INFO'07
International Network of Financial Ombudsmen

The world of financial services – markets, regulation and disputes

Session 6 – plenary session

speakers	Clive Briault	managing director, retail markets	Financial Services Authority, UK
	Simon Orton	dispute resolution partner	Freshfields, Bruckhaus, Deringer
note taker	John Ellwood	adjudicator	Financial Ombudsman Service, UK

Clive Briault, FSA

- The FSA's view of the importance of the ombudsman role
- Why the Financial Ombudsman Service (FOS) forms a critical part of the UK financial services framework.

Market turbulence

Northern Rock's recent difficulties are an example of market turbulence which were triggered by the US sub-prime mortgage crisis and spread insecurity through institutions and countries. This led to a general liquidity drought and affected wholesale market funding and securitisation.

There is a memorandum of understanding between the FSA, the Bank of England and the UK Treasury; each had played its part in monitoring the situation as it developed. Northern Rock was judged to be solvent and the FSA remains confident about the resilience of the banking industry as a whole. As a lender of last resort, the Bank of England had taken steps to assist Northern Rock and HM Government had announced a guarantee on deposits in order to quell uncertainty and restore stability.

Role of the regulator

The FSA regulates 29,000 firms involving 165,000 individuals. Its major objectives are to

- promote confidence and understanding
- provide consumer protection
- fight financial crime

The FSA wants markets to work more effectively to give consumers confidence. Firms need to provide simple information and well-managed Treating Customers Fairly (TCF) regimes through risk-based and principles based regulation (PBR). The FOS and the Financial Services Compensation Scheme (FSCS) each play a part and are operationally independent from the FSA. The FOS, for example, reaches its own decisions, without influence or direction from the FSA.

Whilst the FSCS may provide complainants with limited compensation where firms have failed or closed down, the role of the FOS is to resolve disputes with regulated firms in a fair and reasonable manner, of which approximately 30% are upheld. It aims to put the wronged back into their original position and its decisions are binding on firms (if accepted), but not complainants. The FOS has recently widened its jurisdiction to cover consumer credit complaints, which could involve more than 100,000 firms licensed by the Office of Fair Trading (OFT).

Interaction with the ombudsman
The FSA and the FOS exchange daily information flows and meet regularly to discuss strategy at Board level and below. There is a high level memorandum of understanding and, under the 'wider implications' process, the FOS may refer firms to the FSA for consideration of further regulatory action. This may have significant future consequences about the way in which firms operate. Wider regulation examples include mortgage exit fees and inappropriate use of deposit monies. Currently, the UK is awaiting a High Court test case about the application of unauthorised overdraft charges. At present, complaints on this matter are on-hold, pending the outcome of the court case.

The role of FOS within more principles based regulation.
Clive explained how the 11 published high-level principles required of firms by the FSA had their origins in the rules of previous regulatory authorities. The new conduct of business regime will focus on outcomes, rather than process. Senior management of firms will be responsible for ensuring delivery of acceptable results, embedding cultures within their firms and for monitoring performance against TCF standards.

It is impossible to write detailed rules for every eventuality and there is no certainty firms will adhere to such rules anyway. Existing detailed rules have not succeeded in preventing mis-selling and tend to result in a narrow approach to compliance. The FSA welcomes market led solutions via a wider, more principles based approach. The current Retail Distribution Review (RDR) is an example of this.

The FSA considers that the FOS' position in the new regulatory environment, is as an essential enabler, which assists in promoting a risk-based, outcome-focused approach. Few cases at the FOS turn on the strict application of regulatory guidance and firms adopting the principles and TCF culture are less likely to face upheld complaints.

The FOS is considered to be a key element of the process, without which PBR cannot be pursued, meaning less effective regulation of firms. In the absence of the FOS, complainants would have to consider legal action to resolve disputes, which would be problematic and unappealing to many.

The full text of Clive Briault's speech is at –
http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2007/0928_cb.shtml

Simon Orton, Freshfields

Simon Orton gave a difference perspective. He raised concerns about the power and influence of the FOS as a result of the increased and increasing public awareness of its operation and the general public's developing appetite for complaint.

Following leads from the judicial system, complainants now have access to simpler, more effective methods of complaint which they have adopted with relish. This posed considerable challenges to the UK financial services industry and Simon was further concerned that the role of the FOS in a PBR framework may result in it influencing a firm's complaint-handling process.

He questioned whether the FOS was robust enough to handle more complex cases, including forensic examination and larger sums of redress, possibly involving complicated legal issues. He thought it was difficult for the FOS to investigate factual

issues on mass mis-selling claims, often provoked by a consumer lobby rather than by individual dissent. He suggested that if no other mechanism existed for handling such matters, there was a risk of undoing good work and creating legal uncertainty.

The FOS would be in uncharted territory if it is drawn into the regulatory framework and the shaping of a firm's conduct of business. Simon considered PBR may limit the scope of the FSA's role and whilst not criticising the work of the FOS, suggested the regulatory system of the future may be built excessively around the decisions it issues. He thought the Markets in Financial Instruments Directive (MiFID) may result in similar pressures across Europe that have not yet been experienced outside the UK.

The full text of Simon Orton's speech is at –
http://www.info2007.org/news/simon_orton.pdf

Discussion

- The USA wondered what advice the panel might impart to US regulators especially in view of the sub-prime mortgage situation. The panel thought the choice appeared to be to put more emphasis on affordability in a principles based regime, or write very detailed rules on specific lending types, which risked the regulator determining the market.

- The notion that PBR pressurised ombudsmen into being more expressive was put forward by Canada. Simon was asked in which direction he considered the industry should be heading. Simon reiterated his concern that too much emphasis may be placed on ombudsman's decisions which drew the FOS into the regulatory framework. He considered this to be at odds with the resolution of individual complaints on their own merits.

- Clive added that the test of PBR was to change the approach of senior managers in firms for the better which, in turn, may involve the manner in which firms deal with complaints before they progress to the next stage.

- This resulted in further discussion on wider implications. Mortgage exit charges were again used as an example, the problem being that firms had been applying these charges without reference to the existing contract terms; a practice which had now ceased.

- PBR has operated effectively in Australia for some time and its ombudsman service had systematic powers. Simon was not altogether reassured and restated his worries that financial complaints could raise difficult legal questions and regulatory solutions did not bind complainants who may still be able to revert to the courts.

- The French mediator explained he had powers to control and fine firms but was reticent to do so. In the UK, the FSA can and does impose fines but the FOS preferred to leave such sanctions to the FSA – although many small firms considered otherwise.

- In New Zealand, it was taken for granted that sanctioning was the purpose of the ombudsman scheme, which had been accepted and sometimes welcomed by the industry. The involvement of the ombudsman was not seen as interference in the legitimate exercise of business practice. Simon was

concerned about the way in which UK schemes fit together and about a potentially rigid system linked to ombudsman decisions.

- In Ireland, impartiality is key to the ombudsman's role yet he is duty-bound to bring identified problems to the regulator's attention. He maintained that ombudsmen can and do carry out forensic examination of complex cases.

- A South African delegate asked Simon's opinion about the correct approach to mass complaints and another reminded him of the recent rules-based regulatory experience in South Africa. Simon explained that process was the key to solving mass complaints where complex legal issues are examined in court, rather than at ombudsman level. He expected the OFT bank charges case to be long and complicated but it is an example of correct process. Clive added that a flexible regulatory system is required in such instances and that the UK had one. He said that the ombudsman process is subject to scrutiny and can be challenged by Judicial Review.

The debate closed with the South African example about recent legislation which had produced detailed regulations; further consumer protection legislation was due to be introduced in 2008. This has had and will have further impact on firm's processes. The ombudsman has a key role in defining direction and policy - and can report industry members to the regulators for further action in the event of non-compliance.