Modernising the Redress System

Bryan Cave Leighton Paisner LLP's response to the call for input

1. Introduction

1.1 Bryan Cave Leighton Paisner LLP ("**BCLP**") submits this paper in response to the Call for Input ("**CFI**"), jointly issued by the Financial Conduct Authority ("**FCA**") and Financial Ombudsman Service ("**FOS**"), entitled "Modernising the Redress System".

1.2 BCLP is a fully integrated global law firm. Our London office provides full-service legal advice in the City, throughout the UK and worldwide. Amongst our clients are a large number of FCA regulated firms. Our specialist Financial Services Disputes Team has significant experience of advising clients in respect of many of the major mass redress events that have occurred over the last two decades (including payment protection insurance, interest rate hedging product mis-selling and, most recently, issues with motor finance commission). As such, we felt a duty to our clients and the financial services industry generally to respond to the CFI, setting out our views on the key issues with the current redress system and how we consider these should be addressed both in the shorter and longer term.

2. The Key Problems

2.1 The current regulatory redress system was established more than 20 years ago. There have been several mass redress events during this period but, in our view, the way these have been dealt with suggest that the redress system is in need of urgent reform. The outcomes reached have been unsatisfactory for both firms and impacted consumers.

2.2 From the perspective of firms, the redress bills have been enormous - for the top 10 financial scandals in UK retail banking, the redress bill has been in excess of £72 billion.[1] There has also often been a perception by firms that standards have been imposed on them retrospectively and without consultation and, in many cases, in respect of conduct that has dated back a significant number of years. From the perspective of consumers, the criticism has often been that any redress paid is slow to arrive and inadequate and/or inconsistently applied when it does. As a result, impacted consumers have often turned to claims management companies and litigation funders for assistance and, consequently, have given up large proportions of the redress they are entitled to.

2.3 In light of the above, in response to question 5 of the CFI, we very much believe that the current redress system is hindering the UK financial markets' international competitiveness and growth and will continue to do so unless reforms are brought about.

2.4 Whilst it is possible to identify numerous issues with the way that mass redress events are dealt with, we believe that there are two inter-linked factors that sit at the core of the problems in this area:

(a) a failure by the FCA to appropriately exercise the powers it has been granted in relation to mass redress events where necessary; and

(b) as a consequence of the above, the resultant void being filled by the FOS regime, which was never intended to be a mechanism for dealing with mass redress events.

2.5 We elaborate briefly on each of these problems below.

---

[1] See: https://newcityagenda.co.uk/the-top-10-retail-banking-scandals-50-billion-reasons-why-shareholders-must-play-a-greater-role-in-changing-bank-culture/

a) The FCA's failure to exercise its powers in relation to mass redress events

2.6 The FCA's most powerful tool when it comes to distributing mass redress to consumers is section 404 of the Financial Services and Markets Act 2000 ("**FSMA**"), which enables it to impose *industry-wide* consumer redress schemes on multiple firms that have failed to comply with FCA requirements and caused loss or damage to customers.

2.7 However, despite the fact that the FCA has had its section 404 FSMA power for 24 years, it has only exercised it on two occasions – once in respect of investors who were given unsuitable advice to invest in Arch Cru funds and, more recently, to provide compensation for those given unsuitable advice to transfer out of the British Steel Pension Scheme. We acknowledge that there are limitations on the FCA's section 404 FSMA powers – most notably it can only be used in the context of a breach of the FCA's rules, and not its principles. Nonetheless, we do consider it surprising that, despite there having been several retail mis-selling issues over the last two decades, the section 404 FSMA power has only been used in respect of two, relatively small-scale, issues.

2.8 We infer that there has, therefore, been a reluctance on the part of the FCA to exercise what is probably the key power that currently exists under the redress system to deal with a mass redress event. The reasons for that reluctance are unclear. Moreover, the FCA has even appeared reluctant to exercise its less potent redress scheme powers under FSMA. For example, we believe it has exercised its power, under section 384 FSMA, to require single firms/individuals to pay restitution to customers on only four occasions.

2.9 The most common method used by the FCA to secure redress for customers has involved a less direct and more piecemeal approach. This generally involves starting (or threatening to start) an enforcement investigation against a firm and then concluding the matter by reaching a settlement that involves the relevant firm agreeing to conduct a redress exercise, usually by means of a past business review, in full or partial mitigation of any fine. The outcome is published and the FCA encourages other firms in the sector that have similar issues to take heed and to proactively offer redress where necessary. Often this comes with some supervisory oversight, especially if the firms have a dedicated supervisor/supervision team.

2.10 The challenge here, however, is that, whilst we appreciate that the FCA is now focussed on speeding up its enforcement process, that process has historically been slow.[2] The other disadvantage of the enforcement approach is that it can only be applied on a firm by firm basis and any public Final Notice will typically only comment on the subject firm's failings. Whilst pressure can be applied to other firms, the circumstances of each firm's conduct might be different and the outcome achieved for affected customers is not always uniform.

2.11 Overall, therefore, our view is that the FCA has not, to date, made good use of the formal redress scheme powers it has been granted under FSMA and, where it has used its enforcement stick to seek to obtain firms' agreement to provide redress to customers, the results have often been slow and inconsistent.

b) The encroachment of the FOS into the sphere of mass redress

2.12 When the FOS was established in 2001, it was never intended to be a mechanism to deal with mass redress events. However, as a consequence of the FCA's inadequate exercise of its redress scheme powers (as described above), this is a role that the FOS has *de facto* largely taken on. As is acknowledged in the CFI, the FOS, at its inception, was expected to handle 30,000 complaints a year. It is now assessing over 200,000 complaints a year and a "key driver" of this has been mass redress events.

---

[2] Over the last decade the average length of an FCA enforcement case referred to the RDC has generally been in excess of three years in the annual enforcement statistics published by the FCA.

2.13 In our view, aside from the logistical caseload issues caused to the FOS (which are well documented in the CFI), there are three key issues that, when taken together, make the FOS an inappropriate forum through which mass redress events are handled:

(a) **FOS decisions are typically made without significant scrutiny of the facts and law**: The fundamental purpose of the FOS is to be a simple and quick forum to resolve cases, and so decisions are necessarily made without the rigour of a judicial or regulatory body.

(b) **FOS decisions are very difficult to challenge:** The FOS has a very broad jurisdiction to make decisions based on what it thinks is fair and reasonable in all the circumstances of the case. The only way of then challenging those decisions is through judicial review, where it must, in effect, be established that the FOS has acted irrationally. The combination of these two factors makes challenging a FOS decision extremely difficult. The prospects of doing so will decrease yet further by the additional combination of the FOS applying its fair and reasonable jurisdiction to the somewhat nebulous outcomes-based rules in the FCA's new Consumer Duty.

(c) **FOS decisions on individual complaints have broader implications for firms:** The FCA's rules require firms to:

(i) Take into account patterns of FOS decisions and guidance from the FOS in respect of future complaints that are received;[3]

(ii) Identify and remedy any recurring or systemic issues when handling complaints;[4]

(iii) Proactively offer redress to retail customers, if appropriate, where firms have identified through complaints handling that such customers have suffered foreseeable harm.[5] This requirement has been recently introduced by the Consumer Duty and appears to place obligations on firms to proactively offer redress whether or not customers have actively complained.

2.14 The combination of the three points above means that the FOS is an entirely unsuitable forum for resolving mass redress events. Their effect is that the FOS is afforded a broad discretion to set the standards pursuant to which a mass redress event will be remediated and then, through a single decision made in a short timescale (or set of decisions following a template approach which it bulk issues to multiple firms), is able to bind firms to those standards.

2.15 This clearly cannot be a satisfactory outcome for the FCA, which is allowing the FOS to determine how its rules should be interpreted on an industry-wide basis. It is also an equally unsatisfactory outcome for firms. This dynamic, has on a number of occasions, led to a scenario where the FOS has imposed standards on firms which are regarded as retrospective. It also, importantly, means that firms are deterred from setting up their own proactive redress exercises where they identify harm to consumers, for fear that any exercise undertaken will later be undermined by the FOS applying a different set of standards for remediation.

2.16 The problems identified above have persisted for many years. However, in our view, the situation has now come to a head such that the current *status quo* is untenable and is actively damaging the international competitiveness of the UK financial markets. A number of factors appear to have driven this, including:

---

[3] DISP1.3.2G

[4] DISP1.3.3R

[5] PRIN2A2.5R

(a) an increasing frustration amongst our clients in the financial services industry at facing enormous redress bills (which are existential for some firms) that arise from the application of what often appear to be retrospective standards to historic issues;

(b) the proliferation of claims management companies and their increasing effectiveness at flooding the FOS and the courts with large numbers of complaints that are often unmeritorious;

(c) the proliferation of claimant law firms and litigation funders which mean that mass redress events in the regulatory sphere can now, more than ever, lead to very significant levels of parallel litigation;

(d) the FCA's focus on consumer protection and, in particular, its introduction of the outcomes based Consumer Duty which, as stated above, will give the FOS an even broader discretion to determine how mass redress events are dealt with – as one of our clients has put it to us "*the Consumer Duty means what the FOS says it means in 5 years time…"* There is a legitimate fear that the FOS will interpret the Consumer Duty in a hindsight-driven manner, expecting firms to achieve ideal outcomes for customers.

3. The Solutions

3.1 Having set out what we believe to be the crux of the problems relating to the redress system, we now set out below in this response our views on the possible solutions. Recognising that there is an urgent need for reform in this area, we have focussed on setting out a solution that would not require legislation and could, therefore be implemented in shorter term. We then proceed to consider some potential longer term solutions.

a) The shorter term solution – the Wider Implications Framework

3.2 The starting point here is that we agree with the assertion made in the CFI that "*the most effective way to mitigate the risk of a mass redress event is for firms to take prompt, proportionate and proactive action to identify and resolve harm*"[6] – this is the quickest and most efficient way to get redress to consumers. As the CFI also points out, this accords with firms' obligations to do so under DISP and the Consumer Duty (as described at paragraph 2.13(c) above). In response to question 6 of the CFI, we do not consider that anything further is required in DISP to assist firms in identifying and resolving mass consumer harm. The obligations imposed on them to do so in the FCA Handbook are already well-known and extensive.

3.3 In our experience, however, one of the primary barriers to firms being able to take prompt and proactive action to remedy mass consumer harm once it is identified is, as described above, a concern that any remediation exercise will later be undermined by the FOS. In other words, it is in firms best interests to establish their exposure and remediate as soon as possible, but there can be an understandable reluctance to do so if the FOS's position on the relevant standards for remediation has not yet become clear.

3.4 We believe that this problem can be solved through more effective use of the existing Wider Implications Framework ("**WIF**"), established between the FCA, FOS, FSCS, Pensions Regulator and Money and Pensions Service (the former three being the "core members" and the latter two being the "other members"). The utility of the WIF in dealing with mass redress events is also recognised by the CFI (paras 4.8 to 4.24) and, in that regard, we also set out our views on questions 22 to 27 of the CFI in this section of our response.

Our proposed further changes to the WIF

---

[6] CFI, page 16.

3.5 We welcome the recent changes to the WIF Terms of Reference that were made on the date that the CFI was issued. The most pertinent of these changes appear to have been aimed at improving engagement with other external stakeholders through:

(a) At paragraph 21, providing for a mechanism by which WIF members *may* (but are not obliged to) respond to representations made by stakeholders to the WIF's dedicated email address. For example, WIF members may invite stakeholders to make further written or oral representations, or inform stakeholders that no action will be taken and the reasons why.

(b) At paragraphs 25 and 26, providing for WIF members to attend independent statutory industry and consumer panels at least twice a year, so that members of those panels can, for example, highlight potential new issues that might have significant implications and make representations in respect of any issues already being managed under the WIF.

3.6 Whilst we support the above changes, we also consider that further changes should be made to the WIF Terms of Reference, to ensure that potential mass redress events are brought to the attention of WIF members promptly and that the WIF is then deployed expeditiously to enable firms to deal with those events proactively in the manner envisaged in the CFI and under DISP.

3.7 More specifically, we propose that two further key changes are made to the WIF Terms of Reference that would be significantly more effective than those summarised in paragraph 3.5 above:

(a) **Ability for external stakeholders to trigger the WIF**: At present, only one or more of the WIF members are able to trigger an issue being considered under the WIF. In our view, this should be broadened to enable external stakeholders to trigger the WIF in respect of a potential mass redress event. Those external stakeholders should, we suggest, include industry bodies, individual firms and consumer groups.

In terms of the process, we propose that:

(i) There should be express provision in paragraph 11 of the Terms of Reference to enable external stakeholders to trigger the WIF in respect of a potential mass redress event;

(ii) The WIF members would then meet with relevant external stakeholders to consider whether the potential mass redress event should be considered under the WIF;

(iii) If, following the above steps, the WIF members are of the view that a potential mass redress event should *not* be considered under the WIF, they should be *obliged* to provide the firm or body seeking to trigger the WIF with written reasons for their refusal to do so within a prescribed period.

(b) **Published standards/guidance:** The outcomes set out at paragraph 13 of the WIF Terms of Reference are too vague. In our view, paragraph 13 should be amended (or an obligation inserted into the Terms of Reference elsewhere) to require the WIF members to seek to agree, where appropriate, standards or guidance against which firms should handle complaints relating to a potential mass redress event (whether in business as usual complaints handling, a past business review, or otherwise).

It is acknowledged in the CFI that, whilst the FCA cannot direct the FOS, "*when cases have wider implications, it is appropriate for the FCA to assist the Financial Ombudsman by giving a view on its interpretation of FCA rules and guidance before the Financial Ombudsman resolves the dispute relating to those rules.*" Equally it is asserted in the CFI that "*the Financial Ombudsman makes sure that, where it sees evidence of widespread harm and mass claims arising, it raises these cases with the FCA.*" To date, there has been little public evidence of this exchange

of information happening either way and, to the extent that it has occurred, we infer that it has taken place in private. However, the time has now come to take this a step further, through a more formalised, transparent, and robust process under the WIF.

The key elements of our proposed changes here would be as follows:

(i) The requirement to seek to agree, where appropriate, standards/guidance for complaints handling in respect of a potential mass redress event would commence upon the WIF members determining that a potential mass redress event should be considered under the WIF (either of their own accord or following the triggering of the WIF by an external stakeholder as described at paragraph 3.7(a) above);

(ii) The consideration of the matter would need to take place promptly (although there should still be time taken for proper scrutiny given the wider ramifications);

(iii) There would need to be express provision for external stakeholders (including those suggested at paragraph 3.7(a) above) to make written and/or oral representations in relation to any proposed standards/guidance, together with a corresponding obligation on the relevant WIF members to take those representations into account and to provide written reasons in the event that they disagree with points made in those representations;

(iv) Any finalised standards/guidance should be transparent and must be published. Those standards/guidance should, of course, be sufficiently detailed to give firms sufficient insight into how they should be applied across the applicable range of cases;

(v) The effect of the standards/guidance would be that the FOS would uphold the complaints handling decisions of firms that properly apply them;

(vi) Finally, if the FCA and FOS do not consider it would be appropriate to seek to agree uniform standards/guidance, they would be obliged to provide written reasons for not taking this course of action (for example, one reason for not taking this course of action might be that the FCA considers it to be more appropriate to exercise its statutory redress scheme powers under section 404 FSMA).

3.8 These suggested amendments to the WIF are not radical. Instead, they merely tighten up and incrementally build on what is already in place to ensure that the WIF is used more effectively going forward. Our expectation is that they would benefit all stakeholders involved in the redress system:

(a) For ***consumers***, the proposals would significantly improve the prospects of obtaining fair and reasonable redress as soon as possible and on a consistent basis. If confidence can be restored in the redress system in this way, then ultimately the need will be reduced for consumers to use CMCs and to pursue claims in the courts with the backing of litigation funders.

(b) For ***firms***, one of the key benefits will be that any mass redress events should be identified and addressed at a much earlier stage and before they have had the opportunity to balloon into issues that can become existential – that is the advantage of having a wide array of stakeholders scanning the horizon for such issues and then having the ability to trigger the WIF. This, of course, should equally be a benefit to the ***FSCS***. As above, it will also alleviate the risk for firms that they decide and apply principles for redress to multiple customers, only for the FOS to subsequently take a different approach.

(c) For the ***FCA***, the proposals provide it with the opportunity to secure fair and reasonable redress for consumers on a consistent basis without having to use its

s.404 FSMA powers, which, for whatever reason, it has historically been very reluctant to use.

(d) For the ***FOS***, the proposals circumvent the risk of having to deal with the significant volumes of FOS complaints currently associated with mass redress events, which impair its efficient and effective operation and its ability to handle business as usual complaints timeously.

(e) For the ***HMT***, the proposals have the advantage that they do not require the use of parliamentary time to achieve any changes to primary or secondary legislation. The effect of the proposals should also be to enhance the competitiveness of UK financial markets.

Longer term solutions

3.9 For the reasons set out above, we believe that our proposed amendments to the WIF could be sufficient to alleviate many of the issues with the redress system's effectiveness in dealing with mass redress events.

3.10 As such, whilst we set out our views on some potential longer term solutions below, we believe that these solutions are of secondary priority to our proposed amendments to the WIF:

(a) **A more formalised approach to FOS standard setting in respect of mass redress events**: As described above, we believe that the WIF can be adapted to ensure that mass redress events are dealt with promptly and that WIF members work together to set standards for complaints handling in a manner that is transparent and takes into account the views of the various external stakeholders. In the longer term, this could be put on a more formal footing under FSMA or the DISP rules, enabling the FOS, the FCA or external stakeholders to trigger a process through which complaints handling standards are developed in respect of mass redress events transparently and in consultation with the relevant parties.

(b) **FCA/FOS powers to 'pause' complaints handling under DISP:** In response to questions 17 and 18 of the CFI, we are broadly supportive of the FCA and/or the FOS being granted powers to pause complaints handling under DISP whilst the FCA considers its next steps in relation to a potential mass redress event. Indeed, we recognise that, if our proposed changes to the WIF were implemented, it could be useful for a complaints handling pause to be put in place whilst the WIF members are working on developing complaints handling standards. We do, however, consider that, if implemented, this power should be constrained so as only to permit the imposition of a pause without consultation for a relatively short period of time (for example, no longer than six months). This will encourage the FCA to act promptly. It will also help to mitigate against the risk that longer complaints handling pauses might prove to be counterproductive, in the sense that they may drive frustrated customers looking for redress towards the courts and into the hands of claimant law firms and litigation funders.

(c) **Amendments to section 404 FSMA:** As described above, there has been a clear reluctance by the FCA to utilise the primary power it has been granted under FSMA to deal with mass redress events. It would be helpful to understand from the FCA if there are any underlying reasons for such reluctance. If so, it might be appropriate to consider if these can be addressed by making amendments to section 404 FSMA so that it can be used more effectively by the FCA in future.

(d) **Claims management companies:** We very much agree with the concerns expressed in the CFI about the numbers of unmeritorious and/or poorly evidenced complaints being submitted by claims management companies to firms and the FOS. In this regard:

(i) We are supportive of the idea that there should be different routes to redress under DISP for represented and non-represented complainants. In

particular, the evidential standards for represented complainants should be set higher and firms and the FOS should be permitted to reject complaints submitted by claims management companies that are poorly evidenced.

(ii) We welcome the FOS's confirmation that it will seek to implement its proposal to charge claims management companies up to £250 to make a complaint. To build on this proposal further we also suggest that the FOS considers a ratcheted system whereby claims management companies that have high volumes of rejected FOS complaints have to pay increasingly higher fees.

(e) **Longstop date under DISP:** In response to question 14 of the CFI, we consider that a longstop date should be inserted into the time-barring rules in DISP in order to provide firms with greater certainty. At the very least, we consider that this longstop date should be set at 15 years after the date of the event complained of, in order to mirror the position in section 14B of the Limitation Act 1980. However, we consider that a shorter longstop date can be justified here (for example, 10 years) given the additional logistical complexities involved in considering historic matters and that the FOS is intended to be a quick and informal forum in which disputes can be resolved.

Next steps

We are grateful for the opportunity afforded to us by the CFI to express our views on these very important issues. We would be happy to discuss with the FCA and the FOS any of the suggestions put forward in this response, and particularly our views on how the WIF Terms of Reference can be adapted to make the WIF more effective at promptly dealing with potential mass redress events. If such a discussion would be of assistance, please contact David Scott (david.scott@bclplaw.com) and Rhys Corbett (rhys.corbett@bclplaw.com).