GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: OCTOBER 2018

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In the October 2018 column, Thomas Samuels considers whether, in the light of the proposed expansion of the Financial Ombudsman Service's (FOS) jurisdiction and financial limit, the FOS is likely to be able to adequately deal with more complex matters, and if the expansion provides a good reason for its overhaul.

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HAS THE FINANCIAL OMBUDSMAN SERVICE OUTGROWN ITS PURPOSE?

Introduction

In two recent publications, the FCA has proposed an expansion of the Financial Ombudsman Service's (FOS) jurisdiction and financial limit. This column considers whether the FOS is likely to be able to adequately deal with more complex matters, and if the expansion provides a good reason for an overhaul of the statutory scheme.

FCA policy statement 18/21: SME access to the FOS

The FCA published a *policy statement* (PS18/21) on 16 October 2018, which sets out the regulator's "near-final" rules in relation to the expansion of the FOS jurisdiction to cover small and medium-sized enterprises (SMEs).

Currently, the definition of "complainant" in the FCA's Dispute Resolution: Complaints sourcebook (DISP) covers three types of entity: consumers, micro-enterprises, and certain small charities and trusts (see DISP 2.7). A "micro-enterprise" is defined by one that has fewer than 10 employees, and a turnover or annual balance sheet not exceeding EUR 2 million. Small charities and trusts currently within the scope of the FOS regime are those with an annual income or net asset value of less than £1 million. Although the present definition of complainant may seem to cover relatively substantial undertakings, they are unlikely to have access to substantive legal advice and may be unwilling or unable to fund expensive litigation. This definition is, itself, an expansion on the original definition of eligible complainant, which did not include the concept of a micro-enterprise.

However, the FCA has now concluded that the same considerations apply to the broader category of SMEs. Accordingly, the definition of complainant in DISP 2.7 is to be amended to cover any enterprise (that is, an entity engaged in an "economic venture") which: (i) is not within the definition of a micro-enterprise; and (ii) has a turnover of less than £6.5 million, and either fewer than 50 employees or a total balance sheet of less than £5 million. The intention is that this definition will be replicated in "final" rules published towards the end of this year, scheduled to come into force from 1 April 2019.

PS18/21 considers a number of objections raised at earlier stages in the consultation process. These included responses from the All Party Parliamentary Group (APPG) on Fair Business Banking that a separate tribunal should be established for SMEs because of the complexity of disputes likely to be raised by them and, on behalf of the financial services industry, that SMEs should be able to look after their own interests. In addition, concerns were raised about the competence of the FOS to deal with such complaints (particularly in light of the recent "Dispatches" documentary on Channel 4). However, the FCA concluded that expansion of the FOS jurisdiction was not necessarily inconsistent with a more formal specialist tribunal for SMEs. Moreover, it has addressed concerns over competency by creating a ring-fenced specialist unit of 20 ombudsmen who will deal exclusively with complaints from SMEs.

Also in PS18/21, the FCA confirmed a proposal to expand FOS's financial limit from £150,000 to £350,000 (dealt with in detail in FCA *consultation paper* "Increasing the award limit for the Financial Ombudsman Service" (CP18/31)). Given the regulator's apparent enthusiasm for the change (for example, at paragraph 1.7 of PS18/21), it seems likely that it will also be finalised during the course of 2019. While it is correct that the last increase to FOS's financial limit occurred over six years ago, it was relatively modest - from £100,000 to £150,000.

These changes to the FOS jurisdiction are, in and of themselves, obviously significant. Considered in terms of employee numbers and/or turnover, the amendment to the definition of complainant means that entities which are several times the size of a current micro-enterprise will soon be within the remit of the FOS regime. Moreover, the FCA's proposed increase to the financial limit will more than double the current mandatory maximum award.

FOS decision-making process

The result is that FOS will now be able to determine complaints that are financially substantial and which are far more likely to give rise to complex legal questions than the average complaint raised by an individual. Whereas a court may schedule a multi-day hearing to consider the relevant evidence and law in litigation dealing with equivalent issues, FOS ombudsmen must decide according to what they consider to be "fair and reasonable in all the circumstances" (section 228(2) of the Financial Services and Markets Act 2000 (FSMA)).

The meaning of those words is elaborated upon by DISP 3.6.4R. It requires a FOS ombudsman to take into account relevant law and regulations, regulators' rules, guidance and standards, and codes of practice, as well as what was good industry practice at the relevant time.

The width of an ombudsman's statutory decision-making power has been underlined by a number of decisions dismissing respondents' attempts to challenge final decisions of the FOS. It has been held that what is fair and reasonable can be determined subjectively accordingly to the ombudsman's view of all the circumstances of the complaint (*R (IFG Financial Services Ltd) v Financial Ombudsman Service Ltd [2005] EWHC 1153, at [13]*). Further, in *R (Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service Ltd [2008] Bus LR 1486*, the Court of Appeal confirmed that a FOS ombudsman is free to depart from the common law if he considers it fair and reasonable to do so. As a result, final decisions of FOS ombudsmen have the capacity to become "an important source of new law" (per Rix LJ at [87]).

The flexibility of the FOS regime is also emphasised by section 225(1) of FSMA which refers to disputes "resolved quickly" and with "a minimum of formality". This was underlined by *Irwin J in R (Williams) v Financial Ombudsman Service Ltd [2008] EWHC 2142* when he noted that the FOS is a scheme "now produced in many areas, where a tribunal or ombudsman with specialist expertise in a given subject is asked to resolve complaints or disputes in that area in a speedy and straightforward way, with a minimum of technicality and, it is hoped, at relatively low cost" (at [18]).

Although a FOS ombudsman has a power to dismiss a complaint without consideration if it would be more appropriately dealt with by a court or other alternative dispute resolution (ADR) tribunal (DISP 3.3.4A–4B), it is a mere discretion to do so. Thus, once a complaint has been accepted for determination, it is very difficult indeed to challenge it on the basis that the complaint would be better dealt with by way of formal litigation.

Consequences of FOS expansion

In light of the above, the question arises as to whether the forthcoming expansions to the FOS jurisdiction overreach the original purpose of the scheme. Can an avowedly informal, quick and non-legalistic ADR service adequately deal with disputes involving substantial commercial entities on both sides potentially worth several hundred thousand pounds?

Ultimately the proof of the pudding will be in the eating. However, there is a good argument that the FSMA section 228 fair and reasonable test is incompatible with the types and values of complaint soon to be within FOS's remit. It is noteworthy that the breadth of that process is one of the key distinctions between FOS and many other similar decision-making services. For example, although founded with similar aims, the Pensions Ombudsman must act in accordance with established legal principles when determining complaints of maladministration (see *Pensions Ombudsman v EMC Europe Ltd [2012] EWHC 3508 (Ch) at [29]-[31]*).

The fair and reasonable test is a good indicator that the scheme was simply not designed to deal with complex or very high value matters. However, section 228(2) of FSMA is primary legislation that can only be amended by Parliament, whereas the boundaries of FOS's jurisdiction are in the hands of the regulator and can be changed by amendments to the relevant rules in the FCA Handbook following consultation. As such, it is not within the FCA's power to update the fair and reasonable standard even if it were minded to do so. The result has been a gradual increase in the value and complexity of matters within the FOS jurisdiction without any equivalent consideration of whether section 228 remains fit for purpose.

Moreover, from a respondent's perspective, the lack of any right of appeal does nothing to improve the situation. Although a complainant is entitled to refuse to accept the outcome of the complaint without giving any reason, a respondent cannot do likewise. By contrast, a respondent's only route of challenge is by way of judicial review, which sets a very high bar. As a result, successful challenges to final decisions of FOS ombudsmen have been few and far between. It is to be contrasted with decisions of similar bodies that are appealable to the First-tier Tribunal and the right of appeal, which exists under section 69 of the Arbitration Act 1996.

Conclusion

Perhaps, therefore, the latest expansion to the FOS jurisdiction provides a good moment for Parliament to reconsider the purpose, structure and decision-making process of the scheme. It may be that the APPG on Fair Business Banking's response to the FCA's consultation provides some indication that there is an appetite amongst the legislature for such a recalibration.

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