

Creating a funding model for the future

A Discussion Paper

We are inviting financial services organisations, trade bodies, professional representatives including CMCs, consumer groups and other stakeholders to provide feedback on possible changes to our funding model. We want to ensure that our funding model is fit for the future and more closely reflects the actual cost to us of dealing with different types of complaints.

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Respond by: 5 August 2022

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Introduction

The Financial Ombudsman Service's core purpose is to resolve financial disputes independently, quickly and with minimum formality on the basis of what we consider to be fair and reasonable in all the circumstances of the case.

We also play a key role in the wider financial services ecosystem by enhancing consumer confidence and sharing our insights to help prevent complaints from arising.

In our [Action Plan](#) that we published last year, and following recommendations from our [independent periodic review](#), we committed to consider revisions to our funding model, including those that might incentivise constructive behaviour by the industry, to resolve cases more quickly, and to ensure the financial sustainability of the Financial Ombudsman Service. We have also this year lowered our reserves from six to three months to release funds for our change programme this year.

Our funding should more precisely reflect the actual cost of resolving over a hundred and fifty thousand complaints every year. The diversity of our cases and the proportion that are less scalable, has increased. Moving forward, we need a funding model that is more resilient to cope with unpredictable volumes of complaints.

Our funding model should support our three priorities to:

- enhance our service
- prevent complaints and unfairness
- build an organisation with the capabilities it needs for the future

In our 2022/23 plans and budget consultation, we asked for feedback about our future funding. This paper builds on the feedback which we received, the discussions which we have had with stakeholders since then, and the feedback to our last future funding consultation in 2019.

We recognise that there are different possible funding models. This paper invites a discussion on the principles that should guide our funding model and the forms that funding could take.

We will take feedback to this Discussion Paper into account in consulting on our budget for 2023/24 later this year.

How we are funded

We are currently funded through a combination of case fees, a general levy on firms in the compulsory jurisdiction (which is charged and collected by the FCA) and a levy (which we charge and collect) on participants in the voluntary jurisdiction.

When we were first set up in 2001, our income was split 50:50 between the case fees and levies. Over time, the impact of PPI meant 85% of our income came from case fees. It is currently split 44:56 (levy: case fee).

All financial businesses must pay a levy whether or not we have received complaints about them. This ranges from £45 a year for a small business to over £7 million for a high-street bank.

The amount they pay is determined by:

- the jurisdiction (compulsory or voluntary)
- industry blocks into which a business' activities fall
- the size of its business.

For participants in the compulsory jurisdiction, we ask the FCA to collect a certain amount on our behalf (currently £106 million for 2022/23) and allocate it between its industry blocks, based on our projections of where we believe our caseload will be coming from.

For participants in the voluntary jurisdiction, we charge firms by industry block and collect the levy directly from them.

Our case fee is currently set at £750 for each case, regardless of the type of case, the stage the case is resolved at or the outcome (i.e. whether the case is upheld or rejected). Individual case fees are payable once a case is closed.

We use a group charging account for the largest financial business groups. They pay quarterly, in advance, based on the expected number of complaints. At the end of the year, the actual number of complaints is compared to the expected and, if more than 15% higher or lower, a charge or credit is raised for the excess. Group charging account members currently have an allowance of 15 free cases annually.

Businesses that are not part of the group charging account are entitled to three free cases annually.

We review our funding arrangements each year in consultation with our stakeholders. For example, in our 2022/23 budget consultation, we consulted about lowering our operating cost reserves from six to three months. This was agreed and has released income to support our change programme and helped us to resolve cases more quickly.

Background

1. In our 2019/20 annual plans and budget consultation, we consulted on possible changes to our future funding in anticipation of the FCA's deadline for complaints about PPI, which was 29 August 2019.
2. Our proposals for funding changes centered on bringing a more stable element to our funding through a differentiated levy, including a 'risk-based' element, where the risk is calculated based on the likely demand for our service, or likelihood of complaints referred to us.
3. Following consultation, we concluded that we would not take this concept forward, partly because the existing FCA levy was already a type of risk-based levy. The levy individual businesses pay depends on which FCA industry block it is in and how many complaints we expect to get from those businesses.
4. In 2019 we published a separate [future funding consultation](#) focused on a proposal to rebalance the proportion of income received from levies and case fees, to 50:50. The feedback showed:
 - Support for changing our funding.
 - Widespread support for our established funding principles.
 - Strong support for our wider work to help prevent complaints and encourage fairness.
 - Mixed support on our case fee proposals, with some respondents offering alternatives including collecting case fees at the point we receive complaints, varying them according to outcome or complexity, or removing them altogether.
 - General support for a 'polluter pays' approach (businesses which are responsible for complaints bear the costs of dealing with them), with some concern that by reducing the proportion of our income that came from case fees, this approach was compromised.
5. Our proposed budget for 2020/21 included a proposal for 40% of our income to come from levies, but following the challenges brought about by the Covid-19 pandemic, we agreed with the FCA to freeze the minimum levy paid by businesses. This resulted in only 30% of income from levies. While it had remained our intention to move towards a 50:50 split between levies and the case fee, it is currently 44:56.
6. We have continued to keep our funding under review, and each year we consult on our plans and budget for the following financial year. In our most recent [plans and budget consultation](#), we asked respondents to share their thoughts about our 2022/23 funding and mentioned this discussion paper. We asked for views on what to consider and the following trends emerged, which were broadly consistent with previous consultations:
 - There was support for a 'polluter pays' model.
 - Many stakeholders told us that case fees helped to incentivise the right behaviours to reduce the overall number of complaints.
 - We should have a differentiated fee model mainly focused on the size of a business, the stage at which the complaint was resolved and the complexity of the case or product type.
 - Professional representatives should be charged fees to prevent our case fee being 'weaponised' (our case fees being used by representatives as leverage to pressure firms into paying redress on complaints so cases are not escalated to us).
 - We should be more transparent about how our funding and costs work.
7. Last year's independent review of our service made several recommendations, including that we review our funding model, to ensure that it is still fit for purpose and incentivises constructive industry behaviour. This paper forms part of our response.

Our key funding principles

1. Before we consider the options to improve our funding model, it is important to consider what the underlying principles of our funding arrangements should be.

When we last asked for stakeholder views in our 2019 funding review, our current funding principles garnered wide support.

Our overall principles set out that we are:

- free to customers
- fair
- transparent

and that our costs are:

- broadly proportionate, with the businesses which generate the most work paying the most for our service
- easy to understand
- simple to administer for us and for firms
- sensitive to our operating environment
- sustainable over time
- create no incentive for our service to reach a particular outcome.

2. We now want to build on these principles as we evolve to reflect the changing landscape in which we operate. We propose that our funding model should additionally:

- enable recovery of our total costs so we are not running a deficit
- better reflect our costs in handling different types of complaints
- encourage firms to adopt positive behaviour with consumers, follow our published guidance, and resolve complaints quickly and fairly
- be supported by data and evidence.

Q1: Do you agree with how we suggest building on our current principles and are there any other factors we should take into account?

Options for a future funding structure: 2023/24

Building on the discussions which we have already had with stakeholders, this section focuses on changes that we believe we could put in place in 2023/24.

Subsequent sections of this paper detail options that may be more appropriate beyond the next financial year following changes to processes, systems or legislation.

Based on feedback from this paper and other stakeholder engagement, together with further analysis, refined options will be recommended to our Board to consider in the autumn. We have already discussed our early thinking with the FCA Oversight Committee and expect to discuss with them further in the autumn – the FCA Board is responsible for approving our annual budget.

We know from previous discussions that many stakeholders support the new ideas in principle. We also understand that businesses and their representatives have questions about how they might work in practice and would like to know what the impact will be on our pricing.

At this stage, we have not included any cost projections because the focus of this discussion paper is to make sure that our funding structure options are sound and allow you to provide feedback on how they could most effectively be put into practice.

If we take forward any of the options, we will formally consult on them at the end of this year in our annual 2023/24 plans and budget cycle. At that stage we will be able to provide further details about how, and when, they would be implemented.

Options for updating the levy structure

Compulsory Jurisdiction (CJ) levy

1. We currently have two levies, a general levy for the compulsory jurisdiction (CJ) and a levy for participants who have signed up to our voluntary jurisdiction (VJ). The general levy only applies to firms covered by the CJ and the FCA raises and collects it. It is payable by all firms authorised or registered by the FCA, including those that have not had any cases referred to us. We collect a separate levy from businesses that have joined the VJ.
2. The current CJ and VJ levies (£106 million and £0.7 million respectively) are not designed to recover specific costs, such as staffing and property. Instead, in setting the CJ levy for a financial year, we have previously aimed to raise half our income from the the levies and half from case fees – currently it is 44 per cent from levies and 56 per cent for case fees for our 2022/23 budget.
3. Moving forward, we propose that the CJ levy should recover our fixed overheads such as IT, property and other support functions, rather than cover a particular proportion of our income. This will bring more transparency and certainty to our funding model. It will also provide confidence to firms that we are effectively managing our cost base. As these fixed costs are to primarily cover the organisation's infrastructure, it seems appropriate that these costs are shared by industry. Our initial analysis suggests that our CJ levy for 2023/24 could increase above our current £106 million. However, as we refine our analysis and implement our Action Plan, we expect this will reduce over time.

Q2: Do you agree with our option of changing the CJ levy to recover fixed overheads?

Voluntary Jurisdiction (VJ) levy

4. We currently collect £0.7 million from firms that sign-up to our VJ scheme. This is calculated based on the size of VJ participants' business and in which industry blocks their business falls. However, we propose to charge a fixed fee for all VJ participants instead which we anticipate will be no more expensive than the current arrangement.
5. This option aims to reduce the administrative cost that stems from calculating the generally small amounts of levy for each business individually. This will create efficiencies for VJ businesses which currently have to provide us with detailed information to inform our calculations.
8. Differentiated case fees could allow us to more easily recover the costs of dealing with a case based on how many stages in our casework it needs to go through, or how complex the case is.
9. However, the practical implications and risks of doing this include:
 - additional administrative work for us and financial businesses
 - the need for more detailed invoices and case reconciliation, especially in the short term, which may increase fee disputes
 - a need to adapt IT systems to allow more detailed reporting
 - possibly, change data we publish accordingly.

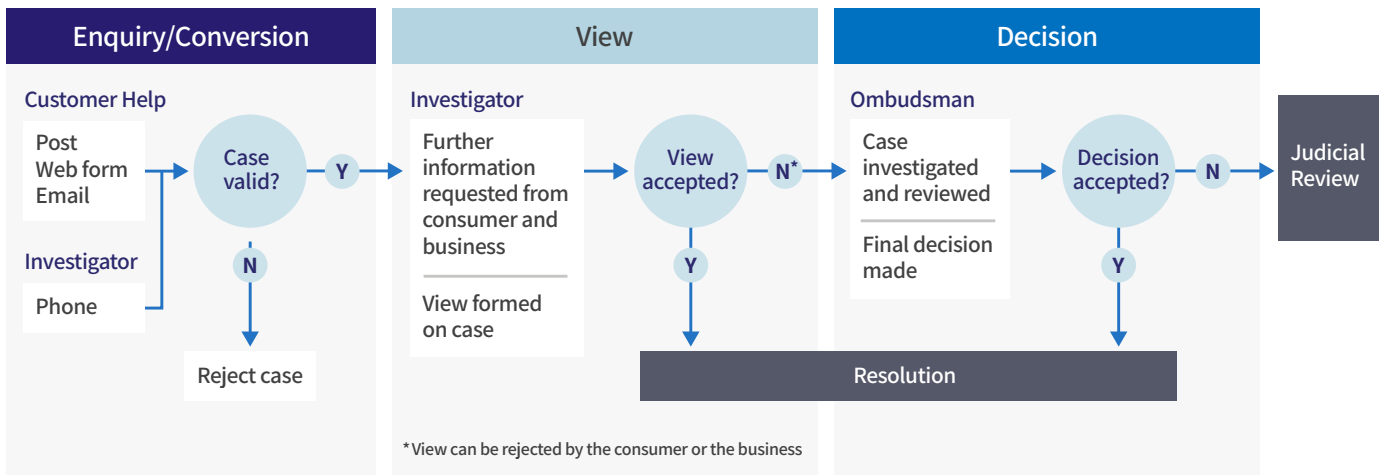
Q3: Do you agree with our proposal for simplifying the VJ levy?

Options for updating the case fee structure

6. The Financial Ombudsman Service has had a flat case fee structure since its inception, with the exception of a temporary supplementary case fee for PPI complaints. The benefits are administrative simplicity and the reduced risk of creating unhelpful incentives.
7. However, the reality is that cases vary widely. Some cases cost much more than our current £750 case fee to resolve, while others cost less. We want to review whether a differentiated case fee model would more effectively ensure that the financial business against which a complaint has been made pays the costs of their complaints. We also want to understand whether it would incentivise firms to engage with us more constructively.
10. In the short term, we propose to explore some relatively simple changes. These changes will balance the need to have a case fee model that more closely reflects the costs of dealing with different kinds of complaints. At the same time, we want to make sure that the impact of any changes – administrative or otherwise – are proportionate. The different fee structures that follow are not intended to be mutually exclusive and could potentially work in conjunction.
11. The alternative would be to retain the current flat case fee model. This approach is very simple to understand and requires no changes to existing processes, for us or financial businesses. This administrative efficiency fits with our broader goal of being an efficient organisation.
12. We would need to review the case fee amount in light of any changes to the levy because the two are interdependent and, in combination, need to cover our operating costs. We also need to consider whether our fees should increase with inflation.

Q4: Should we retain our single, flat case fee or do you support a differentiated case fee model?

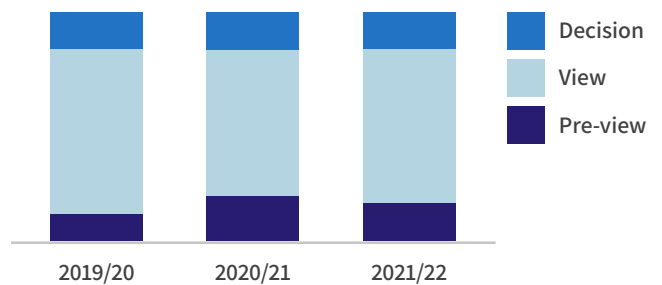
Differentiated case fee according to case stage



The Financial Ombudsman Service case lifecycle

13. One option that has been well received by stakeholders is to charge a different fee depending on the stage at which a complaint is closed. Cases often become more expensive as they work their way through our process as additional resources are spent on them. Expense reaches its peak if complaints go to an ombudsman for a decision.

14. Charging by case stage, therefore, helps to ensure that the full costs of a particular case are recoverable, and should be relatively straightforward to implement. As the fees would only be designed to cover our costs, there would not be an incentive for us to push complaints to the final decision stage.



Details of the stages at which cases closed over the last three financial years (excluding PPI, STL, PBA and the impact of the schemes of arrangement for Provident and Amigo)

Q5: Do you agree that we should charge different case fees according to the stage the case has reached before it is resolved? Do you consider this would create any unhelpful incentives?

Varied case fee according to the type of complaint

17. Another way we could differentiate our case fees is to charge different case fees depending on the type of product or service that is the subject matter of the complaint.
18. The aim of this option is to have an objective way to identify cases that are most likely to be costly to resolve, with a case fee that fairly reflects this. For example, we usually resolve complaints about banking products more quickly than complaints about pensions and investments products, which can often be lengthy and complex.
19. As we already capture data about the product and issues that a complaint relates to, deploying a new charging structure should be straightforward with limited additional costs.
20. One risk is that there can be subsets of cases which are more or less straightforward than others of their type. Pension administration cases, for example, can often be simpler than bank account charge cases. If we were to go ahead with this option, we would keep any revised structure simple initially, and review whether further granularity was needed in future.
21. We think that using differentiated fees by case stage could complement this option of charging according to case type. Using both measures in conjunction could ensure that the fee for a particular case more accurately reflects the cost to us of dealing with it.

Q6: Do you agree that we should vary case fees according to the type of product the complaint relates to? If you agree, do you think we should also introduce fees that are chargeable according to case stage?

Updating the group account fee arrangements

22. We run a group-charging account for the eight largest financial business groups, which accounts for around a third of our caseload. It is based on an annual amount split into four payments.
23. We introduced this model in 2013 to reduce administration costs with a 15% margin on the calculation. That way, financial businesses do not pay more than they need to, unless it is 15% more than the volume of complaints we forecast for them. If numbers are below the 15% margin, they get a refund. The calculation also provides these large business groups with 15 free cases, compared to the 3 free cases for individual smaller businesses.
24. Currently, case fees are paid in advance, based on expected numbers of complaints – as well as reducing administrative costs, it also increases efficiency and creates a steadier cashflow. However, this threshold has not been reviewed since it began. We are therefore reviewing how we improve this data in collaboration with group fee account holders.
25. Without the high volume of volatility driven by PPI, we consider that it would be proportionate to reduce the margin from 15% to 5% and remove the free case allowance.
26. We have already discussed reducing the margin with the large financial businesses which are part of the group account arrangements and the large industry trade bodies. There is broad agreement about this direction of travel.

Q7: Do you agree with reducing the margin of 15% to 5% and removing the free case allowance in group fee account arrangements?

Charging fees as soon as we receive a case

27. A case becomes chargeable as soon as it is referred to us, but for financial businesses other than the eight firms that are part of the group account arrangements, we only invoice for our fee once a case is closed – closed either because it has been settled, because the consumer has withdrawn the complaint, closed by virtue of an investigator’s view or due to an ombudsman’s final determination. This approach reduces the administrative burden on all parties, but it does mean that the Financial Ombudsman Service remains at a higher risk of not recovering any costs if a firm cannot pay. For example, the cost of bad debt and lost income in 2021/22 was approximately £15 million and our provision for 2022/23 is £17 million.
28. Charging an initial fee as soon as we receive a chargeable case (‘conversion’), with an outstanding fee payable on closure, will help to protect us and levy payers from not recovering the cost of work for firms that cannot pay. It could also dovetail with our differentiated fee structure option. We would need to monitor the impact of this charging arrangement to ensure that the administration involved does not become inefficient and disproportionate.

Q8: Do you agree that an initial fee at conversion will protect us and levy payers from the risk of not recovering costs for completed work?

Setting a time limit for claiming for refunds on overpaid case fees

29. We propose to revisit the scope of the FCA Handbook’s rules on case fees (FEES 5.5B.27R to FEES 5.5B.29R) and introduce a general time limit of 12 months from the date on which a case fee is paid for a firm to seek to claim repayment of it, compared to the current 2 year period. We note that the FCA’s corresponding rule in FEES 2.3.2CR also currently sets a 2 year limit.

30. We consider that 12 months is plenty of time for a firm to make a claim. It could address business inertia and encourage firms to act more quickly if they consider that they have overpaid a case fee. It will also give us more certainty about our financial position and reduce our administration.

Q9: Do you agree that a time limit of 12 months to claim for overpayment of fees provides firms with a sufficient opportunity to make any claim for repayment?

Publishing more detailed data on complaints

31. We publish data about the complaints we receive against individual firms on our website. If we apply any of the options set out in this paper, such as using case stage as a fee criterion, we could also introduce this additional ‘layer’ of data into our regular reporting to allow us to be more transparent with our stakeholders.
32. We would need to explore how useful publishing the additional information would be for our other stakeholders and customers, how it could help meet our core purpose of resolving complaints and our wider strategic objectives, especially around preventing complaints.

Q10: Do you agree that we should include the data that results from any new fee structure as part of the quarterly report we publish on our website?

Ideas for future funding beyond 2023/24

1. From our previous conversations with our stakeholders, there were a number of options that whilst of interest to many, would not be possible to implement in 2023/24. For example, some would require changes to primary legislation.
2. However, we would like to better understand stakeholder views on these proposals so that we can decide whether we should consider them for the future.

Charge professional representatives a fee to bring complaints

3. A proposal we often hear from stakeholders is that we should charge professional representatives a fee to bring a case to us. The thinking is that it will stop 'frivolous or vexatious' claims and make sure that representatives bring better quality submissions to us.
4. We hear a lot of claims from financial services businesses and trade bodies about high numbers of baseless cases from representatives that are unworkable due to information gaps. But we do not see evidence to validate these claims and it is very rare that we see 'frivolous or vexatious' cases.
5. Given the strength of feeling around this issue, we have spoken to the FCA which oversees the regulation of CMCs to see if they also receive complaints in relation to 'frivolous or vexatious' conduct on the part of CMCs. The FCA has told us that they have received a small number of complaints but have seen limited evidence to support them and none have so far resulted in formal action being taken.
6. Parliament set up the Financial Ombudsman Service to be free to consumers. There is a risk that a fee to a professional representative could become a barrier to legitimate complaints because it is passed on to the consumer. In any event, the [Financial Services and Markets Act 2000 \(FSMA\)](#) does not presently give us the power to charge CMCs or other professional representatives a fee.
7. If we consider that a complaint is frivolous or vexatious, we have the power to dismiss it under the rules of the FCA Handbook ([DISP 3.3.4](#)).

Where a complaint is dismissed for this reason, it is not a chargeable case under our rules so financial businesses would not have to pay a case fee.

Q11: Do you have evidence to demonstrate problematic behaviours from CMCs and do you think a charge from the Financial Ombudsman Service would prevent them?

Varied case fee according to case complexity

8. It has been suggested that case fees which are varied according to 'case complexity' would allow us to more accurately reflect the effort and expertise used in resolving a case. This is often seen as an attractive option by stakeholders as it allows us to use data to set a fee that will enable us to fully recover our costs and retain the 'polluter pays' concept.
9. There are a number of factors which may be an indicator of complexity including where:
 - a novel or important point of law or regulation is central to the outcome of the dispute,
 - the outcome of the dispute could have significant implications for a large number of cases
 - the amount at stake in the dispute, and whether it significantly exceeds our award limit
 - the parties have legal or other representation
 - actual or proposed litigation or regulatory action which is likely to be directly relevant to the dispute
 - vulnerability of the complainant or other sensitive factual issues.
10. For a fee based on 'case complexity' to be effective, and to avoid protracted case fee disputes, which would be costly to industry and to us, this fee would need to be based on clearly objective criteria.

11. We also need to consider the potential interaction with other case fee measures, such as case type and case stage to make sure there is no duplication as it is possible that a differentiated fee based on a combination of case stage and case type might serve as a reasonable proxy for case complexity. We consider that we should keep this option of refining differentiated fees further to capture case complexity under review, but do not currently propose to introduce it for 2023/24.

Q12: Would you like us to consider introducing differentiated fees based on case complexity in future? How should complexity be defined and how could fees based on complexity be applied most effectively?

Discounts for cases resolved in batches

12. For several years we have looked for opportunities with larger firms to get quicker outcomes and make efficiency savings by resolving cases in batches.

13. As our role is to consider each case individually there are only certain types of cases where this would be appropriate. For example, in areas of mass claims, such as PPI, it has been very effective.

14. In 2021/22, we launched our [Outcome Codes initiative](#) to incentivise firms to make offers on groups of similar cases to enable faster resolutions for consumers. In five months, we received nearly 7,000 offers from around 100 different businesses providing around £22 million redress to consumers. About half of these complaints were about fraud and scams.

15. Whilst this initiative worked well, there could be certain challenges in deploying it more widely – for example, in defining what a ‘batch’ is. For large businesses, it could be hundreds of cases, but it should be accessible to smaller businesses as well. One approach could be to calculate a batch as a percentage of the total cases that a business has with us. But there might also need to be a minimum number.

16. Others have expressed concern that batch closures may include cases that businesses would not have upheld, meaning they are penalised with higher uphold rates. However, we would expect all business offers to be made in line with our approach, including not settling cases that would otherwise be rejected.

Q13: Would you like us to consider offering discounts for cases resolved in batches in future, or do you think that fees based on the stage a complaint reaches would have the same impact? What would be an appropriate minimum and maximum number of complaints to form a batch?

Introduce supplementary fees for uncooperative firms

17. It has been suggested that we should charge additional fees to financial businesses which do not work constructively with us. As we are not a regulator, it is not our role to penalise firms, but [DISP 1.4.4R](#) does require financial businesses to cooperate fully with the Financial Ombudsman Service and to comply promptly with any settlements or awards made by it.

18. When businesses do not behave constructively, we incur additional costs because it can take us longer to resolve complaints and creates inefficiencies. Examples include: refusing to engage with us, not sending us the required documents on time; needing multiple contacts with a firm before we receive all the information we need.

19. Implementing an additional administrative charge for firms which cause unexpected and unnecessary costs might incentivise them to engage constructively with us, but we would need to make sure that we have a clear, well-defined basis on which to charge these cases. We would also need to consider the behaviour of the consumer bringing the case, so that firms aren’t unfairly charged.

Q14: Would you like us to introduce supplementary fees for firms which are uncooperative and how do you define ‘uncooperative’?

Ideas we have considered but are not proposing to take forward

There are other ideas for improving our funding structure that we have carefully considered but do not think are viable at this point. We want to be open about how we have arrived at our choices and we would like you to let us know if you disagree with our conclusions.

Here we outline the options and the reasons we do not think they would be feasible.

1

Introduce a tiered case fee based on volume of cases and firm size so that firms that bring a higher volume of cases get charged higher fees.

Why we believe it is not viable

It would be too complicated to work out and administer efficiently.

2

Remove the three free cases allowance for non-group firms so all businesses get charged for the caseload they generate.

Why we believe it is not viable

This would add significantly to our administrative costs and those of some smaller financial businesses.

3

Charge a higher fee for cases we find in favour of the consumer in line with the 'polluter pays' model.

Why we believe it is not viable

There is a risk that we would be perceived as upholding complaints motivated by financial incentive.

4

Exercise our powers under the [Financial Services and Markets Act 2000](#) to make a rule permitting an ombudsman to require a complainant to contribute to our costs where their behaviour was unreasonable or they caused a delay.

Why we believe it is not viable

We think that it would be unlikely to change behaviour. We already have the ability to dismiss a case if classed as 'frivolous or vexatious'. If a case is dismissed for this reason, there is no case fee chargeable to the firm.

Q15: Do you agree that these options should not be taken forward or should we reconsider any of them – and if so, why?

How to respond

Please tell us what you think of our proposed options by emailing consultations@financial-ombudsman.org.uk by 5 August 2022.

A feedback statement will be published in October.

We will consult on our budget for 2023/24 in December, as part of our usual budget cycle.

The options we plan to take forward from this paper, based on your feedback, will form part of that consultation.



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