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Mark Hoban MP
Financial Secretary to the Treasury
HM Treasury
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18 January 2011

From Natalie Ceeney and Hector Sants

Dear Mark,

REGULATORY REFORM: THE OMBUDSMAN SCHEME

In response to the Government's proposals for a new approach to financial regulation, the FSA and the Financial Ombudsman Service have jointly considered what changes might be made to the current legislation governing the ombudsman scheme, based on the two organisations' experience under the current regime.

We are happy to say that we both agree on the way forward that we are recommending to you on the future arrangements for the ombudsman scheme. We have worked closely together on this, and believe that we have found a progressive way in which in our different, but complementary, powers could be used effectively in a reformed regulatory regime. We believe that our proposals, as set out in this letter, are in the interests of improving the clarity, efficiency and effectiveness of the scheme and are in line with the objectives for reform that the Government is seeking.

Both the FSA and the Financial Ombudsman Service have made suggestions in previous correspondence. Following our discussions, we believe that changes are only required in three areas, so this note supersedes our previous suggestions.

Transparency

You have already announced that you intend to consider options for using greater transparency as a regulatory tool. We have set out in *Annex A* a way which we believe would enable the Financial Ombudsman Service to publish more information in a way that is both flexible and in line with the Government's objectives.

Oversight and governance

We agree that two objectives are key on this:

- that the governance of the Financial Ombudsman Service is strong and accountable, ensuring effective and efficient operation of the scheme; and
- that the operational independence of the Financial Ombudsman Service is maintained.

To support these objectives under the new regulatory regime, it will be important that the CPMA and the Financial Ombudsman Service have in place an effective memorandum of understanding, or similar. This should be capable of being flexed as circumstances change, and would set out in detail how these objectives would be achieved in practice.

Such detail would clearly be inappropriate for inclusion in the Bill. But we do believe that there would be merit in including in the Bill (perhaps in paragraph 2(2) or paragraph 7 of Schedule 17) an obligation on the CPMA and the Financial Ombudsman Service to put in place a mechanism for ensuring that the two objectives are met. The mechanism would make transparent how we are delivering against these objectives, contributing to increased stakeholder confidence in the scheme and how we work together.

Technical changes

We have agreed that a small number of technical (and, we think, uncontroversial) adaptations to the provisions in FSMA would be desirable, in order to take into account our joint experience of the operation of FSMA over the last ten years. These are set out in *Annex B*.

We would be happy to discuss these proposals further with you.

We are copying this letter to Alison Cottrell, Emil Levendoglu and to the Bill team.

Yours sincerely,

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ANNEX A
TRANSPARENCY

The Financial Ombudsman Service is due to become subject to the provisions of the Freedom of Information Act during 2011. This would require the ombudsman service to respond – in a reactive way – to requests from individuals. This would lead to information being released in a partial and piecemeal way, with the risk that parties may the "spin" the information to their own ends. We believe that it would be in the public interest if the service could instead *proactively* publish information in a more balanced way – without disrupting the proper exercise of regulatory powers by the CPMA or damaging confidence in financial services more generally.

The information that the Financial Ombudsman Service might be enabled to publish in this way could include, for example, its decisions in individual cases and other insight from its work.

An approach to transparency such as this would not normally require primary legislation. However, the existing statutory framework in FSMA is not helpful and may constrain the ability of the Financial Ombudsman Service to publish significantly more information. A more permissive statutory framework would put beyond doubt Parliament's intention that the ombudsman service should be open about what it sees – where this contributes to the delivery of the CPMA's functions, improving firms conduct of business and maintaining consumer confidence in financial services.

This would require an amendment to the current provisions in FSMA. We recommend that an amendment be made to paragraph 8 of Schedule 17 to provide a general power for the Financial Ombudsman Service to publish information that goes beyond its statutory function (in section 225) of resolving individual complaints.

Such a provision would enable the ombudsman service to determine, in discussion with the CPMA and others, the detailed approach to take to publication. A permissive provision such as this would allow the service to respond flexibly to a changing external environment and enable the approach to transparency to evolve over time. Consumers and financial businesses would continue to be protected by the general law relating to privacy including relevant provisions in the Human Rights Act.

ANNEX B

TECHNICAL CHANGES

The FSA and the Financial Ombudsman Service agree that the following technical adaptations to the provisions in FSMA would be desirable, in order to take into account our joint experience of the operation of FSMA over the last ten years.

Successor firms

In many cases dealt with by the Financial Ombudsman Service, a successor firm takes over the liabilities for the acts or omissions of a predecessor. It would be helpful to make explicit on the face of the statute (currently s226 FSMA for the compulsory jurisdiction, and s226A for the consumer credit jurisdiction) that in such a situation the successor firm then becomes (for the purposes of the ombudsman's jurisdiction) the appropriate respondent to a complaint made to the ombudsman scheme.

In discussions with previous Treasury ministers it was agreed that, in principle, this clarification would be desirable, in order to avoid any (in our view mistaken) argument that the existing wording should be construed narrowly to say that the proper respondent is the predecessor firm.

It might be considered that making such an amendment would raise some exposure in respect of past ombudsman decisions and prompt challenges. We consider that any risk of firms successfully arguing that previous ombudsman decisions had been flawed (i.e. for jurisdiction reasons) is low.

Late acceptance of an ombudsman determination/acceptance in writing

The requirement (s228(4)(c)) to notify acceptance of an ombudsman determination before a specified date does not take into account that there are occasions when the complainant is legitimately unable to do so. Currently, an ombudsman is unable to extend the time for acceptance or accept a late acceptance, even in exceptional circumstances. It would be appropriate to make explicit that the date may be a conditional date and provide for late acceptance.

Similarly, the requirement that the complainant notify acceptance of an ombudsman decision in writing does not take into account that some find this difficult (e.g. for reasons of disability). It would be helpful therefore to make it explicit that the ombudsman can make allowance for this.

Losses exceeding the award limit

There has been some uncertainty about whether acceptance of an ombudsman's determination means that the complainant is prevented from pursuing in court the balance of any loss exceeding the monetary limit in s229(5) FSMA – currently £100,000 but proposed for increase to £150,000. A recent High Court judgment

(*Andrews v SBJ Benefit Consultants Ltd*) held that an acceptance by a complainant of an ombudsman award extinguished the cause of action and so prevented the recovery of further amounts in court.

We see this as an opportunity to codify that decision. That would eliminate any remaining uncertainty so that such a challenge does not arise again (and avoids expecting customers to know about the High Court decision).

Slip rule

It would be desirable to provide for a slip rule whereby the ombudsman can rectify clerical mistakes or accidental errors in his determination without these having the effect of nullifying it. Rule 17 of the Personal and Occupational Pension Schemes (Pensions Ombudsman) (Procedure) Rules 1995 provides a model for doing this.

CPMA ability to make rules covering "pre-regulation" complaints

The FSA makes rules under s138 FSMA for the redress of complaints arising from conduct of business that is regulated by the FSA. However, the jurisdiction of the Financial Ombudsman Service is wider than that and extends in some respects to complaints about business that was not at the time regulated. The FSA may make rules requiring a respondent to "make such procedures" as are considered appropriate for the resolution of complaints, using the power in paragraph 13(4) of Schedule 17 FSMA. There is some doubt as to whether this is power allows for comprehensive rules that include redress or may be limited to procedural matters like time limits for processing complaints. It would be helpful to expand the provision so that it is clear that the Authority can make comprehensive complaints rules. Such rules would include, for example, those currently set out in the DISP section of the Handbook covering *inter alia* requirements to conduct root cause analysis and to consider the position of consumers who have not complained.