

## **Regulators and the Ombudsman – the critical role of the Financial Ombudsman Service**

### **Remarks by Vernon Everitt, Director of Retail Themes Division, Financial Services Authority**

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1. Thank you very much for the opportunity to address this important event. The BIOA clearly plays a significant role in providing information for the public about ombudsman and complaint handling schemes and acting as a focal point for schemes, complaint handling bodies and other members of the Association to seek and exchange information. So, given the audience, I am even more mindful than usual that everything I say must be fair and reasonable.
2. I've been asked today to set out how the FSA views the importance of an ombudsman in supporting the delivery of our objectives. So in that context, I'd like to talk about four things:
  - overall, to explain why an effective ombudsman for financial services is such a critical part of the system of consumer protection in the UK and why it enables the FSA as regulator to take a risk-based and proportionate approach to discharging its obligations;
  - the distinct roles of what we call the 'three sisters' – that is regulator, ombudsman and compensation scheme – in the financial services markets;
  - how regulator and ombudsman work together in practice; and
  - how we see that relationship developing as we move towards a more principles-based approach to regulation in the financial sector.

#### Responsibilities of the three sisters

3. I should begin by explaining the roles of each of the three sisters.
4. I guess that the first thing I need to do here is make it clear that, although we are each only nine years old, there is a highly developed system of co-operation between us. No sisterly squabbling here about who has the best Bratz doll or which member of Take That is the best singer. Instead, we work together to deal with what are often extremely tricky or sensitive issues, particularly where they may have wider implications for the industry as a whole. I promise that the sister analogies stop there.
5. The Financial Services Authority (FSA), Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS) are operationally independent of each other and each occupies its own clearly defined territory staked out by the Financial Services and Markets Act 2000.

6. In descriptions so summarised that they would seriously raise the blood pressure of our lawyers, the cake is carved up as follows:
- The FSA is the single *regulator* of virtually all elements of financial services in the UK. I say virtually because unsecured consumer credit falls to our colleagues at the Office of Fair Trading (OFT) under the Consumer Credit Act – more on which anon (and, of course, OFT has the competition role across the entire economy, including in financial services). The overall aim of the FSA is to promote efficient, orderly and fair financial markets and to help consumers in retail and wholesale markets get a fair deal. Our regime relies on a mix of high level principles and rules and we aim to define the *outcomes* our regulation must deliver rather than regulatory *processes*. Moreover, we act proportionately and in a risk-based way in a regime that explicitly recognises that some failures in the system – be that in terms of poor treatment of individual consumers or the collapse of some firms – are inevitable. So the existence of an ombudsman and compensation scheme provides the essential foundations for the entire regulatory system.
  - The FOS delivers *informal dispute resolution* – i.e. as an alternative to the courts – where consumers and firms have not been able to sort out an issue between them. FSMA demands that complaints are considered by reference to what is, in the opinion of the FOS, fair and reasonable in all the circumstances of the case. Where the complaint is upheld in favour of the complainant (which happens in about a third of the cases considered), the FOS generally aims to put people back into the position they would have been in if things hadn't gone wrong. The FOS's decisions are binding on the firm, but not the consumer who can proceed to the courts if not satisfied. Until recently, the FOS dealt almost exclusively with complaints about firms authorised by the FSA. However, from earlier this month, its jurisdiction was widened to cover complaints about firms licensed by the OFT to perform unsecured consumer credit business.
  - And to complete the picture, the FSCS provides a scheme by which it can pay *limited compensation* to the customers of firms regulated by the FSA which have, for some reason, failed. Given today's audience, I won't dwell on this element of the system any further, but suffice to say that the existence of such a scheme is vital to maintaining consumer confidence in financial markets but its limited nature makes clear that consumers are not relieved of the need to make their own informed choices about where they put their money.
7. The FSA sets down, or approves, most of the rules under which the FOS and the FSCS operate and we appoint both the Chairmen and the other members of the Boards of these organisations. But, as mentioned, each sister is operationally independent of one another. For example, the FSA cannot, even if we ever wanted to, influence or change decisions made by the FOS in individual cases. This is an entirely deliberate consequence of the way in which the UK system of financial regulation has been constructed.

#### Working effectively with the FOS

8. So how do we ensure that we work together effectively? After all, the operational independence of the FOS makes it absolutely vital that we have systems in place to do so and that consumers and firms are clear about how this operates.
9. There is a daily flow of communication between our respective organisations; regular bilateral meetings between our dedicated liaison teams and regular strategic discussions which take place at Board level. Further, the FOS is represented on various FSA stakeholder groups – for example, our Treating Customer’s Fairly Consultative Group. In addition to this, there are two main mechanisms in place:
  - First, we have recently published a revised Memorandum of Understanding. Previously, we had a ten page document that gave an account, in excruciating detail, of our respective legal responsibilities and ways of sharing information. In the spirit of focusing on outcomes and the big things that really matter, we have changed this to a much shorter document which gives a higher-level explanation of our roles and how we work together.
  - Second, we are looking at ways to further improve our ‘Wider Implications’ (WI) process which covers how we handle issues where complaints may have wider regulatory implications for firms and consumers. The essence of the process is that the FSA and FOS can consider whether regulatory action would be appropriate. For example, the FSA may instead take supervisory or enforcement action or offer the FOS and the firm an interpretation of existing rules. However, it is important to note that, in some cases, the FSA’s actions can only deal with matters going forward and that the ombudsman service will remain available to deal with complaints from individual consumers about the past actions of firms. On the other hand, the FSA and the FOS may decide that regulatory action would not be appropriate. In this case, the process allows for the FOS to consult industry and consumer representatives.
10. Recent examples of the WI process in action are:
  - Mortgage exit administration fees, where earlier this year an industry-based solution was found to dealing with unfair variations in such fees with the ombudsman remaining available to deal with any complaints from consumers who were not treated in keeping with that solution;
  - With-profits investment funds, where we published a description of our process for considering management actions by with-profits insurers. We also provide relevant information so that the ombudsman can consider, in individual cases, whether a fund’s investment decisions can be regarded as a legitimate exercise of commercial judgement; and
  - Where consumers were recommended investments issued by a bank or building society but the IFA paid them into his own accounts. Here, we raised the issue with the British Bankers’ Association (BBA) and the Building Societies Association (BSA). Following this, the acceptance of cheques made out simply to a bank or building society and paid into the account of a third party was phased out, thus reducing the scope for fraud. Again, the

ombudsman service remained available to deal with complaints from individual consumers.

11. Given the FOS's new complaint handling responsibilities under the consumer credit jurisdiction, similar WI arrangements are being discussed between the FOS and the OFT. Indeed, the current topical issue concerning unauthorised default charges on current accounts (about which FOS is currently receiving 10,000 inquiries a week) is a good example of how the three organisations already work closely together on matters of mutual interest. This extension of the WI process also fits in well with the ongoing strengthening of the FSA's relationship with the OFT.
12. At the same time as we, the FOS and the OFT discuss this, we will also be looking to see how we can strengthen the involvement of industry and consumer representatives to bring them in at an earlier stage, when considering an issue with wider implications.
13. So there are very clear ways in which we collaborate and communicate to ensure that the regulatory system as a whole addresses issues in the most appropriate way.

#### The role of the Ombudsman under More Principles-Based Regulation

14. And so on to my final point. The role of FOS is an essential enabler of our move towards more principles-based regulation.
15. The FSA is trying to focus more on the outcomes that really matter – better outcomes for consumers, for investors and for markets. This will involve firms' senior management developing a greater understanding of how the Principles and other high-level requirements should apply in practice, and driving and embedding change throughout their firms. A more principles-based approach also provides senior management with the scope to compete and innovate while meeting our requirements. This includes allowing firms to compete by voluntarily exceeding these minimums.
16. This is not about any lowering of our standards or passing standard-setting to the industry or to the FOS. Our Principles are themselves rules. They articulate the outcomes we require firms to deliver. For example, firms must conduct their affairs with integrity, they must pay due regard to the interests of their customers and treat them fairly, and they must maintain adequate financial resources.
17. The very existence of the FOS helps to facilitate the FSA taking this risk-based, principles-based and increasingly outcome-focused approach. The vast majority of cases considered by the FOS turn on questions of fact or the application of general legal principles rather than on the application of detailed FSA rules. And at the end of the day, firms that put in place a culture and a set of operating procedures that deliver the outcomes we are seeking are unlikely to find the FOS upholding cases against them on a regular basis.

18. Some firms are concerned that the move towards principles-based regulation will create greater uncertainty about what their obligations are to consumers, and that they may be held accountable for these by the FOS rather than by us. There is some concern that the FOS may interpret high-level rules and principles differently from us. This could limit the potential benefits from our move to more principles-based regulation.
19. But, again, it is important to bear in mind that most cases considered by the FOS turn on disputes of fact or the application of general legal principles. This is unlikely to change as a result of our move to more principles-based regulation. So we believe that it will not change the FOS' role and its interaction with the overall regime. And the wider implications process I mentioned earlier will continue to capture those issues with the potential for broader application across the industry.
20. And we very much welcome the steps the FOS is taking to commission an independent review to examine, among other things, whether it is making the most effective use of the information it holds to improve the understanding of firms and consumers. We believe that greater transparency about the approaches being taken by both organisations can be very helpful to all our stakeholders.

### Conclusion

21. In conclusion, and returning to the original question, we are firmly of the view that the FOS is key to allowing us to concentrate on the wider issues that are likely to cause consumer detriment. Without an ombudsman service, the FSA would not be able to pursue the risk-based strategy that it does and consumers would need to resort to an already over-worked court system to resolve individual disputes. And the highly respected system of financial regulation in the UK would be much less effective for that.
22. Thank you again for the chance to discuss these issues with you today.