MORTGAGES AND GENERAL INSURANCE REGULATION: TRANSITIONING COMPLAINTS

Summary of respondents' views

Financial Services Authority (FSA) regulation of mortgage business will be implemented with effect from 31 October 2004 for mortgages and from 14 January 2005 for general insurance.

At present complaints about such products bought from firms who have signed up to the Mortgage Code Compliance Board (MCCB) and the General Insurance Standards Council (GISC) are dealt with by arrangements set up by those bodies.

After FSA regulation commences, complaints about products bought in the regulated market will be dealt with by the Financial Ombudsman Service (FOS).

On 22 September 2003 the Treasury published a consultation document seeking views on whether the FOS should be given powers to deal with complaints about products bought from MCCB or GISC members before FSA regulation commences but which arise after it comes into force ("transitional complaints").

This document summarises the outcome of that consultation.

Question 1 - Could the industry put in place practicable arrangements for dealing with transitional complaints? Would an industry led solution be preferable?

The majority of respondents considered that the industry would be unable to put in place practicable arrangements for dealing with transitional complaints.

These respondents noted **enforcement** would be difficult because the ultimate sanction of ejection from the industry body would have little effect. **Funding** would be hard to raise when the industry would also be paying FOS for their post-FSA regulation complaints. And maintaining an organisation to deal with a small and reducing number of complaints would be **inefficient**, with the cost of administration being disproportionately high to the number of cases. The industry led solution would be **confusing to consumers**. One respondent gave the example of a consumer contacting the FOS with a mortgage complaint; FOS would have to ask when the mortgage was bought, whether the intermediary was an MCCB member at the time, and whether that intermediary belongs to the transitional industry led process

On the other hand, there were respondents who believed that the industry could put in place practicable arrangements; one questioned the possibility of an FSA grant for a complaints 'run off' department. Another respondent expressed interest in an industry led solution dependent however on the level of funding required.

HMT Treasury comment: the responses overall strongly suggested the industry would be unlikely to put in place practicable arrangements for dealing with transitional complaints.

Question 2 - Do you consider that complaints relating to the business of MCCB firms before 31 October 2004 which are made after 31 October 2004 should be transitioned to the FOS?

Most respondents, including the main industry bodies[1] supported the transitioning of complaints against MCCB firms. They supported the arguments in favour of transitioning noted in the consultation document.

- Benefits to consumers: mortgages tend to be large, long-term financial transactions. Therefore consumer detriment can be considerable, and may only be apparent years after the sale.

- Level playing field: FOS already has jurisdiction for mortgage complaints against banks, building societies and insurers. It would save confusion to avoid a situation where the broker is not covered even though the product provider may be.

- Seamless transition: there would be no gap in the availability of independent and robust complaints handling procedures.

- Continuity with "N2"[2]: transitioning would reflect the situation at N2 when other self regulatory complaints mechanisms (both voluntary and statutory) were transitioned to FOS.

Other arguments in favour included that consumers seeking **redress through the courts would be an inadequate solution** for those on low incomes or lacking confidence in asserting their consumer rights in a complex legal context.

Other respondents commented that there would be **efficiencies for firms dealing with one dispute resolution scheme** and considered transitioning to be an improved use of regulatory resources. Also they believed that by transitioning **confidence in the industry** would be maintained.

Most respondents also considered that the *arguments against* such transitioning provision had little force.

Incomplete market coverage – some respondents noted this argument had little force as MCCB firms cover 98% of the market.

FOS and MCAS processes may differ: - however respondents noted FOS and MCAS are similar in their key aspects. They are free to consumers and both bodies' decisions are binding on firms.

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[1] The CML (Council of Mortgage Lenders) and the Association of Mortgage Intermediaries (AMI)
[2] 30 November 2001, the commencement of FSA regulation for a range of financial services, implementing much of the Financial Services and Markets Act 2000

Most respondents considered that the **costs of transitioning complaints would be outweighed by the consumer benefits**, and several noted that the **projected costs of the FOS were less than the costs of the MCAS arrangements to which MCCB firms had already signed up to.**

However some respondents did oppose transitioning complaints of MCCB firms raising concerns about the **costs, particularly that Professional Indemnity Insurance (PII) cover might need to increase.**

There was also concern that the **higher profile of the FOS** might lead to an increase in complaints. In particular one respondent was concerned that there may be a number of transitional complaints relating to life time mortgages.

Some respondents were concerned that transitioning **would not create a level playing field** because the number of firms affected would be limited to those that opt for direct FSA authorisation. Firms would be outside the scope of the transitional arrangements if they were to close down or set up a new firm, or act as appointed representatives to FSA authorised persons.

Another respondent was concerned about whether the **FOS would be able to absorb the increase in workload.**

HMT comment: Transitioning complaints would provide clear benefits to consumers. MCCB has a wide market coverage and the costs to firms of transitioning complaints to the FOS are likely to be lower than the MCCB arrangements firms have signed up to. Most respondents supported transitioning. For these reasons the Treasury has decided that complaints against MCCB firms for business transacted before FSA regulation commences but which arise afterwards should be transitioned to the FOS.

Question 3 - Do you consider that complaints relating to the business of GISC firms before 14 January 2005 which are made after 14 January should be transitioned to the FOS?

Most respondents supported transitioning complaints against GISC firms to the FOS, and supported the arguments in favour of transitioning noted in the consultation document.

Benefits to consumers: insurance plays a key role in mitigating the effects of a difficult and unexpected event such as an accident or a burglary, and therefore the impact of mis selling can cause considerable detriment to consumers.

- Level playing field: FOS already has jurisdiction for general insurance complaints against banks, building societies and insurers. It would save confusion to avoid a situation where the broker is not covered even though the product provider may be.

- Seamless transition: there would be no gap in the availability of independent and robust complaints handling procedures.

- Continuity with "N2"[3]: transitioning would reflect the situation at N2 when other self-regulatory complaints mechanisms (both voluntary and statutory) were transitioned to FOS.

Other arguments in favour included that consumers seeking **redress through the courts would be an inadequate solution** for those on low incomes or lacking confidence in asserting their consumer rights in a complex legal context.

Other respondents commented that there would be **efficiencies for firms dealing with one dispute resolution scheme** and considered transitioning to be an improved use of regulatory resources. Also they believed that by transitioning **confidence in the industry** would be maintained. T**he volume of transitional complaints is likely to drop away after the first year or two,** as most insurances are annually renewable.

Most respondents considered that **the costs of transitioning complaints would be outweighed by the consumer benefits.**

However there were those who argued against transitioning complaints against GISC firms for the following reasons:

Costs: unlike the FOS, which applies a case fee, the GISC DRF is free to firms. However, the FSA is consulting on a new proposal that from 2004-5, a firm will incur no FOS case fees if it has less than three cases against it in a year[4]. GISC state that in the year to April 2003 only 14 firms had more than 3 cases that went on to become formal complaints under its Dispute Resolution Facility (DRF). This suggests that only a relatively small number of insurance brokers would be subject to charges by the FOS for transitional complaints.

In addition **GISC have revised downwards the numbers of cases going to its DRF,** which would have been equivalent to FOS cases incurring the case fee, from 500 to 171. Both the GISC DRF and the FOS are multi stage processes dealing with thousands of complaints. Most of these are dealt with without the need for formal proceedings, and, in the FOS's case, without firms therefore incurring the case fee.

Given the GISC DRF and FOS processes are not identical we cannot be sure how many GISC cases would progress to being FOS cases incurring the case fee were the FOS to take responsibility for them. However on reflection both GISC and the FOS consider that 171 is the best figure for the number of complaints in the year ended April 2003 which would have incurred the case fee had the FOS been the responsible body.

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[3] 30 November 2001, the commencement of FSA regulation for a range of financial services, implementing much of the Financial Services and Markets Act 2000

[4] FOS Plan and Budget for 2004-2005. Available from the FOS website – www.fos.org.uk.

Assuming a similar number of complaints (about 200) in the first year of transitioning, then, combining this with the impact of the proposed FOS fees, the additional costs to the industry of transitioning complaints would amount to some £43,000 in year 1, £11,000 in year 2, £2,000 in year 5 and £2,000 in year 10. The reduction in costs in future years is due to the fact that most general insurance is annually renewable.

This compares with the original estimates in the consultation document of £388,000, £78,000, £4,000 and £4,000 respectively. The original estimates were based on the original information we had from GISC and the FOS, and assumed not only a higher number of complaints but that each complaint would incur the full case fee.

Incomplete market coverage: GISC covers much less than half of the insurance market. In so far as the FOS regime would be more onerous than the GISC regime (binding awards and case fees), transitioning for GISC firms only could be seen as penalising such firms. Some firms may exit GISC in the run up to FSA regulation to reduce the impact of transitional provisions, which could only apply to the period when the firm was in GISC;

Profile of the FOS: there could be more complaints because of the FOS's higher profile than under the current arrangements.

FOS and GISC processes may differ: in particular it was noted that the GISC DRF can only make recommendations to firms whereas the FOS makes binding awards. One respondent however noted that so far firms have always followed GISC recommendations.

Some respondents suggested that complaints against all firms who sell insurance, not just those registered with GISC should be transitioned to the FOS. However the consultation document explained that where an independent mechanism for complaints does not currently apply, the Government does not consider it has the legal powers to bring complaints within the scope of the FOS. This is because such provision would not be "transitional" as there are no arrangements currently in place to transition.

Even if the law permitted it, we do not think it would be equitable to firms to retrospectively transition their pre-FSA complaints when they had not signed up to an independent dispute resolution facility. **Therefore transitioning complaints against all insurance brokers would be undesirable in both legal and policy terms.**

<u>HMT decision</u>*:*

The arguments for and against transitioning complaints against GISC firms are finely balanced. Transitioning complaints would provide protection to customers of GISC firms who had signed up to transitional arrangements.

On the other hand, the FOS regime would be more onerous than the GISC DRF. Its decisions are binding on firms. It has a higher profile amongst consumers and there is the risk of some firms incurring case fees. Transitioning complaints would be seen by some

as penalising those who had agreed to sign up to GISC self regulation with a more onerous regime.

However, we think the latest information, in particular the FOS proposals on fees, will minimise the costs to the industry. Also numbers of cases dealt with by FOS would reduce rapidly through most policies being annually renewable. **Therefore we consider that the benefits of transitioning complaints against GISC firms outweigh the relatively low expected costs.**

In the light of this, the Government has decided that consumer complaints against GISC firms for business transacted before FSA regulation commences but which arise afterwards be transitioned to the FOS.

Question 4 - Do you have any comments on the draft Orders?

There were various technical comments on the Orders.

Some respondents were concerned that the draft Order would allow firms to avoid transitional arrangements entirely if they leave MCCB or GISC a short time before the commencement of FSA regulation.

Some respondents were concerned that the draft Order only applied transitional arrangements to MCCB and GISC firms which became authorised by the FSA, and not to those firms which exited the market or became appointed representatives.

One respondent noted that it would save a great deal of unproductive effort if any transitional order waived the requirement for public consultation on changes to the FSA handbook for firms that relate solely to: setting out the effect of any new transitional order; and applying the existing rules and guidance (which have already been the subject of consultation) to MCCB firms and GISC firms in respect of transitioned complaints.

HMT decision: Transitional arrangements should apply to complaints that relate to when the firm was a member of GISC or MCCB, even if they leave MCCB or GISC a short time before regulation, and the Order has been amended to this effect. However if a firm leaves MCCB or GISC prior to commencement of FSA regulation transitional arrangements would not apply to that period in which that firm was not a member of MCCB or GISC, as there would be no arrangements during that period to transition.

Transitional arrangements will only apply to MCCB and GISC firms which became authorised by the FSA, and not to those firms which exited the market or became appointed representatives. Regarding those firms who have exited the market, there would be difficulties of enforcement of FOS settlements, and the FOS does not have powers over firms which have never been authorised by the FSA. Not transitioning complaints against such firms also reflects the current MCAS arrangements which do not apply to firms which have ceased membership of MCCB.

Regarding **appointed representatives**, FOS and the FSAS do not have powers to impose settlements on appointed representatives but do so through their principals. Transitioning complaints against appointed representatives would therefore impose a retrospective liability on the Principal for the behaviour of its appointed representative for the period before the Principal had was the Principal and before it had control over the appointed representative's behaviour. This would be unfair on the Principal.

Given the need for the industry to know quickly precisely how the transitional arrangements will work, and given that relevant provisions have already been the subject of consultation, the transitional order waived the requirement for public consultation on changes to the FSA handbook for firms that relate solely to: setting out the effect of any new transitional order; and applying the existing rules and guidance (which have already been the subject of consultation) to MCCB firms and GISC firms in respect of transitioned complaints.

The Order also inserts provision for information-sharing, between MCCB and the FSA and between GISC and the FSA.

Question 5 - Do you have any views on the assumptions made in the draft Regulatory Impact Assessment?

Many of the respondents had no further views on the assumption made in the Regulatory Impact Assessment.

One respondent commented that the RIA does not take into account the cost to consumers of not transitioning. One respondent suggested that it would be helpful to have an indication of the cost to a consumer to pursue a complaint in court as without this the comparative information is of limited value.

In addition they commented that the FOS case fee is overstated and would be lower than £600 in the first year due to the improved experience from the endowment caseload. The respondent concluded that the case fee would not be consistent throughout the ten-year period, as with improved experience FOS could allow a lower case fee.

Another issue relating to cost in the RIA raised by a respondent was that the specific cost for the different options are uncertain, particularly if FOS costs were to be reduced for smaller companies should a 'fast track' option be put into place.

One respondent also questioned the assumption that GISC intends to operate in any ongoing regulatory role after 14 January 2005.

HM Treasury
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