

**The Association of Mortgage Intermediaries
Response to Discussion paper 06/2
Financial Ombudsman Service compulsory jurisdiction: funding review**

Executive summary

This response is from the Association of Mortgage Intermediaries (AMI). AMI represents over 70% of all mortgage intermediaries and this response has been developed following close discussion with both directly authorised and network member firms.

We set out our answers to the specific questions raised in the Discussion Paper below. However, there are some additional points we wish to make to provide a more helpful response.

Move to the new model

We support the move away from the current method of funding FOS. The Discussion Paper provides, by-and-large, a comprehensive view of the options available to fund FOS and we firmly support the need to move to the new funding models set out in the later group of options. Key decisions around the number of “free cases” are discussed further but the overall direction of travel is one AMI is in agreement with.

Given this is a Discussion Paper; we have also considered other funding options which we would like to register with FOS. In particular, we believe some serious thought should be given to a complainant fee and to a pre-funding approach that would see firms pay when a complaint was received with FOS rather than at the end of the process.

A complainant fee (which could either be a deposit returned if the case was won, or a small non-refundable sum), would help to deter the “have a go” culture which has developed in financial services complaints, in our view. The free complaint process operated by FOS has both lead to and encouraged the growth in complaint management firms and seen a significant cost being placed on independent financial advisers (IFAs) in particular. We believe that the consumer right to complain is inviolate but so is a firm’s right to expect a level-playing field between complainant and defendant.

At present mortgage intermediaries receive a relatively low level of complaints but recent research conducted by AMI amongst our membership revealed significant worries that their clients would be next to be targeted by complaint management companies. Nearly three-quarters (73%) thought complaint management companies would try to target mortgage clients in the future, while 78% thought the number of complaints made against mortgage intermediaries would continue to rise in the future.

Pre-funding could offer FOS a huge liquidity boost which would have a significant impact on its financial position. The extra “working capital” this system would provide should be costed out to examine the impact on lowering case fees.

These points are discussed further below.

FOS “Small Firms Division”

FOS have recognised the urgent need to review their funding basis and we welcome this decision. In our view, the current model penalises smaller firms who receive few complaints whilst being too supportive of larger, more frequent users. Smaller firms are unused to dealing with FOS and this is evidenced both in how cases are prepared for FOS’ examination and in the desire these firms have to wish to enter into a longer dialogue with FOS staff members. It must be remembered that for smaller firms, it is the individual mortgage intermediary who will pay both the case fee and any redress due. This fact means that the intermediary concerned will want to see not only “justice being done but also being seen to be done.” Hence, the anxiety caused when case decisions are not explained fully.

AMI recommends that FOS consider establishing a “Small Firms Division” in the way FSA has. This team would be expected to deal with cases from smaller firms and would be allowed the flexibility to recognise the particular needs of smaller firms. For instance, these firms have little experience in dealing with FOS process and may need more assistance in piloting a complaint through the system. The team could look at the special communication needs of firms – provide more training and practical assistance. Indeed, they may go further and, ideally, allow more oral hearings – and a specific process be established by which this could occur. We particularly recommend that FOS re-consider its view on oral hearings and their role in “justice being seen to be done”.

The proposals may have a cost implication but we recommend that work is undertaken to estimate this, given the current discussion around funding. We firmly believe that the creation of a specialist team would not be seen as “anti-consumer” or be interpreted as a desire to stifle complaints. Indeed, consumers may welcome an oral hearing.

FOS and business costs

During FSA’s recent study on the “costs of regulation”, a key cost-driver was the production of suitability letters. Many IFA firms stated they would continue to produce these even if the requirement for them was lifted. Apart from the good business-sense of ensuring clients have a documented recommendation,

describing the particular “route through the forest”, firms stated that it was “fear of FOS” that would ensure their continued use.

We are sure that FOS do not wish to be seen as a key cost-driver for firms, nor as a source of business anxiety. Thus, the creation of a “Small Firms Division” could look at FOS’ role here. This work will be necessary given the Markets in Financial Instruments Directive’s (MiFID’s) different suitability definition and requirements, so the work may provide an opportunity for FOS to take the lead and demonstrate it is both focused on handling consumers’ complaints and sensitive to the ever increasing costs of UK regulation.

We recommend FOS undertake such a review, whatever the outcome of this Discussion Paper, given that suitability letters are not part of the MCOB or ICOB requirements and, it could be argued, that an uneven playing field exists.

Timing

We note that the Discussion Paper also refers to the current discussions around the future funding of the Financial Services Compensation Scheme. There is a comment about introducing the two initiatives jointly. Whilst we see that this approach makes financial sense for firms and support the concern, we would not wish to see FOS review held back in case the FSCS timetable slips.

We recommend that FOS press ahead with its review at the fastest possible pace.

Specific questions

Q1: We suggest that the funding arrangements should seek to strike a reasonable balance amongst the following factors:

- fair shares amongst firms of different sizes, types and behaviours;*
- sustainable over time through variations in case numbers;*
- no undue incentive for firms to reject justified complaints, nor accept unjustified complaints;*
- practicable for the FSA and the ombudsman service to assess and collect;*
- easy for firms to understand; and*
- no transitional difficulties if the system is changed.*

Are there any different or additional factors you consider relevant?

The only factor that we believe should also be considered is the potential exposure of firms to ‘blackmail’ should case fees be set at too high a level. Any new model must seek to avoid this.

Q2: Do you think the balance between annual fees and case fees is an issue of principle? Or do you consider it an issue to be resolved pragmatically and, if so, on what basis? Where would you strike the balance and why? Would you strike the balance in the same way for all firms or differently for smaller-user and larger-user firms?

No, we do not consider it to be a matter of principle. The split between annual and case fees should, ideally, reflect management expenses and the actual cost of dealing with cases. The annual fee should be applied to firms, not permissions. We support a flat rate fee per firm to reflect that all firms benefit from the existence of an Ombudsman service and are potential users of FOS. As such they should take an equal share of the management costs.

The amount paid in case fees should reflect the amount of use by a firm. However, there should be due recognition of the impact that even a low number of case fees has on small firms. In the IFA sector we are witnessing increasingly aggressive activity by claims management companies that is putting severe financial strain on many small firms, most of whom are having to pay case fees even though none of the complaints against them are upheld. There is something fundamentally wrong with any system that has the ability to put a firm out of business through 'proving its innocence'. We therefore consider it essential to extend the number of free cases to a level that will remove the burden of case fees from firms that receive a low volume of complaints but sufficient to cause financial hardship.

Q3: Do you agree that the special case fee (applicable in only 2% of cases) should be abolished, so the standard case fee applies to all cases where a case fee is payable?

Yes. The difference in cost is fairly small and we see no reason to retain dual pricing which adds to administration costs.

Q4: Do you consider that, even if the standard case fee is altered, it should be invoiced and collected when the case is closed rather than when the case is received by the ombudsman service?

The move from paying case fees on closure, rather than up front (as under the previous Mortgage Code Arbitration Scheme) was supported by the industry at large. Firms generally resent paying in advance of any work being undertaken, particularly where jurisdiction could be an issue.

However, in light of the increased volume and the time taken to complete cases, compared with in the past, there may be a case for pre-payment of case fees

being revisited. FOS would need to undertake a financial assessment and if pre-payment results in a substantial reduction in the case fee, it may be worth pursuing. But we would need to be convinced that any savings on case fees would be sufficient to outweigh the adverse effect on larger firms financial budgeting. A further, though less relevant aspect of pre-payment is that it does split the total cost of dealing with a complaint where redress is also payable.

Q5: Do you have any further comments on the issues raised in Chapter 4, or any additional issues that you consider should be taken into account?

No.

Q6: Which of the options (A to K) listed in Chapter 5 do you favour? Why do you favour that particular option?

AMI fully supports a move to a model that charges a flat rate fee per firm. Retaining permission-related levies, based on different tariffs, creates an element of double counting for virtually all AMI members. Treating all regulated firms with access to the service equally reduces complexity and administration costs. The total cost borne by firms should fall to those that use the service most. In our response to Q2 we have stated that an increase in the number of free cases is necessary to remove the financial strain of case fees on small firms, most of which relate to complaints that are not upheld.

Option F is therefore our preferred choice as it delivers the flat rate and extends the number of free cases from two to five. This will ensure that the vast majority of mortgage intermediary firms are unlikely to incur case fees. Having stated our preference we accept that there is a valid argument that option H, a flat rate and ten free cases, may be more appropriate for other sectors, where complaint levels are slightly higher.

Q7: Do you have any other options to propose, in the light of the information provided by this paper and the issues raised?

We fully support the right for consumers to complain and would not wish to put up barriers that might deter genuine complaints. But there is evidence of a growing culture of unsubstantiated complaints being made as complainants have nothing to lose. Many of these complaints are promulgated by complaint management companies, or the false perception that there is some central fund that pays redress by return. This type of complaint devalues the Ombudsman service and means firms incur the expense of not just a possible case fee, but the time spent dealing with the complaint. We hope that the regulation of CMCs will alleviate some of the problem.

Despite this, we would prefer to see in any future model, a requirement for complainants to pay a modest fee when lodging a complaint which would be

refundable if the complaint was upheld. We believe this will help flush out those with no real grievance and free up the resources of FOS to deal with genuine cases. We accept that this would require a change to primary legislation but this is not a sufficient reason for the option to be dismissed without due consideration.

Q8: If you represent a larger –user firm, would your firm be interested in the possibility of buying pre-paid blocks of case fees at a discount, but on the basis that unused pre-paid case fees would not be carried forward to the next year?

Some of our larger members have expressed an interest in pre-paid blocks and we believe this option should be given further consideration

Q9: Do you think we should cap the annual fees for credit unions, cash plan health providers and friendly societies whose tax-exempt business represents 95% or more of their relevant business (FOS fee blocks 13 to 15)?

No. As stated previously, we consider that all regulated firms with access to the service should pay a flat fee irrespective of size or business volume. What justifies a cap on fees, for example, of a friendly society whose relevant business volume exceeds that of a sole trader mortgage intermediary?

Q10: Do you think regulated network firms should continue to be treated the same as other regulated firms? Or do you consider that the appointed-representative members of the network should be treated (for annual fees and case fees) as if they were each regulated firms?

We have encouraged all of our network members to respond to questions 10 and 11 direct so that they may offer a view based on their own commercial experience. We do not have access to sufficient data (with members' permission to share the information) to respond in-detail to these questions.

Given the different experiences of the newer networks and those with longstanding businesses, FOS cannot expect the market to reach a single view behind which all can unite.

Our settled view is therefore, that network should be allowed to select the option that works best for them. This will be a “one-time” opportunity to determine which of the two approaches they believe is fairest. We understand that the networks have committed to providing the necessary management information to make this system work. Whilst it does not present the simplicity of a single solution, it does allow for the competitive evolution of the market and so, we believe, is the fairest outcome.

Q11: *If you represent a network, it would be helpful if your supplied the following information for your network in relation to the calendar year 2005. In this context: 'cases' means cases closed by the ombudsman service during 2005; 'current members' means those who were members when the case was closed; and 'former members' means those who had ceased to be members when the case was closed:*

- *the name of the network;*
- *the total number of appointed-representative members;*
- *how many deal with investment only;*
- *how many dealt with insurance only;*
- *how many dealt with mortgages only;*
- *how many dealt with two of these;*
- *how many dealt with all three;*
- *the total number of cases closed by the ombudsman service;*
- *how many were against current members;*
- *how many were against former members;*
- *how many current members had no cases closed by the ombudsman service;*
- *how many current members had 1 or 2 cases closed by the ombudsman service*
- *the total number of those cases;*
- *how many current members had 3 to 5 cases closed by the ombudsman service*
- *the total number of those cases;*
- *how many current members had 6 to 10 cases closed by the ombudsman service*
- *The total number of those cases;*
- *How many current members had 11 to 24 cases closed by the ombudsman service*
- *The total number of those cases; and*
- *How many current members had more than 24 cases closed by the ombudsman service*
- *The total number of those cases.*

We have asked all of our network members to provide this information direct.