying them depending on complaints' outcome or complexity, or removing them altogether.
- Other respondents – including some businesses and all the consumer organisations that replied – supported our proposal. These respondents typically emphasised the importance of ensuring our funding arrangements allow us to effectively respond to potential volatility and complexity in our current and future work.

There's more detail about this area of our consultation from page 10 to page 16 of this feedback statement.

Our response

There's potential for significant volatility in demand for our service – whether as a result of unpredictable mass-scale issues or of firms' financial vulnerability. And there's ongoing uncertainty about how many PPI complaints we'll receive in the months ahead.

We're still of the view that our proposal strikes a good balance. It will mean that case fees still represent a significant proportion of our funding, while ensuring our service is resilient to volatility and sustainable into the future – and also reflects our funding principles.

Though we expect our case fee to rise from April 2020 – having been frozen for the past seven years – maintaining our current arrangement would result in far greater increases in future.

However, we've heard very clearly that many businesses and trade bodies want more time to assess and understand the impact of rebalancing our case fee and levy income.

In light of respondents' feedback, and based on our current assumptions for 2020/21, we expect to consult in December 2019 on a proposal that approximately 60% of our funding should come from case fees and 40% from our levy in the next financial year. And we also expect to consult on setting the individual case fee at around £650.

We'll continue to review the position, with an aspiration to reach a split between case fee and levy income in the order of 50:50.

Changing the number of “free” cases to 10 per firm, and to 50 for each group within our group account fee arrangement

In our consultation, we considered the impact of changing the number of “free” cases for which firms pay no case fee. Having reviewed our funding options in today’s context, we proposed to reduce the number of free cases, while still keeping it at a far higher level than before its 2014 increase.

Current arrangement

90%

82%

of firms who have complaints referred to us each year won’t pay case fees

Our proposal

Feedback

- Many businesses with typically lower complaints volumes told us the current “free” case allowance should be maintained – in many cases pointing to what they saw as the problem of unsubstantiated complaints. Some felt the difference in income for us was too small to justify the change.
- In general, group account fee firms supported the reduction in their number of “free” cases, with a couple suggesting there was no need for free cases at all.

Our response

As our service becomes smaller, the additional funds we’ll receive from changing the number of free cases will become increasingly more significant as a proportion of our income.

We recognise that some businesses may pay more in case fees than they currently do. But there will still be a significant level of protection for firms that generate only a very small part of our workload. Based on our current assumptions, we estimate that eight in ten firms whose customers use our service still won’t pay any case fees.

For these reasons, we expect to consult on changing the number of free cases to 10 for non-group account fee firms and to 50 for those within the group account for 2020/21.

There’s more detail about this area of our consultation from page 16 to page 17 of this feedback statement.

Maintaining reserves of a minimum of six months' operating expenditure

In our consultation, we explained the important role our reserves have played in our strategy to handle the fallout of mass PPI mis-selling. In view of the ongoing uncertainty we face about future demand for our service, we considered whether we should look to hold a higher level of reserves than our current policy sets out.

Our proposed levels	At least 6 months' operating expenditure
Our current policy	3 months' operating expenditure

Feedback

- In most cases, respondents supported our proposal to increase our reserves to a minimum of six months' operating expenditure.
- Of those who didn't agree or gave only tentative support, many asked for more detail about why we'd decided on this approach in the context of our projection that we'll be a smaller service.

Our response

We're pleased that many of our stakeholders recognise the important role our reserves continue to play in bringing stability for us and firms that fund us – and reducing the likelihood that we'll need to ask for additional funds partway through the financial year.

While our formal policy has been to hold three months' operating expenditure in reserves, we've been running with a higher level of reserves for a number of years – and using them to fund our transition through the conclusion of PPI, in line with our long-term strategy.

We expect to consult on a proposal to change our reserves policy, so we'll look to hold a minimum of six months' operating expenditure from 2020/21.

There's more detail about this area of our consultation from page 17 to page 18 of this feedback statement.

The feedback we received

This section gives more detail about the feedback we received to each question we asked in our consultation, together with our response.

It's intended to reflect the broad direction of the feedback, highlighting relevant comments and suggestions – rather than being an exhaustive list of all the individual comments we received and considered. In some cases, we've combined our response to linked questions, and we've focused our response on those proposals that generated the most diverse and strongest feedback. Where appropriate, we'll discuss respondents' specific feedback with them as part of our ongoing engagement.

The context for change

Looking to the future

Question 1

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

Most respondents agreed with the assumption that our service will be smaller in future. Some of these respondents, as well as many others, highlighted areas where they thought we might see more complaints than today, though none flagged anything they believed would match PPI in scale. These new areas of potential complaint growth included those relating to our claims management company (CMC) and small business jurisdictions.

Fraud and open banking were mentioned by several respondents from banks, insurers and building societies as issues that could create demand for our service. Consumer groups and consumer credit businesses told us it was likely we'd continue to see complaints relating to responsible lending, particularly in short-term lending. A large bank and trade body flagged the insurance pricing super complaint brought by Citizens Advice to the Competition and Markets Authority. A range of respondents told us that CMCs would be looking to shift their focus to other product areas, including mortgages and bank accounts, to substitute for the loss of PPI-related business.

Some respondents had done their own calculations, which they believed showed that our service would cost firms they represented more in the future (see feedback to question 5). One trade body asked for a more detailed forecast for the end of PPI, and a CMC questioned whether businesses' backlogs of PPI checks would mean PPI actually took longer to wind down. Additionally, we know from feedback from businesses since the PPI deadline that they've received very high volumes of enquiries and complaints.

Question 2

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

Many respondents – spanning a range of sectors and types of organisation – agreed with our conclusions that the end of PPI will bring fewer opportunities for economies of scale, and that we expect to see increasing complexity in our casework.

Respondents from banks, insurers and a trade body pointed to complaints in our new small business jurisdiction as a likely source of greater complexity. One bank told us that, in the short term, considering PPI complaints made after the deadline under exceptional circumstances may be complicated to deal with. Others highlighted customer vulnerability and push-payment fraud as potential drivers of more complex complaints; on the other hand, a couple of respondents said they thought FCA frameworks around vulnerable customers and fraud would mitigate complexity in these areas. Further suggestions about areas of potential complexity were complaints involving open banking and section 75 of the Consumer Credit Act.

In addition, a few businesses and a trade body pointed to complexity in the types of concerns being raised with them via CMCs: for example, complaints about the calculations of interest, and the use of subject access requests in combination with obscure legal arguments in areas such as mortgages. Another trade body thought complexity could arise from people raising additional evidence once their complaints had been referred to our service.

Our response to questions 1 and 2

We're grateful for the perspectives stakeholders have shared with us about the complaints landscape beyond PPI. And we're reassured that there's broad agreement with our own planning assumptions, as well as our assessment of current and potential complexity in our casework. We've encouraged stakeholders to discuss the individual points they raised during our engagement with them.

Our consultation was designed to give a picture of the likely direction of travel, and was underpinned by assumptions and forecasts that will continue to change. We'll be consulting again in December 2019 about our plans for the next financial year, at which point we'll share our most recent outlook about both complaints volumes and the income we need. This will help firms assess their own individual contributions to our costs – though our own forecasting relies to a significant extent on the projections that stakeholders share with us as part of our plans and budget-setting process.

Our wider role

Question 3

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

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

There was widescale support for our work to help prevent complaints and encourage fairness. Some respondents encouraged us to invest in this capacity, and said they would like further engagement with us.

While no respondents said they didn't support our wider work, a small number told us they felt we should focus on efficient case handling, or asked us for more insight into the types of activities we'd outlined. A trade body told us that complaints prevention was primarily firms' role, and that our own work should complement these efforts. Other respondents suggested that we focus on improving our case handlers' knowledge and skills about their particular industry areas.

A number of respondents shared suggestions for specific areas where they wanted us to bolster our work to prevent complaints and encourage fairness. These ideas included running workshops about our fair and reasonable remit, fraud, and compensation for trouble and upset.

A few respondents asked for more granular, or more frequent, data on complaint volumes and trends, more insight into our decision-making, and more regular updates such as **Ombudsman News**. Other suggestions included producing more case study videos, setting up a 'chat bot' and making use of artificial intelligence, and offers to collaborate with respondents to promote fraud awareness, as well as the availability of our service.

Staying effective and sustainable

Question 4

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

Stakeholders shared a number of helpful ideas for how we could improve our ways of working – including how we could work more efficiently with them.

In many cases, these suggestions centred on improving communication channels to help minimise the time and other resources involved. For example, some businesses pointed to processes that they felt should be reviewed and digitised, as well how they felt communication channels could be used more effectively when resolving complaints. Many respondents suggested more generally that we could enhance our technology; chat bots and AI were again mentioned as tools that were already in use in the financial services sector, which we might look to use ourselves.

A few trade bodies and large banks suggested that we could save money by relocating more of our operations outside of London, or to cheaper premises. There was also interest in our use of contractors, and how this featured in our future plans. While some respondents saw using a flexible workforce as an efficient way of scaling up and down, others wanted to know more about what would happen as our PPI work drew to a close.

A few respondents said they thought an expansion of our complaints-prevention work could be a potential source of efficiency. And others told us we should be making greater use of our powers to dismiss frivolous or vexatious complaints.

Our response to questions 3 and 4

We're reassured by stakeholders' support for our wider work, and grateful for the suggestions they've shared with us about what more we can do. Financial businesses and CMCs have a responsibility to learn from complaints, including those that reach us. And the more proactive we are in helping them do that, by regularly engaging and sharing our insight, the more likely it is that emerging issues won't escalate into wider areas of complaint, or that problems won't arise in the first place.

As we've discussed under question 5, the proposals we set out in July ensure that this type of activity – which has wider value to the financial services sector and consumers engaging with it – is funded in a fair and sustainable way. However, we recognise too the challenges in measuring the impact of this type of work: for example, understanding where problems might have arisen, but didn't. We'd welcome further conversations with stakeholders about how to better understand the impact of our insight and engagement. We'll also consider stakeholders' suggestions for additional areas of focus as we plan for future engagement.

We also welcome the suggestions we've received about improving our ways of working, reducing our costs and increasing our efficiency, and will take these into account in our planning. As some respondents noted, our PPI contractor casehandlers continue to play a key part in helping us manage our PPI workload, where there's ongoing uncertainty about the volume of complaints we'll see. As PPI subsides, we expect to reduce our use of contractor casehandlers – though we'll retain some element of this flexible workforce to help us manage changes in demand for our help.

Our 2020/21 plans and budget consultation will give more detail about the current picture with PPI, as well as how we plan to develop our service in the year ahead and beyond.

Our proposals

Rebalancing levy and case fee income

Question 5

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

We received mixed feedback about this proposal. In many cases, businesses and trade bodies' objections centred on the idea that firms' contribution to our funding should rise with the amount of work they generate for us. These respondents felt that a 'polluter pays' principle would be compromised by our proposal, and there would be less incentive to reduce complaints – but drew different conclusions about the result. Respondents representing smaller businesses (in terms of complaints volumes) told us that firms like them would be penalised. Some larger businesses, whose levies are typically higher, said they would end up subsidising smaller firms.

A number of respondents said they wanted more information about our future costs and projections, so they could make a better judgement about the impact of the proposals on their organisations or those they represented. Some had carried out their own calculations, and a bank asked whether, for comparison, we could show what would happen if we retained our current funding arrangements.

A few respondents suggested our service might become over-resourced as a result of the proposed changes. A trade body which was generally against the proposal said that, if it were introduced, it should be accompanied by a reduction in the case fee, and a 'rebate' for complaints that weren't upheld in consumers' favour.

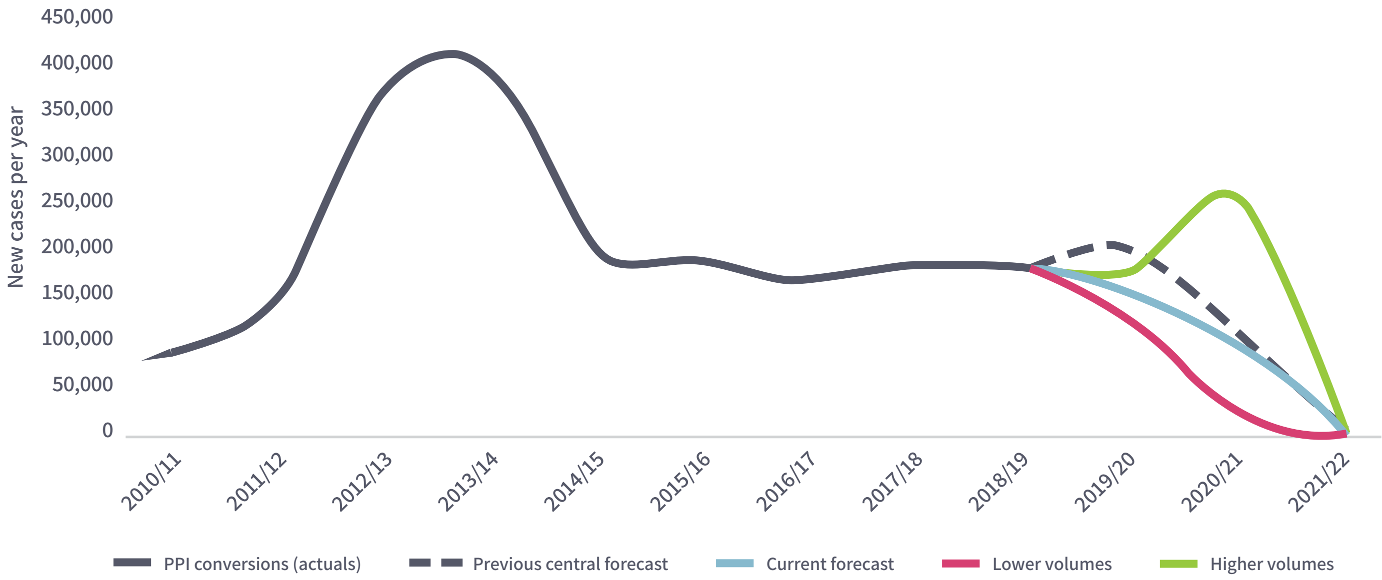
Other respondents felt the proposal was reasonable. Those representing both businesses and consumers welcomed our aim of generating more certainty and stability in our income. Consumer organisations in particular underlined that it was essential we have the ability to respond to emerging issues and vulnerability among the parties involved in complaints. Some business respondents suggested more than 50%, and in some cases all of our income should come from our levy – for example because they felt case fees might incentivise firms to restrict customers' access to our service, or because they believed it would mitigate against the issue of complexity in complaints delaying the payment of case fees.

Our response

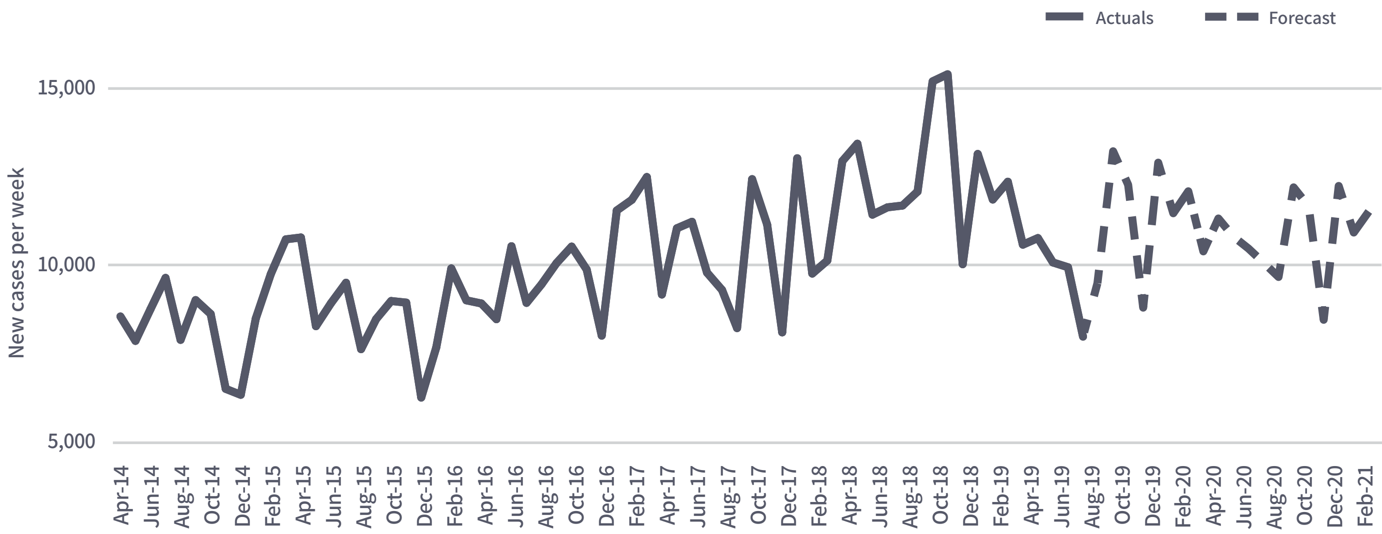
The diversity of firms we cover – in terms of their size, complaints volumes and nature of activity – are reflected in the variety of positions individual respondents have taken toward our proposals in this consultation, as well as in previous conversations we've had. In considering our funding arrangements, we need to take account of these often conflicting views, and then decide on an approach that's practical, fair and aligned with our funding principles.

As we explained in our consultation, we think there's potential for significant volatility in demand for our service – whether it's as a result of unpredictable mass-scale issues or firms' financial vulnerability. This includes ongoing uncertainty about how many PPI complaints we'll receive in the months ahead. Taking a higher proportion of income from our levy will ensure firms that are responsible for high numbers of referrals to us will pay for those cases, while also meeting the objective of generating more certainty over our income, so we can manage and resource our service effectively, including covering those costs that aren't variable. We know certainty about our funding is also important to firms, and this was reflected in the responses we received.

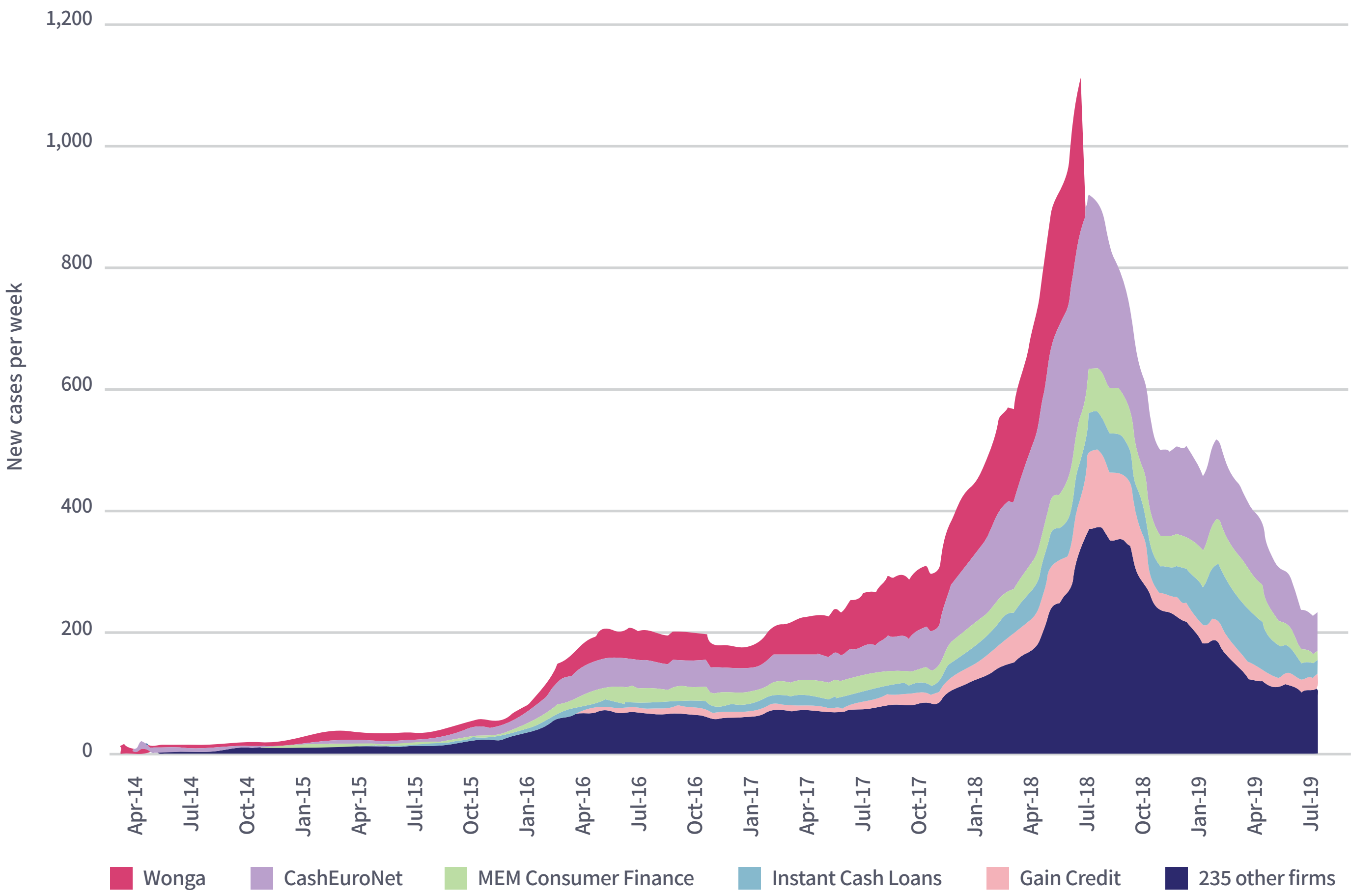
Future PPI volume scenarios



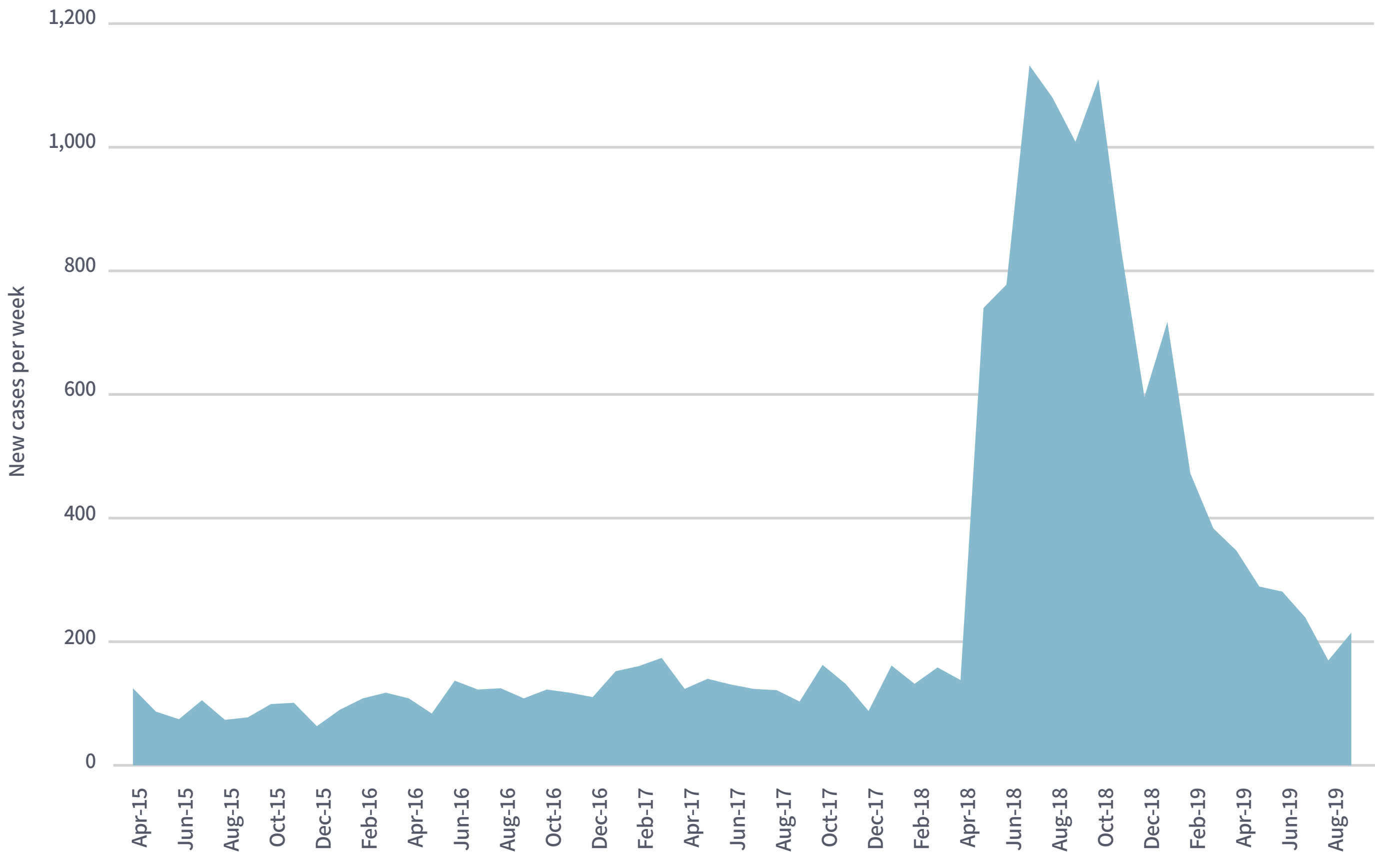
Future general casework volume scenarios



Complaints about short-term lending



Complaints about TSB showing impact of IT failure



It's clear that a number of respondents feel strongly about the importance of the 'polluter pays' element of our funding. We agree that case fees provide an important incentive to reduce complaints – and we're still of the view that our proposal strikes an appropriate balance. It will mean that case fees still represent a significant proportion of our funding, while also ensuring our service is resilient to volatility and sustainable into the future.

Supporting a post-PPI service

During our engagement with stakeholders, we've been very open about the way the end of our PPI casework will also mean fewer opportunities to benefit from significant economies of scale and efficiencies in resolving complaints. We've used our experience of resolving millions of PPI complaints to develop tools and resources to help support the consistency of our answers, as well as to manage the expectations of the parties involved in complaints about their likely outcome. And given the volumes of complaints involved, our engagement with large businesses and CMCs around PPI has had the potential for widescale impact.

While our flat case fee structure has the advantage of simplicity – as we've highlighted elsewhere in this statement – underlying this is significant variation in the level of resources needed to resolve different types of complaints. Given the potential for economies of scale, as well as the fact our approach in this area is now well-established, PPI complaints are typically less time and cost-intensive than many other areas of our work. Even at higher projections for future PPI complaints volumes, we think it will be necessary to make changes to our funding model in the next financial year – to ensure we're able to manage potential volatility and complexity in our casework in a way that's financially sustainable.

However, we've heard very clearly that many businesses want more time to assess and understand the impact of rebalancing our case fee and levy income in the way we've suggested. In light of this feedback – and the further conversations we've had with stakeholders since our consultation closed – we expect to consult on a split of approximately 60:40 between case fee and levy income respectively for the financial year 2020/21. We'll maintain our aspiration to reach a split in the order of 50:50 in future years, and continue to engage with stakeholders about the timings as the post-PPI landscape becomes clearer.

The level of uncertainty around future demand means it's not possible to establish precisely the balance between our case fee and levy income. If actual complaints volumes – which are influenced by businesses' and CMCs' behaviour – are different to our forecasts, the expected proportions of levy and case fee income might change.

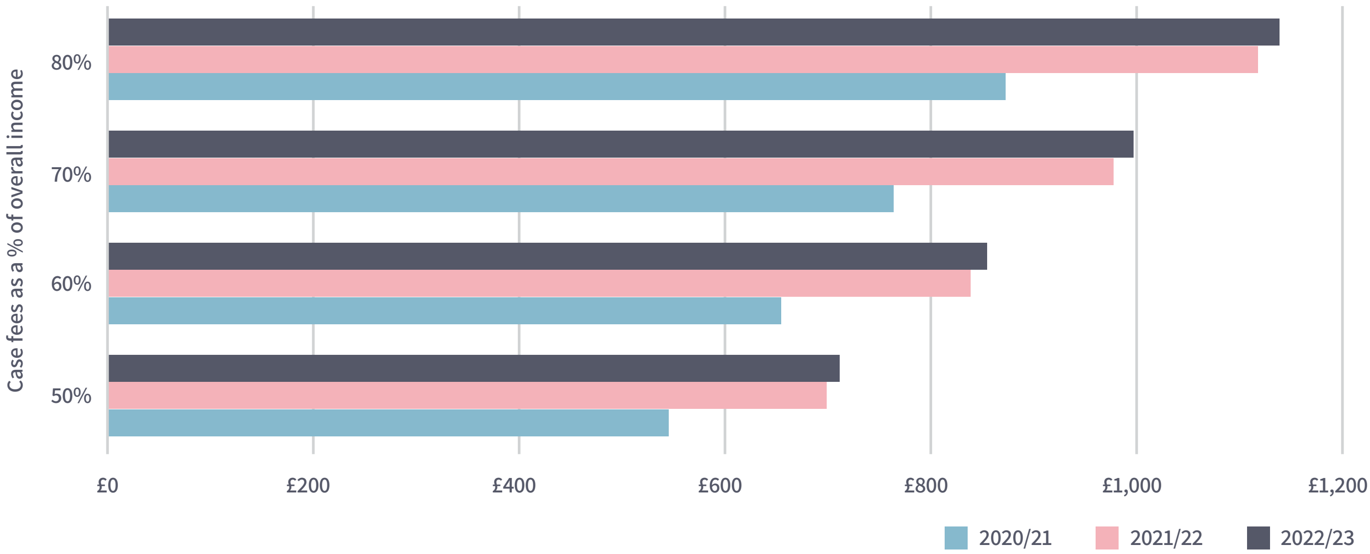
Though we've frozen our case fees for seven years, we've always made it clear that this approach won't be sustainable indefinitely. We expect to consult on an individual case fee of around £650 for the next financial year.

Our analysis

In presenting our proposals, we considered whether it would be useful to provide commentary on their likely impact. In practice, as we've already noted, there's often no 'typical' firm within each broad sector. So our view was that offering our own analysis alongside our proposals could actually be unhelpful, and possibly misleading. The consultation was aimed at confirming whether stakeholders agreed with our analysis of the challenges we're facing, such as volatility in demand, and with the key funding mechanisms we proposed to help us meet them. Each year, our plans and budget consultation will give more detailed projections for complaints volumes in the year ahead, which will help firms to better assess the financial impact on their own individual businesses.

We've also considered what would happen if, as some respondents suggested, we maintain the status quo. As the chart on page 14 shows, our modelling indicates that the level of the individual case fee in future years rises with the proportion of our overall income that comes from case fees. So there would still be a financial impact on firms, but without the benefits of stability and certainty of income – both for our service and the businesses that fund it – associated with increasing the proportion of our income that comes from the levy. The exact impact of this on each sector will depend on how much of our casework they account for.

Potential changes to individual case fees with different proportions of case fee income



As we've noted under question 7, some respondents shared concerns that some customers and CMCs were using case fees as a bargaining tool to settle complaints in their favour. Although we don't know the prevalence of this type of behaviour, it's unlikely that a rising case fee would put a stop to it; instead, it would mean that a larger amount of money was involved.

In addition, we've explained that the wider work we do, including regular strategic and operational engagement and insight sharing, has value for all firms in helping to prevent complaints and all the associated costs, as well as developing a shared understanding of fairness and contributing to wider confidence in the financial services sector. Taking more income from our levy will help us continue to fund and invest in this proactive work. As we've highlighted under question 4, a majority of respondents told us they appreciate our work in this area.

Question 6

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

Some respondents said they supported our view that alternative 'risk-based' funding arrangements would fall short of our overarching principles: in particular, to avoid complexity. Other respondents restated their view that they wanted more information from us, including about how we'd analysed and ruled out the illustrative options we'd presented in December 2018.

Respondents put forward a number of alternative ideas about who should pay case fees and how the levels might vary. The largest proportion of these ideas involved some form of case fee discount (including no fee) for complaints that we don't uphold in consumers' favour – or firms with lower overall uphold rates should pay less for our service. Reflecting feedback we've consistently received over the years, some businesses restated their view that case fees should vary based on complaints' complexity – and also that CMCs be charged case fees for referring cases to us, with the cost dependent on complaints' outcome or the quality of CMCs' submissions. A bank suggested that capped fees should apply to complaints with very similar circumstances that we're able to resolve together.

Other respondents suggested ways we could look to achieve more certainty over our income. For example, a number of respondents said we should consider collecting case fees at the point we take on a complaint, helping to secure our income upfront. A bank said we could consider using supplementary fees again in the future, as we did at the peak of PPI complaints.

Some respondents shared views about our levy – for example, that it should relate solely to our overheads, or be set by a trusted third party. A trade body said we should consider using other known industry metrics, such as complaints per 1,000 customers, to decide how our costs should be allocated.

Our response

We're very grateful for the suggestions stakeholders have shared about how we might achieve our funding objectives in alternative ways, in line with our established funding principles. Having carefully considered these ideas, we think our solution better avoids complexity, both in the transition and ongoing administration. We'd be happy to discuss stakeholders' individual suggestions with them, but don't plan to take any forward.

Suggestions about case fees

One of the most commonly-shared ideas was that case fees should vary depending on complaints' complexity – something that has consistently been raised in response to our plans and budget consultations over the years. As we've said before, although we understand the appeal in theory, in practice such a system would create an additional, unwelcome industry of defining and debating where complaints sit on the scale. This would take us away from our core role of resolving disputes, compromise our ability to do so quickly and informally, and create a further level of complexity – and possible area of contention – to manage. We don't think this is consistent with our principles that our funding arrangements should be simple and easy to administer.

A number of respondents also asked whether we could collect case fees upfront. Intuitively, this appears to overcome the problem of the payment of case fees being delayed, or our not receiving fees at all (for example, when firms go into administration). However, the transition to this system would be very complex – involving businesses paying for complaints that are already open with us, as well as new referrals. We don't think this meets the principle of having no, or minimal, transitional difficulties if the system is changed: a further principle underpinning our funding. In addition, based on our experience with the supplementary PPI case fee, it's possible that raising invoices upfront could lead to more case fee disputes – because when a consumer contacts us, the business they think is at fault isn't always the one we establish is responsible for their complaint.

Suggestions about a new risk-based arrangement

There seems to be broad agreement with our analysis that 'risk' can be defined in many ways. Although we didn't hear this reflected back in stakeholders' responses, we explained in our consultation that our existing funding arrangements have risk-based elements, because the amount firms pay in levy is linked to the volume of complaints we expect they will generate, and those that generate more complaints pay more in case fees.

It's unlikely the range of views stakeholders expressed could be reconciled into a new definition that everyone was satisfied with. And we think the alternatives to our current way of thinking about risk are problematic for the reasons we described in our consultation (page 19). We highlighted, for example, that even if there was agreement about how risk should be calculated, we'd still need to agree the thresholds for different 'tiers' of risk. How many firms would be included, and how would they feel about potentially subsidising 'polluters' outside the ranking that suddenly generated high volumes of complaints?

For these reasons, we still think that trying to put an alternative risk-based system into place would result in unresolvable differences of opinion and unwelcome complexity. So we don't plan to do so for the time being.

Suggestions about CMCs using our service

Likewise, charging CMCs to bring complaints could result in outcomes that aren't aligned with our funding principles. People have a right to ask a third party to complain on their behalf – and any charge for CMCs would inevitably mean the cost was passed to consumers, potentially creating barriers to using our service. Charging financial businesses only for complaints we upheld – whether or not these complaints were brought by CMCs – would create unacceptable complexity, as well the perception that we had an incentive to resolve complaints a certain way.

However, in the same way as we see poor practice from financial businesses, we also see behaviour from CMCs that's frustrating and unhelpful. This is something reflected very strongly in respondents' feedback. We do a significant amount of work to help improve the way CMCs engage with our service and complaints generally – with the aim of preventing cases being referred to us (and to financial businesses) unnecessarily, and improving the quality of the submissions CMCs do make.

Our conversations with CMCs can lead to them reconsidering their decision to take forward large volumes of complaints. In the case of packaged bank accounts, this involved thousands of complaints being taken back by CMCs. We've also consistently shared examples of poor practice with CMCs' regulators, who have in turn made their expectations clear. This type of action on our part can stop financial businesses receiving, and bearing the cost of, significant volumes of complaints. Like our engagement with financial businesses, it's important our future funding arrangements allow us to fund it sustainably.

Number of "free" complaints

Question 7

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

Respondents' views ranged from wanting to keep the current number of "free" cases to removing them altogether. Understandably, opposition was strongest among representatives of those firms who were likely to pay more case fees as a result of the lowering of the threshold. A common view was that the change would penalise businesses who, relative to others, treated their customers well – especially when set against a potential increase in the levy.

A number of businesses and trade bodies pointed to what they viewed as speculative claims made by CMCs, as well as certain customers' use of the case fee as a bargaining tool to secure compensation. These respondents variously suggested that we charge CMCs or consumers for "groundless" or non-upheld complaints – or that only upheld complaints should count towards the free case quota. On the other hand, some larger firms felt businesses shouldn't get any free cases at all.

Several respondents asked for more insight into our thinking around the appropriate threshold level. Some told us the increase in income it would generate wasn't significant enough to justify the change, or questioned whether we could raise income in other ways, such as releasing contractor staff once our PPI work had drawn to a close.

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

We received responses from firms both within and outside the current group-account fee arrangement. Respondents from the group-account firms were broadly supportive of the change, or felt its impact would be less significant compared with that of the proposed rebalancing of levy and case fee income. In line with their response to 7a, some larger firms told us they didn't see a need for free cases at all.

Among firms outside the group account arrangement, there seemed to be some misunderstanding about its purpose. A trade body representing relatively smaller businesses told us it was concerned that larger firms had been getting a concession, and felt they should be treated the same as smaller firms. Another repeated its view that non-upheld complaints shouldn't count towards the quota. One group account firm disagreed with the proposal, because in their view it wouldn't have any effect on our casework. Another thought that the change could create an incentive for firms to leave the group account arrangement.

Our response

For clarity, the group account fee arrangement is a way of helping ensure that we receive income in a stable and predictable way – with the additional benefit of helping to minimise our administrative costs around billing firms generating large volumes of complaints. Established in 2013/14, it involves the largest business groups (initially four and now eight) that account for the majority of our work (54% in 2018/19) paying a quarterly fee upfront. This fee is based on our existing 'stock' of open complaints, recent case volumes and the number we've budgeted to deal with. Each business group is made up of several firms, and the allowance of 125 free cases is designed to reflect this. However, 125 cases, or 50 under our proposal, is lower than the total of all the free cases these firms would get individually.

As our service becomes smaller, the additional funds we'll receive from changing the number of free cases will become increasingly more significant as a proportion of our income. We recognise that some businesses may pay more in case fees than they currently do. But there will still be a significant level of protection for firms that generate only a very small part of our workload. The proposed threshold is far higher than the three free cases that firms had before the level was increased at the height of PPI complaints. Based on our current assumptions, we expect that more than eight in ten firms whose customers use our service still won't pay any case fees.

A lower threshold also creates a greater incentive to reduce complaints: a driver that businesses have told us they consider a very important part of our funding arrangements. However, at levels lower than in our consultation, the costs of administering the free case system begin to outweigh the income we receive. For these reasons, we think the proposed level is appropriate. So we expect to consult on changing the number of free cases to 10 for non-group account fee firms and to 50 for those within the group account for 2020/21.

We acknowledge the suggestions we've received about introducing a conditional element into our case fees, but don't think it's the right approach to pursue. As we've explained in our response to question 4, any link between the payment or level of our case fees to complaints' outcome could be seen as creating an incentive for our service to reach a certain outcome. And, in the same way as a 'sliding scale' arrangement, such a system would introduce additional complexity, as significant time and resources would be spent on disputes over which case fees should be chargeable, and what that charge should be.

On the question of the case fee being used as a bargaining tool, we've limited insight into this issue. Respondents who made this point typically represented sectors where we're more likely to find customers have been treated unfairly, and so uphold a higher than average proportion of complaints (which are often the conditions that give rise to more CMC activity). Although there's clearly work to do in these sectors to ensure fair outcomes for customers, we'd encourage businesses to uphold only those complaints they believe have merit, as this will reduce the appeal of this type of behaviour. As we've explained in our response to question 6, we continue to share information about CMCs' conduct with their regulator, the FCA, including any areas of concern about their conduct.

Level of reserves

Question 8

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

The majority of respondents – representing both large and small businesses – agreed that our proposal was reasonable. Some stakeholders, especially consumer organisations, emphasised that it was essential for us to be responsive to volatility.

Among respondents who broadly supported the proposal, some suggested we stagger the increase over a couple of years. And some told us they thought six months' operating expenditure should be the maximum reserves level we held.

Of the respondents who didn't agree, or who offered tentative support, many asked for more detail on how we'd modelled the different options for our reserves, and whether our proposal was appropriate for a future in which we anticipate being a smaller service; some felt that, as PPI subsides, we should look to reduce our reserves accordingly. Some trade bodies said they were concerned the change would put disproportionate pressure on smaller firms, and a few other industry respondents questioned whether the level of volatility we'd predicted justified raising our reserves to the level we'd suggested.

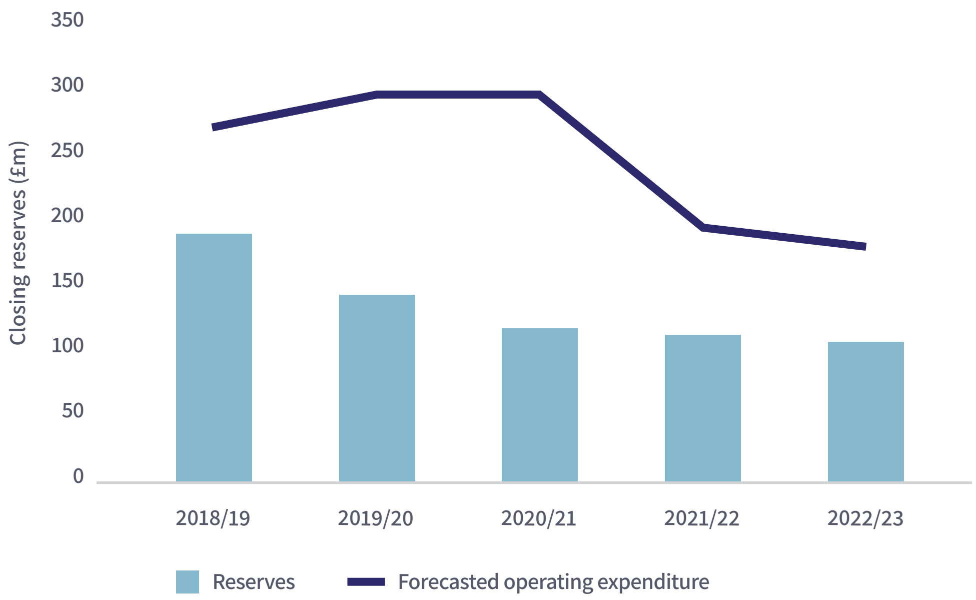
Our response

Many of our stakeholders recognise the significant role our reserves continue to play in bringing stability to our funding. The risks and uncertainties we're managing include the volume of PPI complaints we can expect to be referred to us over the next few months – as well as the potential financial vulnerability of consumer credit firms. In 2018, the collapse of Wonga and Curo Transatlantic had a financial impact on us of around £4m, and Instant Cash Loans owed us around £1.2m in unpaid invoices when it entered into a scheme of arrangement earlier in 2019. In October 2019, a further lender, CashEuroNet – which accounted for more than 3,000 new complaints to us in the first six months of 2019 – also went into administration.

As our overall operating budget falls in future years in line with our expectations, there will be less flexibility in our budget – and fluctuations become more challenging to manage. Holding higher reserves reduces the likelihood that we'll need to ask for additional funds partway through the financial year.

In view of the broad base of support from stakeholders, we expect to consult in December 2019 on changing our reserves policy to six months' operating expenditure from 2020/21. Based on our current forecast for 2019/20, by the end of the year we expect to be holding around six months' operating expenditure as reserves. Our position in future years will depend on a range of factors, particularly volumes of complaints. We'll provide more detail in each year's plans and budget consultation.

Our indicative end-of-year reserves position



Next steps

Question 9

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

There was broad recognition among respondents that our funding arrangements need to change. However, a significant number felt we should only implement the new model once PPI had been resolved, and all parties had a clearer picture of the horizon. Many large banks, building societies and trade bodies suggested a timeline of well into 2020/21 for the conclusion of PPI. Some also felt that other factors, such as extensions to our jurisdiction from April 2019, the FCA's consultation on fees and levies, as well as the uncertain political and economic outlook, might be reason to delay implementation.

Other stakeholders, including a bank and a trade body, felt the timing should be flexible enough to let firms adequately prepare, and that we should offer more concrete evidence of what the impact on firms will be. A few respondents told us the timing of our consultation itself wasn't ideal because it fell over the summer holidays, and that the consultation period should have been longer than six weeks.

Our response

Our July 2019 consultation was the next formal stage in a process of ongoing engagement with our stakeholders about our future funding arrangements.

As we've illustrated on page 3, these conversations started in 2015, when we consulted on our 2016/17 plans and budget. Since then, we've used our face-to-face engagement with stakeholders, as well as formal plans and budget consultations, to highlight and discuss the challenges of ensuring our sustainability and effectiveness while managing a highly volatile workload and uncertainty about future complaints volumes. This engagement has included twice-yearly meetings with our industry steering groups – which represent the different financial services sectors we cover – and funding-focused roundtables in 2018.

When we consulted on our 2019/20 plans and budget in December 2018, a separate chapter on our funding outlined the need for us to prepare for a time when PPI didn't dominate our casework. The imperative that our funding should support future planning, and fund the wide range of additional work we do, was also identified by Richard Lloyd in his independent review of our service. As part of our December 2018 consultation exercise, we asked for, and responded to, stakeholders' views on some illustrative potential features of funding arrangements. We used this feedback to inform the proposals we consulted on in July 2019. Across all these engagement channels, a broad range of stakeholders have agreed on the rationale for reviewing our funding arrangements.

We acknowledge some respondents' views about postponing any changes. One of the key reasons for our current proposals is the need for us and firms to have greater stability and certainty about our funding, in an operating environment that's far from stable or certain. As we've set out in previous plans and budget consultations, part of our multi-year strategy for responding to the unprecedented challenge of PPI has been to use our reserves to fund this work – making a deficit over successive years. And as we've explained on page 13, the conclusion of PPI will bring far fewer opportunities for economies of scale and efficiencies in resolving complaints. Because of this, we plan to put our proposals into effect from the next financial year.

However, as we've highlighted under question 5, recognising the need to help firms adjust to the changes, in December 2019 we expect to consult on moving to a split of approximately 60:40 between case fee and levy income from April 2020. We'll maintain our aspiration to reach a split in the order of 50:50, keeping in touch with stakeholders as the picture becomes clearer.

Question 10

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

Many respondents used this section to restate points they'd made earlier on. Of these comments, the most frequent was a request for more detail about the cost impact of our proposals on their particular type of business, or for information about the benefits for businesses and consumers more generally.

Some smaller businesses repeated their view that it was unclear how an anticipated decrease in future complaints volumes should lead to an increase in our costs to businesses. A trade body told us our proposals needed to be seen in the context of a wider general rise in regulatory costs. Another trade body that generally supported our proposals suggested that we build in a periodic review of our funding arrangements as our caseload continues to evolve.

Other respondents asked for more engagement with us around emerging issues, or to help them better understand our decisions about complaints.

Our response

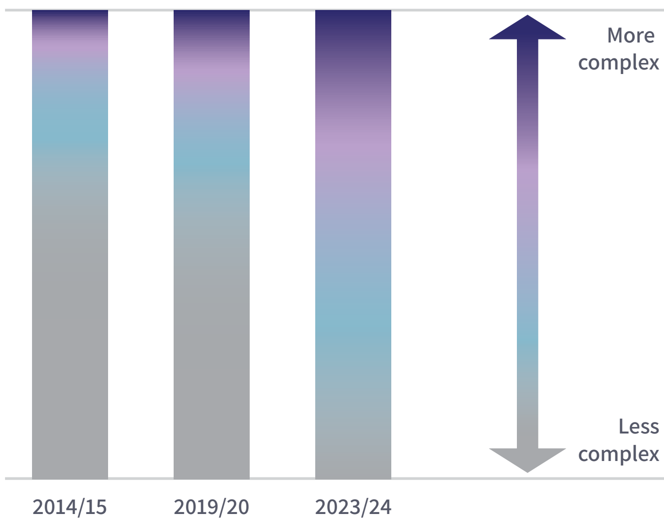
We're grateful for respondents' additional feedback and suggestions.

As we've said previously in this feedback statement, the discussion in our consultation was based on a number of assumptions made at that point in time about the medium-term outlook. These assumptions will continue to be revised, in the context of significant uncertainty about future volumes of PPI complaints and volatility more generally. So our view was that offering our own analysis alongside our proposals could actually be unhelpful, and possibly misleading.

In December 2019, stakeholders will have the opportunity to consider and respond to our 2020/21 plans and budget consultation, which will share our latest forecasts for cost and complaints volumes. We'll continue to engage with stakeholders throughout the next few months as we shape our plans for 2020/21 – as well as once our new funding arrangements are in place, and our post-PPI caseload becomes clearer.

Our funding consultation explained that, although we expect a smaller caseload in the future, we're expecting to see a continued trend toward complexity – with fewer opportunities for economies of scale – as well as ongoing volatility in demand for our help. Many stakeholders have agreed with this assessment.

Broad trend in complexity



As we’ve said elsewhere in this statement, by increasing the proportion of income from our levy, our proposals are aimed at helping us respond to challenges we face, by increasing the amount of our income that’s stable and certain. In addition, our funding arrangements need to reflect the work we do that has a wider value to businesses and their customers, by helping to prevent unfairness arising in the first place. A majority of respondents to this consultation, as well as during other engagement, have expressed strong support for this work.

We’ve addressed further points raised in this section in our responses to relevant consultation questions.

List of non-confidential responses

Aberdeen Standard Investments

Apfin (CashASAP)

Association of Alternative Business Finance (AABF)

Association of British Insurers (ABI)

Association of Financial Mutuals (AFM)

Association of Mortgage Intermediaries (AMI)

Aviva

Barclays

British Insurance Brokers' Association (BIBA)

British Vehicle Renting and Leasing Association (BVRLA)

Building Societies Association (BSA)

Cabot Credit Management Group

Cambridge Building Society

Capital One

Citizens Advice

Citizens Advice Scotland

Consumer Council of Northern Ireland

Consumer Finance Association (CFA)

Coventry Building Society

Credit Services Association (CSA)

FCA Financial Services Consumer Panel

Finance and Leasing Association (FLA)

Furness Building Society

Hinckley and Rugby Building Society

HSBC

Intermediary Mortgage Lenders Association (IMLA)

Investment and Life Assurance Group (ILAG)

Leeds City Credit Union

Legal & General

Lifeline Financial Planning

Lloyds Banking Group

LV

Mansfield Building Society

Marsden Building Society

MoneySavingExpert

Nationwide

Newcastle Building Society

No1 Copperpot Credit Union

Nottingham Building Society

Personal Investment Management and Financial Advice Association (PIMFA)

Phoenix Group

Premium Credit Limited

Royal Bank of Scotland

Santander

Scottish Building Society

Scotwest Credit Union

The Protection Specialist Limited

The Tipton Building Society

UK Finance

Wescot Credit Services

West Bromwich Building Society

Zurich

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Service

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