



Financial Ombudsman Conference 2007

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Thank you for inviting me to talk to you this morning. I have been given a rather broad remit to talk to you about “dispute resolution, regulation and markets”. I would like to share some thoughts on how these three fit together and, I hope, provoke some discussion.

I ought to say at the outset that my perspective on these issues may be rather different from that of many of you. My particular interest, as a litigation partner in a large law firm, is in advising and protecting the interests of large financial institutions who are our clients – the regulated community. You may think that you should therefore treat what I say with a degree of scepticism. However, whilst it may be tempting to see the regulated community as on the opposite side of the fence from the protection of consumers – particularly, if your role is in resolving disputes between firms and consumers – consumers are ultimately the customers of those firms and essential to their businesses. So, the perspectives may be different but often the aims are similar.

I would like to start by talking a little about the consumer environment in the UK, before looking at the role of the ombudsman and some of the emerging issues.

The consumer environment

If we wind back 10 years, it’s fair to say that the landscape for consumer justice in the UK was completely different from that today. For those who had complaints against financial institutions, the civil justice system was remote from the man in the street. The Court system was seen as slow and costly and as inaccessible, other than for those with serious personal financial resources. There was a host of ombudsman or arbitration schemes, each covering different segments of the market, but with little consumer recognition or awareness. And even if consumers knew how to go about asserting their rights, there was little appetite for doing so. Perhaps, a British reticence to complain.

A number of things have happened since then that have changed the landscape beyond recognition.

First, there was the combining of regulators into the FSA and the FSA’s strong focus on consumer protection and on improving the retail markets, an agenda which it has championed relentlessly.

Second, there was the combining of ombudsmen into the Financial Ombudsman Service, which was designed to be a “one stop shop” for consumers. The impact of putting the ombudsmen and arbitration schemes together was to greatly increase consumer awareness that there was an independent body through which their complaints could be adjudicated informally, quickly and at no cost. And this has greatly increase the use of the ombudsman service.



Thirdly, in the 1990's, a series of reforms were put in place within the court system, to enable consumers to have "access to justice". Among a number of procedural improvements, the Court service set up something called "money claim online", which allows consumers to start Court proceedings through the internet from the safety of their own living rooms. Consumers have now started issuing proceedings in huge numbers. In the first half of this year, largely because of customers starting proceedings for the refund of bank charges, and paying the £50 fee for doing so, the Court service made an unexpected profit of several millions of pounds.

Finally, the internet has played an important role more generally. Websites have developed that are dedicated to championing consumer causes - particularly, in relation to claims about financial products. On these sites, consumers share their experiences in dealing with firms, seek information and help, and download forms for use in court or with the ombudsman, sample complaint letters and so on. The internet has also enabled an enormous growth in so called "claims farming companies", companies who will take forward consumers' claims on their behalf, in return for a share of the proceeds. Again, targeting particular types of financial products.

When it came to claims about endowment mortgages, 5 years ago or so, there was real concern that consumers were reticent about complaining or if they did complain and their complaint was rejected by the firm, that they would be unlikely to take their complaint forward to the ombudsman. Recent experience suggests that that reticence has largely been overcome. Consumers in this country are getting used to complaining. The internet enables them to mobilise effectively and quickly in large numbers. They know how to bring their claims to the ombudsman. And they are also using the Court system in large numbers. Putting it another way, consumers have the tools that they need to protect their rights, and they are learning how to use those tools.

In many ways this is a testament to the strength of the reforms that brought the FSA and the ombudsman into being. But it also poses some real challenges not only for financial institutions but also for regulators and ombudsmen. I will come on to explain in a moment what I think those challenges are.

The role of the Financial Ombudsman Service

The financial ombudsman service sits at the heart of much of what consumers are able to achieve. It does not fall to the ombudsman to decide every case – or even any significant proportion of cases – but (for want of a more appropriate expression) the ombudsman can end up being the tail that wags the dog.

Let me explain what I mean. The ombudsman considers those complaints that firms have rejected, so it is the second stage in a two-stage process. In considering complaints, firms are required to handle the complaints fairly. They also have wider duties to treat their customers fairly. This is an area that is carefully policed by the FSA – and rightly so.

In practice, this means that once the ombudsman has reached a view of a particular practice or product, and made that view clear – which it does through publications such as Ombudsman News - then firms will start to handle complaints in the same



way. They do this partly because they think that's the right thing to do. They do it partly out of pragmatism, because if they reject a complaint which the ombudsman will accept, they risk incurring the case fee and ending up in the same position.

And they do it partly because the FSA encourages firms to do so, so as to ensure firms act consistently with their obligations to handle complaints fairly and treat customers fairly. It is a moot point whether firms are under an obligation to handle complaints in the way that they know the ombudsman would decide them, but in any event in practice they do so in very great numbers. So, the ombudsman may for example handle a thousand complaints about a particular product but its handling of those complaints could affect the firm's handling of many times that number of similar complaints.

Challenges for handling large scale claims

So, what are the challenges for regulators and ombudsmen that I have alluded to? Speaking personally, I am concerned that the system is not robust enough to handle the mass claims. It was designed for individual complaints – one off problems affecting small numbers of customers – and yet it is being called upon to handle issues where the stakes are hundreds of millions of pounds and where the legal, factual and evidential issues for deciding the rights and wrongs are enormously complicated.

I would argue that – whether you look at it from the perspective of consumers or firms - it is wrong to place on the ombudsman the burden of determining complex legal issues which have financial consequences on this sort of scale. That, in a sense, is a relatively straightforward point and the ombudsman does recognise this and where appropriate stand aside to enable legal issues to be determined by the Courts.

Equally – but probably more controversially - I would say that it is extremely difficult for the ombudsman to investigate and decide the factual issues that determine, for example, mass mis-selling claims. It is not my aim today to champion industry selling practices, but consumer concern about past practices can often be provoked by the Press and other interests, often applying today's standards to the past, and often looking at matters with the benefit of hindsight. It is of course the ombudsman's job not to use hindsight. When the financial stakes are as high as they have been on some occasions in the past, the burden of proof and the matrix of fact within which mis-selling type questions need to be decided are absolutely critical. The nature and extent of the factual enquiry that is undertaken on these matters can make a great deal of difference to the outcome.

I would suggest that the appropriate mechanisms do not really exist for managing and deciding these complex and very high value problems, particularly in a consumer environment which evolves as quickly as it now can. At the moment, the onus for decision making falls on the ombudsman but I would argue that this places the ombudsman system under a great deal of pressure, it risks unforeseen consequences, and it risks undermining the very good work that the ombudsman does. Speaking as one who advises financial institutions, it creates legal uncertainties and it may also create prudential risks.



Ombudsmen and regulation

Ombudsman decisions do not affect only complaints handling. They can also directly affect the way that firms conduct their business. This is the area where the ombudsman can be drawn unwittingly into the realms of regulation.

As you will know, the UK regulatory environment is moving increasingly towards stripping away the detailed rules and placing greater emphasis upon the broad, high level principles which prescribe how firms ought to behave. This means that, increasingly, there is no particular rule that prescribes how a firm should behave. The regulatory focus is on outcomes – in other words, encouraging firms to make their own judgments on how to run their businesses, provided those are consistent with the high level standards.

In a number of respects, this put the ombudsman into uncharted territory. There is increasingly a gap beneath the high level principles which will not be filled by any specific regulations. Often there will be no clear answer as to how a firm ought to behave and the regulatory system places the onus on firms themselves to reach those judgements. The risk is that when the ombudsman decides in a case in one of those areas that the firm's actions were not "fair and reasonable", that in some sense sets a standard with which the firm should comply. Or, perhaps, should have complied. In other words, the effect of the ombudsman's view can be to determine whether past practice met the necessary standards and to set standards for the future.

I think that this is inevitable in the system that we currently have in the UK, but it places the ombudsman in a difficult position. If a firm has to handle its complaints in a way that is consistent with the ombudsman's view of the same practice, then the firm will also have to ask itself – and indeed is being encouraged to ask itself – whether it should change the business practices that the ombudsman finds to be unfair. So, the ombudsman's position becomes a driver for business practices. This puts the ombudsman into an uncomfortable position and places stress on the regulatory system.

Partly to deal with this, the ombudsman and the FSA have put in place something called the "wider implications process", which enables issues that have a broader implication than the particular case to be taken out of the normal process and among other things to be the subject of consultation with the FSA. In that way, the regulatory input should come from the correct source, namely the regulator. It will be interesting to see how this works in practice but personally I have some doubt that it can alleviate this issue to any great extent. The issues often arise not because there is a question about the application of the FSA's rules but more likely because of the precedent setting effect that the regulatory system gives to the ombudsman's decisions.

In addition, a side effect of the move to more principles based regulation may be that there will be less scope for FSA involvement, as the detailed rules become less important. One of the interesting features of more principles based regulation is that there will be an increasing number of market based solutions, with industry codes of practice filling some of the gaps beneath regulation. It will be interesting to see whether the FSA feels able to decide within the wider implications process what these



codes of practice mean and how they should be applied. And if the FSA does not take on that role, will the ombudsman have to police the codes of practice?

Conclusions

I should say that none of these comments are in any sense a criticism of the work done by the financial ombudsman service. My concern is more about the way in which that work fits into the regulatory system and the structures that we have in place. I would suggest that the ties that bind the ombudsman and the FSA are becoming too rigid; in other words, the regulatory system is building too much around the ombudsman's decisions and it is this that places the ombudsman into a difficult position. I would also suggest, as I have said, that the system needs to be adapted to deal with the environment of mass consumer complaints— where the sums of money at stake can be truly eye watering.

In the hope that I could avoid being too parochial, I carried out a straw poll of some of my partners in other continental European jurisdictions to see to what extent these issues are beginning to arise elsewhere. I had partly in mind the high level rules in MiFID that introduce similar concepts to the UK requirement to treat customers fairly and the encouragement that MiFID gives to ombudsman schemes.

My straw poll indicated that on the whole the same pressures have not, at least to date, arisen outside the UK. There seem to be a number of different reasons for this. One factor may be that we in the UK are relatively unused to notions of fairness –whether applied by regulators or by ombudsmen. This may be rather more familiar territory elsewhere, particularly in civil law jurisdictions, and so, perhaps, in some ways the environment may feel a little less alien.

I hope that I will have managed to provoke some points for discussion. Thank you for your patience.