The APPG on Fair Business Banking

Response to FCA Consultation CP18-31

December 2018

Response to FCA consultation on SME access to the Financial Ombudsman Service

About the APPG

An All-Party Parliamentary Group (APPG) is a cross-party interest group of parliamentarians. The APPG on Fair Business Banking is a platform through which businesses, professionals and trade bodies can discuss issues regarding commercial banking and its role in the life cycle of a business, and through which parliamentarians can access information on banking, finance and related issues, including business rescue and insolvency, on behalf of constituents. As a cross-party group, with a large membership of both MPs and peers, the APPG is an effective vehicle to effect meaningful change via the parliamentary system. The Group does not have charitable status, or official status in the House, nor is it funded by Parliament. It relies wholly on the participation and contribution of parliamentarians, industry members and stakeholders committed to creating a strong platform for business in the UK to thrive.

Challenging misconceptions about businesses

A large part of the work of the APPG involves challenging existing views and perceptions about private businesses.

The term "private businesses" encompasses not just all of the small and medium-sized enterprises (SMEs) that are so often called the "lifeblood" of the economy, but also larger entrepreneur-owned entities with multi-million pound balance sheets and hundreds of employees. Cumulatively, and through their interconnected relationships with employees, customers and suppliers, private businesses have a huge positive impact on the UK economy.

In our experience, what the vast majority of these private entrepreneur-owned businesses have in common - and that includes **all SMEs** - is that

a. they all need access to financial services during their life cycles and
b. they are ***not*** **on a level playing field**, in terms of size and negotiating power, with their main suppliers of financial products and services, the big banks.

Not a level playing field

There are some key issues which prevent the majority of private businesses and **all SMEs** from being on a level playing field with large financial firms.

There is still negligible competition between a small number of very large, well established and powerful suppliers of commercial financial services, each of which remains too systemically important to be allowed to fail, which results in a lack of variety of price and features between the main suppliers' offerings in this market.

A lack of choice and negotiating power can leave business consumers without sufficiently clear information and understanding of features and risks to make informed decisions about financial products and services that will meet their needs and give them a certainty of outcome. With no requirement for financial firms to provide transparency, a duty of care or to act in good faith,

problems can be sealed into commercial banking relationship from the outset. There may be little option but to agree to unfavourable and onerous contractual terms in order to access the funding necessary to develop or grow a business. Once committed to certain facilities, business customers are unlikely to be able to easily switch between suppliers, if a better alternative can be found. They will also find it extremely difficult to make a successful legal challenge against any commercial contractual terms they have agreed to that cause damage and appear unfair.

The huge disparity in power between the main financial services providers and their business customers leaves those customers open to a potential abuse of power. There is currently little disincentive to deter large financial firms from hastening or even participating in the failure (insolvency) of their business customers or selling on their debt to unregulated entities and thereby potentially exposing them to asset-stripping due to commercial or regulatory pressure to de-risk or exit certain markets.

Losses experienced by businesses can have a more serious and widespread effect than those experienced by other consumers. The financial sums involved can often be much greater and the impact of those losses or of the resultant failure of a business can be felt not just by the business owner(s) but also by its employees, customers and suppliers. Larger businesses are as much at risk as smaller ones, if they are not in a position to negotiate on an equal footing with financial firms, but the scale and extent of the loss or failure and number of those affected by that loss or failure can be much greater.

The damage to individuals and the wider economy as a result of problems between businesses and their financial services providers cannot be understated; job losses, personal bankruptcy, mental health problems, suicide, family break-ups and cuts in local and national funding from loss of revenue to councils, HMRC and others, are all common effects.

Establishment of an effective and accessible Dispute Resolution forum

Among the core goals of the APPG is the establishment of an effective and accessible Dispute Resolution forum for businesses which find themselves in dispute with a financial services provider.

Our joint inquiry with the APPG on Alternative Dispute Resolution into suitable mechanisms that can be employed to provide a long-term dispute resolution platform for businesses in financial disputes has established that while FOS provides an essential and useful service for large numbers of non-business consumers, it is lacking in essential skills, powers and understanding of key issues necessary to provide a satisfactory resolution process for many high value business disputes. Certain difficult issues will simply never be adequately addressed by an ombudsman, including insolvent businesses, disputes with financial institutions that operate outside the regulatory perimeter and large and complex claims.

In his report “Fair Business Banking for All – How to improve access to justice for businesses in financial disputes”, our Co-Chair, Kevin Hollinrake, makes a number of key recommendations including the introduction of a specialist Financial Services Tribunal for disputes between businesses and their financial services providers.

About the APPG Response to CP18/32

We have not attempted to answer every individual question in the FCA’s consultation paper and some of our answers are given in response to more than one question.

Private businesses that are not on a level playing field with the main suppliers of their financial services - this includes all SMEs and also a good number of other larger businesses - currently have few options for dispute resolution. Court action is out of reach financially for the vast majority of businesses which find themselves in dispute with their financial services provider, in the same way that it would be unthinkable for most other non-business consumers with a high value financial complaint.

In principle the APPG is inclined to view in a positive light any proposal that could increase the chances of more private businesses achieving a satisfactory level of redress – i.e. one that is likely to compensate them for all or most of the damage and losses that they have experienced as a result of misconduct or other mistreatment by a financial firm.

However, we strongly disagree with the FCA's viewpoint in para 1.18 on page 6 of CP18/31:

"*We are clear that the ombudsman service is the right scheme to consider complaints from larger SMEs, charities and trusts, and personal guarantors of loans to a business they are involved in*."

We remain convinced that there are serious longstanding gaps in dispute resolution provision for private businesses, that a significant section of the business community is not satisfactorily served by the FOS and that the FOS will remain incapable of addressing all of these gaps following the extensions in eligibility criteria that the FCA expects to introduce in 2019. While any increase in the maximum award limit is to be welcomed, it will not address the fundamental and unacceptable gaps in dispute resolution provision that persist for this group of customers.

The APPG maintains that there is a compelling and urgent need for a different form of dispute resolution, alongside the FOS, for complex and high value business disputes and that some kind of specialised financial services tribunal is most likely to satisfy this need.

APPG response to Q1, Q2, Q3 and Q4

Q1: Do you agree with our estimate of the volume of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?

Q2: Do you agree with our estimate of the value of high value complaints, including the assumptions we have made? If not, are you able to provide any data to support your view?

Q3: Do you agree with our assumptions about the volume and value of high value complaints that might be referred to the ombudsman service by newly-eligible SMEs? If not, are you able to provide any data to support your view?

Q4: Do you agree with us that, for the reasons given, the number of high value complaints that are not currently made to the ombudsman service because of the award limit is unlikely to be significant? If not, are you able to provide any data to support your view?

The FCA has evidently arrived at the conclusion that the current maximum award limit for the FOS is far too low for a significant minority of complaints the service handles and upholds. The APPG agrees with that conclusion.

We are pleased that the FCA has acknowledged "the risk of very significant harm if the award limit means fair compensation is not paid by firms" to those individual complainants with high value complaints.

With respect to the FCA's estimates and assumptions on the volume of high value complaints, we are surprised to see that such a huge proportion of the upheld complaints displayed in Figure 2

(page 11 of CP18/32) fall into the category of having 'unknown' compensation values. Given that most of the other groups in the chart provide for a relatively wide range of values, we cannot see why it should not be possible for FOS or the FCA to arrive at a more accurate categorisation of the compensation value of many of those upheld cases represented within this section.

It is clearly not acceptable that any complainant should be presented with a 'take it or leave it' outcome (as the FCA itself acknowledges) without clear and certain information as to the monetary value of the redress proposed or recommended by FOS. It appears from Figure 2 that this is happening in well over half of cases where an upheld FOS decision results in an award or recommendation.

If an upheld complaint does not automatically result in a clear-cut redress award amount then the FOS should require the firm concerned to provide both the service itself and the complainant with a calculation of its expectation of the quantum of redress in that case. Where FOS has recommended that the firm should pay in excess of the maximum award limit then that firm should confirm whether or not they intend to honour the recommendation in full. In every case the complainant should be presented with a quantifiable calculation of redress before being expected to decide whether or not to accept the FOS decision. Once a complainant accepts a FOS decision, it is binding and if they are dissatisfied with the level of redress received, there is usually no possibility of increasing the redress amount either through the courts or by making another complaint to FOS on the same issues. It is therefore very important that the complainant should have a reasonably accurate calculation of their anticipated redress payment in order that they can make an informed decision.

FOS and/or the FCA could increase transparency further for all customers by publishing more details, including the actual amount of compensation due or recommended in each case, whether or not each final decision was accepted by the customer and, if so, how much of this the firm actually agreed to pay and how long it took to make the payment to the customer.

According to Figure 2, the group of customers with unknown compensation is far larger than all of the customers with a known compensation amount put together. We would suggest that, in the face of such inexplicable uncertainty about the quantum of redress due to over half of all customers with compensation awards, the FCA cannot have complete confidence in the accuracy of the figure of (approximately) 2,000 upheld complaints each year which involve fair compensation recommendations above £150,000. It also does not seem to be safe to assume that "decisions with unknown compensation have the same distribution as those with a specified money amount."

For the APPG to be able to comment with any great detail on the FCA's estimates and assumptions with respect to the value of high value complaints, it would be necessary to have a clearer breakdown of the types of customers, in particular the proportion of businesses, and their respective types of complaints and compensation values, that fall into the group whose compensation awards exceeds the current £150k limit.

In view of our experience that there can be very large variations in the level of losses sustained by business customers with essentially similar complaints, we would question how useful and accurate it can be to attempt to extrapolate key data from a sample of just 40 complainants, which includes both business and non-business customers.

In order to arrive at a realistic figure for aggregate financial harm, the FCA needs to calculate the ***actual*** compensation shortfall between the current limit of £150k and the full level of fair redress recommended by FOS, rather than the difference between the current limit and the proposed new

limit of £350k. It is also not entirely clear why the FCA should chose to use the median of each money award range, rather than the mean, as the average for that range. This could result in significant distortions if there is not an even spread of compensation values within each category.

In its previous consultation document CP18/3, the FCA stated "Our analysis suggests around a fifth of all SME disputes by number are above the current award limit" (paragraph 4.15, page 22). We are therefore puzzled as to why it has chosen to apply much lower percentage rates (between 4% and 7%) to arrive at its estimates of how many high value complaints will be made each year to FOS by newly eligible business complainants.

APPG response to Questions Q5, Q11

Q5: Do you agree with our proposal to increase the ombudsman service's award limit to £350,000 for complaints about acts or omissions by firms on or after 1 April 2019?

We agree that the ombudsman service's award should increase substantially from the current limit of £150,000 – i.e. by more than the amount that would allow for increases in inflation since it was last increased in 2012.

We also agree that it can be spectacularly unfair to some customers if it is left to a firm to decide whether or not to compensate those customers fully according to what the FOS has decided is a reasonable amount of redress.

The FCA estimates in CP18/31 that around a quarter of the cases where fair compensation is likely to exceed the current maximum limit have a recommended compensation amount in excess of £350,000 and in around 250 of these there is likely to be compensation of over £400,000 recommended. We believe that a limit of £350,000 is not adequate to fully cover the damage and losses in many of the high value business complaints that the FOS is currently expected to adjudicate on and it is likely to be insufficient in more cases following the expansion of its remit to cover complaints from businesses that are larger than microbusinesses.

Previous FOS consultation CP18/03, Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7 indicates that a new upper limit of £400,000 would cover just 16% of the value of redress recommendations over and above £150,000, while a limit of £600,000 would still only cover less than 60% of the share of potential redress outside the current limit. The APPG sees a high proportion of disputes with claim values greater than £600,000. The APPG would prefer to see no upper limit on FOS compensation awards. However, it is our view that if there must continue to be a limit, then £600,000 is a much more suitable level for that limit than £350,000.

We are also extremely disappointed that the FCA's consultation does not solicit views on an option to apply the larger increased award limit to matters of complaint that arose prior to 1st April 2019. We disagree very strongly with the proposal to apply this limit only to complaints about acts and omissions that occur after 1st April 2019.

We agree with the following statements made by FCA in CP18/31 about how important it is that customers are able to access adequate levels of redress when damage has been caused by a financial firm, and that an award limit that is set too low can jeopardise this:

2.11 Being able to complain to the ombudsman service reduces the risk of harm to financial services consumers, both individually and in aggregate. As a basic matter of fairness, people who have suffered – because of a firm's act or omission – a financial or non-financial loss, such as distress or inconvenience, need to be directly compensated by firms for those losses. If it is not easy for

individual consumers and businesses to get redress, firms' incentives to maintain high standards of behaviour, culture and product governance will be reduced. Potentially, this could affect even larger numbers of consumers and reduce trust in the integrity of the market as a whole.

2.12 The benefits of consumers having access to the ombudsman service will not be fully realised if the award limit means that complaining to the service does not result in payment of all – or at least a substantial portion – of the compensation the service believes is due for loss or damage. So, it is important that we periodically review the award limit and ensure it is set at an appropriate level.

We also agree with statements by the FCA on the anticipated benefits of an increase in the award limit, including this one in paragraph 1.13, page 5 of CP18/31:

…we believe our proposed rules will:

• ensure more consumers and smaller businesses will receive fair compensation when things go wrong in their relationship with a financial services firm and the firm is at fault

• strengthen firms' incentives to resolve complaints quickly and informally, or to avoid them altogether, in turn helping to build consumer trust in the integrity of the industry

• support our duty to promote effective competition in the interests of consumers, because:

– firms that cause substantial financial harm to consumers will have to pay more redress because of poor conduct, meaning firms with better conduct may be able to outcompete them

– consumers will know that all firms will be required to pay higher amounts of compensation in the event of a dispute, rather than this being at individual firms' discretion (and therefore not knowable at the time of purchase)

If the FCA proceeds with its current plans, these benefits will not accrue for a very significant group of customers whose complaints relate to issues that happened before 1st April 2019. The FCA's current proposal to differentiate between the dates of origin of issues in dispute and apply different award limits to them will not only be very difficult to implement in practice, but will almost certainly disadvantage a disproportionate number of complainants with complex, high value claims, perpetuating the current insufficient levels of redress for many years to come.

It can take several years for problems with financial products and services to crystallise and/or become apparent. Thousands of business owners entered into IRHPs at the behest of their bank, for instance, between 2006 and 2008 and some prior to 2006, but most remained unaware or did not fully understand the risks and potential financial impact of these products until at least the second quarter of 2009, after interest rates had dropped dramatically. For some businesses the full impact may have taken longer to materialise, for instance not until they attempted to renew their facilities or take on further debt or sell assets against which their loan(s) and IRHP(s) were secured. It is quite normal for complaints about these and other complex products to be lodged several years after the products were 'sold' or the relevant agreements entered into.

In respect of this change, the FCA is proposing to update the Handbook with the following simple, unqualified text:

3.7.4 R (1) The maximum money award which the Ombudsman may make is:

~~£150,000~~.

(a) £350,000 for a complaint concerning an act or omission which occurred on or after 1 April 2019; and

(b) £[160,000] for a complaint concerning an act or omission which occurred before 1 April 2019.

We believe that if the FCA proceeds to produces its final rules along the lines of this text, without any further qualifications, it will be open for firms to insist that the lower maximum award is applicable to any upheld complaint about any product or service or even to any relationship that was entered into prior to April 2019, even where the alleged loss or damage or a customer's realisation of that loss or damage does not occur until after this. This seems extremely unfair. In addition to unresolved high value issues that customers (including newly eligible business customers) may be considering referring to the FOS in the near future, there are likely to be issues with products and services transacted prior to April 2019 that are not yet apparent but that will become evident in the coming months and years.

Some firms are also likely to claim that certain acts or omissions complained about and occurring after April 2019 were triggered by events that preceded this time and so should not count as qualifying for the higher compensation award were upheld. One example of this might be where a business complains about their treatment within their bank's 'special measures' or 'business support' department. The bank may claim that the complaint relates principally to lending agreements and/or contracts that pre-dated the transfer of the business to that department and anything that occurred while it was there.

We would urge the FCA not to implement the tiered increases in the way that it is proposing to do in the consultation, but instead to make the larger increase applicable to all complaints made on or after the implementation date, regardless of whether or not the act(s) or omission(s) at the heart of those complaints occurred before or after the implementation date.

At the very least, before any final decision is taken on the applicability of the award limit increase(s), further analysis is urgently required to identify the length of time that can elapse between when an act or omission by a firm takes place and when the customer complains about it.

APPG Response to Q6, Q7, Q8, Q9, Q10, Q16, Q17

Q6: Do you agree with our proposal to automatically adjust, in line with general price inflation, the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 every year from 2020 onwards?

Q7: Do you agree that the measure of general price inflation used to automatically adjust the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?

Q8: Do you agree with our proposal for a one-off adjustment, reflecting general price inflation between 2015 and 2019, to the ombudsman service's award for complaints about acts or omissions by firms before 1 April 2019?

Q9: Do you agree with our proposal to automatically adjust every year from 2020 onwards, in line with general price inflation, the ombudsman service's award limit for complaints about acts or omissions before 1 April 2019?

Q10: Do you agree that the measure of general price inflation used for both the proposed one-off and automatic adjustments to the ombudsman service's award limit for complaints about acts or omissions on or after 1 April 2019 should be the CPI?

Q11: Do you agree with our assessment of the impact of our award limit proposals on the ombudsman service?

Q16: Do you agree with our decision to rule out having different award limits for different types of complaint or complainant? If not, why do you think there should be different limits?

Q17: Do you agree with our view that there should be a limit to the amount of compensation the ombudsman service can require firms to pay to complainants? If not, how – if at all – would the ombudsman service's approach to dispute resolution need to change for it to be able to require firms to pay any amount of compensation?

If a dispute resolution mechanism is to be fit for the purpose of resolving the kind of complex and high value financial disputes in which many businesses, small and large, find themselves, then there can be no upper limit on the amount of compensation that a firm is required to pay where the dispute is resolved in favour of the customer. The APPG has seen no reason to change its view that while the FOS continues to perform an essential and useful service for thousands of non-business consumers with relatively simple, low value complaints, it is not the appropriate dispute resolution forum for many more complex, high value disputes. Far reaching changes would be required to make the FOS fit to resolve the majority of these disputes, including, but by no means limited to, the removal of any maximum award limit.

It makes sense to essentially leave the FOS to handle the kinds of low value, straightforward disputes to which it is best suited and introduce a different, purpose built mechanism suitable for the resolution of complex, high value disputes. There remains a clear and pressing need for this to happen and the APPG is convinced that it is inevitable that it will happen.

We disagree with the imposition of any award limit and are equally opposed to there being different award limits for different types of complaint or complainant. However, if there is a limit, it should be no lower than £600,000 and it makes sense that its value should not be allowed to deteriorate significantly in real terms, but that it should keep up with inflation. We have little comment to make on the best method and most appropriate index to achieve this other than to question why the limit should necessarily be rounded down by as much as £5000 on each occasion it is reassessed. It is conceivable that some years the rounding down exercise may almost completely negate any prospective increase. It should either be rounded down by up a smaller amount – perhaps by £1000 - each time, or else there should be an allowance to round the amount up sometimes, where it is more logical to do so.

APPG response to Q14

Q14: Do you agree with our assessment of the impact of our award limit proposals on individual firms?

The view of the APPG is that firms that treat all of their customers fairly and with respect and transparency at all times, including in the event of any complaints, have nothing to fear from the proposed changes. Firms that rely on unscrupulous sales methods and opacity to maximise profits by matching up unsuspecting customers with inappropriate products are dependent on an unsustainable business method. We trust that such firms would be impacted by the implementation of the FCA's award limit proposals.

APPG response to Q18

Q18: Do you agree with our view that the award limits for the ombudsman service and the FSCS should not be aligned?

If by not aligning the award limits for the FOS and the FSCS, there is a risk that customers with high value complaints upheld against some firms will not receive an adequate level of redress then there is a clear need for the two to be aligned.

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