Redressing the balance?

Nathan Willmott and Polly James explain how financial services firms might be affected by the Government’s proposals for improving consumer redress

In its recent White Paper, “Reforming Financial Markets” (July 2009), the Government said that not enough was being done to improve standards in firms’ complaints handling, and to ensure that consumers can obtain redress from firms that have failed them. The Government is therefore proposing wide-ranging reforms to the processes by which consumers can seek redress against firms. Its key proposals are:

- To extend the FSA’s existing powers to enable it to require firms to carry out past-business reviews and to make redress, either on an industry-wide or a firm-specific basis
- To introduce by statute a new form of collective action through which consumers can seek redress through the courts.

This article considers the strengths and weaknesses of the current regulatory regime for consumer redress, and the implications of the new proposals for firms and consumers.

The FOS
Under the current system, the vast majority of consumer complaints are dealt with on an individual basis. The customer must complain to the firm in the first instance; if the firm’s response is not satisfactory, the customer can then refer the complaint to the Financial Ombudsman Service (FOS), which may order compensation of up to £100,000 per complaint. Once the FOS has made its determination, the customer can either accept the decision – in which case it becomes binding on the firm – or reject the decision and pursue a legal claim through the Courts.

The FOS’s new practice of “naming and shaming” the firms which receive the greatest number of complaints, and have the greatest proportion of complaints upheld, is likely to address to some degree the Government’s desire to improve firms’ complaints handling standards. However, a perceived downside of the FOS regime is that each adjudicator is empowered to resolve complaints according to what is “in his opinion, fair and reasonable in all the circumstances of the case” (see DISP 3.6.1R). This is a very wide discretion, and one that many firms feel can give rise to inconsistencies in the way in which similar complaints by different consumers are dealt with.

Under the current system there is also a “wider implications” process, under which the FOS (among others) can refer to the FSA any issues on which a large number of complaints are being received, and which appear to have wider implications for consumers.

Past-business reviews
In addition, under s.404 of FSMA 2000, the Treasury has the power, at the FSA’s request, to order firms to carry out a full “past-business review”, with a view to requiring the firm to provide redress to consumers on a collective basis. To exercise this power, the Treasury must be satisfied that there has been widespread or regular failure and that private persons have suffered (or will suffer) loss. It has not been widely used to date (a key reason why the Government now proposes to give similar powers to the FSA).

FSA enforcement actions
The FSA also has the power to order firms that are found to have breached their regulatory duties to pay redress to whole classes of consumers, whether or not those consumers have actually complained. In practice, firms often fear the consequences of the FSA’s customer compensation programmes more than the financial penalties that it can impose. For example, in the FSA’s action against Lloyds TSB in respect of failures concerning the sale of Extra Income Growth Plans in September 2003, the fine of £1.9m was dwarfed by the cost of implementing the customer compensation plan, which was estimated at £98m (see paragraph 2.1.6(iii) of the Final Notice dated 24 September 2003).

However, FSA enforcement actions can often take several years to complete, and therefore cannot be relied upon as a means of securing prompt consumer redress. In just one case, the FSA has entered into a settlement with

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So what are the implications for firms and consumers if the Government’s proposals are implemented?

It is easy to see why consumer groups feel that the FSA’s powers to order collective customer redress should not be limited to (a) cases where the FSA has brought enforcement action against the firm concerned, and (b) cases where the Treasury has agreed to exercise its powers under s. 404.

However, under any new statutory procedure whereby the FSA could order financial services firms to pay collective redress to consumers, there would need to be significant procedural protections.
For firms’ compliance functions, moreover, such an extension of the FSA’s powers would be likely to result in a significant increase in regulatory risk, and the need to re-review the firm’s systems and controls accordingly.

A new form of collective consumer action
The Government’s proposals in relation to creating a new form of collective consumer action are not yet fully formulated. However, in “Reforming Financial Markets”, the Government expressed the view that the best solution would be to give the FSA a new power to “appoint a nominated, qualified representative body or person to pursue a representative action though the courts, where the FSA believes that there is evidence of a breach of its rules” and set out some key features of the proposed regime, as follows:

- It would only be available in exceptional circumstances, where the issue was so serious that existing safeguards (i.e. FSA enforcement action, FOS) were inadequate
- There would need to be a sufficient number of potential claimants (no minimum number has yet been decided)
- The claims would need to be sufficiently uniform (again, this remains vague)
- The court hearing the action would decide whether it should be brought on an “opt-in” or “opt-out” basis
- The representative body or person would not receive legal funding, and might be required to provide security for costs.

On one level, the introduction of a new form of consumer collective action may be viewed as a positive development, since there would be fewer individual customer complaints to handle. Dealing with multiple complaints collectively may also improve the consistency with which complaints on similar issues are dealt with, leading to welcome clarification of the standards actually required of firms.

However, the downsides are likely to be significant for firms’ risk management functions. The level of legal and regulatory risk posed by consumer collective actions is likely to be both significant and entirely unquantifiable, at least until there is a body of precedent available that will assist firms in assessing the likelihood of the action succeeding, and the financial consequences if so. Furthermore, the suggestion that a collective action could take an “opt-out” rather than “opt-in” form could have huge ramifications, particularly for those firms with the largest numbers of customers.

The Government has invited responses to its proposals by 30 September 2009. Its intended timeframe beyond 30 September 2009 is not yet clear, although, since primary legislation will be required in any event, any changes will not be imminent. In the meantime, compliance officers and risk managers are sure to watch developments with great interest.

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1 The FOS recently published, for the first time, consolidated complaints data in respect of individual firms. This covered the number of new complaints received by each firm in each of five categories (banking and home credit, mortgages and home finance, general insurance, investments, and life & pensions), and also the percentage of resolved complaints against each firm in each category that were upheld by the FOS, compared with the industry average.
2 The consultation questions relevant to the issues discussed in this article can be found at page 148 of “Reforming Financial Markets”. 