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The Financial Ombudsman Service: Fair and Reasonable?

A summary of a Thesis submitted for the Degree of Master of Laws in the University of Buckingham

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This is a brief overview of the aforementioned thesis submitted to the University of Buckingham ("UoB") for a Research Masters degree in Law. For those interested in the full Thesis, which does contain reasonable amount of background information and case law, this can be found within the 'News' section of www.enhancesolutions.co.uk

Introduction

Within a speech made on 6 June 2001 by the Financial Ombudsman Service's ("FOS") then Chief Ombudsman, Walter Merricks, he acknowledged the *"unusual nature of the FOS"* as being *"A jurisdiction required by law to be based not on legal rights"*.

The Courts too have commented on this unusual state:

"By way of postscript, I do have personal concerns about a jurisdiction such as this which occupies an uncertain space outside the common law and statute. The relationship between what is fair and reasonable, and what the law lays down, is not altogether clear."

[Justice Jay, Aviva vs FOS 2008 EWCA Civ 642]

In other words, as an alternative dispute resolution service, the FOS are entirely within their legal rights not to follow case law when making decisions on disputes presented to them. Instead, the ombudsman can decide a dispute based on what he believes to be fair and reasonable in the circumstances of the case and in so doing, may depart from 'legal rights' such as case law. The extent to which the 'unusual nature of the FOS' manifests in practice was explored in a research thesis which undertook an analysis of 840 ombudsman decisions.

This is a brief overview of the above thesis submitted to the University of Buckingham ("UoB") for a Research Masters degree in Law. For those interested in the full content, which does contain reasonable amount of background information and case law, the Thesis can be found within the News section of www.enhancesolutions.co.uk

Initial Hypothesis

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The Thesis was researched and written by Kevin Jack between April 2019 and April 2021, with the Masters confirmed in April 2022 – the reason it took 12-months was that the UoB took a while to find an external verifier who had sufficient expertise in the topic!

The initial hypothesis was that:

- The Financial Ombudsman Service ("FOS") frequently departs from case law precedent when determining complaints based on what is fair and reasonable in all the circumstances of the case; and,
- That the flexibility afforded to the FOS in being able to look beyond legal precedent in reaching decisions gave rise to uncertainty for regulated firms falling within the FOS's jurisdiction.

Methodology: Overview

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The research element of the thesis comprised analysis of 840 FOS decisions made between 2014 (the first full year of published decisions) and 2020, in order to examine across banking, insurance and investment-based cases, the type of disputes considered by the ombudsman and the extent to which legal precedent, rules and regulations informed those decisions. Specifically, when looking at these cases, the following factors were considered:

- **The decision**, whether Upheld, Partly-upheld or Rejected.
- Whether a '**Distress and Inconvenience**' award had been made.
- **Award quantum** - whether this was £50,000 or more (this figure was chosen on the basis that it is deemed a significant award for many firms to meet). It should be noted that the award limit has increased in recent years, however for much of the survey period, the award limit was £150k.
- The extent to which a '**Duty of Care**' argument was advanced by the complainant and/or the FOS. This is because within case law, duty of care principles (proximity, foreseeable harm and the court deciding it is fair, just and reasonable to impose a duty of care) are well established. Therefore, is it common for FOS decisions to explicitly consider duty of care?
- The extent to which **legal precedent**, via previous court cases, forms part of the decision, whether introduced by the complainant, respondent or the FOS. Referred to in the thesis as 'hard letter' law.
- The extent to which **regulatory rules and guidance** forms part of the decision. This will usually be FSA/FCA rules/guidance – COBS 2.1.1R, the 'client's best interests rule' is an example. Of such a regulatory rule.

The results are set out in the next slide.

Overview of the survey results

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Item	All categories	%	Investment	%	Insurance	%	Banking	%
Fully upheld	230	27%	91	33%	77	27%	62	22%
Partially upheld	70	8%	23	8%	24	9%	23	8%
Not upheld	540	65%	166	59%	179	64%	195	70%
TOTAL	840	100%	280	100%	280	100%	280	100%
(See Note 1)								
D&I award	176	21%	68	24%	66	24%	42	15%
D&I only	84	10%	23	8%	32	11%	29	10%
(See Note 2)								
Award > £50k	20	100%	20	100%	0	0%	0	0%
(See Note 3)								
Duty of care cited	5	100%	4	80%	0	0%	1	20%
(See Note 4)								
Legal precedent	8	100%	7	88%%	0	0%	1	12%
(See Note 5)								
Rules/guidance	20	100%	11	55%	1	5%	8	40%
(See Note 6)								

Notes from the previous table

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1. The uphold rates are based on the number of cases that have been not upheld; fully upheld; or, partially upheld, each as a percentage of the data size, hence 840 cases for all categories and 280 for each of the investment, insurance and banking categories.
2. The Distress and Inconvenience ("D&I") award records firstly where a D&I formed part of the FOS award; and, secondly of these cases, where the D&I was the sole award. As with (1) above, the percentages are based on the number relative to the whole data universe of 840 decisions and 280 for each of the categories.
3. In relation to the award quantum, this identifies the total number of awards in excess of £50k; and, of that population, how many are present in each of the individual categories.
4. In relation to Duty of Care, this identifies the total number of decisions where duty of care was explicitly referenced within the decision (regardless of outcome); and, of that population, how many are present in each of the individual categories.
5. In relation to Legal Precedent, this identifies the total number of decisions where case law was explicitly referenced within the decision (regardless of outcome and by whom); and, of that population, how many are present in each of the individual categories.
6. In relation to Rules and Guidance, this identifies the total number of decisions where regulatory rules and/or guidance was explicitly referenced within the decision (regardless of outcome and by whom); and, of that population, how many are present in each of the individual categories.

The conclusions from the Thesis follow from the next slide.

Conclusion 1: The FOS is aligned with most UK ombudsman services

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- In using a 'fair and reasonable' approach to determining complaints, the FOS is a 'typical' ombudsman.
- When compared with 19 other UK-based ombudsman services, they adopt a similar approach to determining complaints (albeit the complaints are usually less complex with less financial quantum riding on them – for example, car sales or double glazing complaints). Please see the full Thesis for details of the other ombudsman services considered.
- The exception to the above is the Pensions Ombudsman, the service which most closely reflects the matters covered by the FOS - see the next slide.

Conclusion 2: Misalignment with the Pensions Ombudsman

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- Despite sometimes covering the same subject matter, there is an inconsistency between how the TPO and FOS settle disputes – the TPO is compelled to find as a court would, there is also no limit to the amount of the award that may be granted.
- Consequently, a complainant with a strong case and/or high loss may wish to pursue a complaint via the TPO (assuming it falls within the TPO's jurisdiction) rather than the FOS where a limit applies to the money award. Conversely, where the respondent feels the complainant's case is on a weaker legal footing, they may wish to drive the complaint to the more 'adversarial' TPO, rather than a more 'inquisitorial' approach that could be adopted by the FOS, who are not bound to follow legal precedent.
- Given both the FOS and TPO deal with disputes in relation to pensions maladministration, which can fall within the regulated financial services sector and therefore within the FOS's jurisdiction, it is contended that the two ombudsmen should be more aligned.
- This is not new thinking. In 2019 the Department of Work & Pensions published a review of TPO [Department for Work & Pensions, *Corporate report: Tailored Review of the Pensions Ombudsman,* Gov.UK, (27 August 2019)] which concluded:

"[W]e have heard a clear case for addressing the fact that there is a specific area of overlap in jurisdiction, with both the TPO and FOS able to give different decisions, under different rules for cases that involve maladministration of personal pensions. We make initial proposals to build a better evidence base for considering options to resolve this, as a matter of proper public administration and as future legislative priorities allow."

- This led to two recommendations that the TPO should collaborate with the FOS to *"reduce the potential for customer confusion and the duplication of efforts"*; and, based on shared data analysis, for both boards to consider whether policy changes are required to *"reduce the scope for jurisdictional overlaps and gaps"*. [Form and function recommendations 1 and 2].
- To date, there is little evidence of this happening.

Conclusion 3: The FOS adopts a professional approach

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- The way in which the FOS operates as a dispute resolution service is set out clearly within FSMA and the FCA's DISP Sourcebook.
- The number of complaints it handles is testimony to the fact that *prima facie* the FOS is an accessible ADR. This should not be disrupted.
- Notwithstanding that one or other of the respondent or complainant may disagree with the outcome, the range of FOS decisions reviewed for this paper demonstrated a professional, thorough and where appropriate, a sensitive approach to the handling of the dispute with typically a detailed rationale for the decision, even in the rare instances where legal precedent has not been followed.

Conclusion 4: FOS decisions are rarely legally challenged

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- Circa 0.005% of cases were legally challenged.
- Within the period under review (2014-2020) there had been eleven judicial reviews challenging FOS decisions, which was a surprisingly low figure, given that 221,156 initial FOS adjudications have been referred to an ombudsman.
- Where challenged by a judicial review, the process deployed by the FOS has tended to stand up to legal scrutiny and has reinforced the fact that the ombudsman can depart from legal precedent when deciding a case based on what is fair and reasonable taking the facts of the case into account.
- It is contended that this is reflective of both i) an understanding by the party against whom a decision has been made that the FOS is on a firm legal footing given the wide remit of using what is fair and reasonable factors in arriving at the decision; and, ii) typically within respondent firms, in light of (i) firms and/or their insurers are often reluctant to devote both financial and human resource, and possible reputation damage, in relation to fighting a decision in the courts.

Conclusion 5: Widespread use of D&I payments

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- While not the primary focus of the research, the data analysis concluded that over a quarter (28%) of upheld complaints comprised solely distress and inconvenience payments. These are often relatively low value awards.
- While a useful tool in settling a dispute, it does arguably mean that a lot of FOS resource is devoted to arriving at these types of decisions.
- Presuming the 28% figure is representative of the wider FOS adjudications, then the number of solely D&I awards is potentially significant. For example, within the 2019/20 FOS annual report, 262,712 complaints were resolved with an uphold rate of 32% (94,947 cases).
- If 28% of these were solely D&I awards this equates to 26,585 cases. There are of course different ways of measuring the cost to the FOS of handling these complaints, however within the 2019/20 Annual Report, a unit cost of £920 is cited, this being the total running costs divided by the number of resolved complaints.
- Using this amount suggests a cost to FOS of over £24m in processing these 'D&I only' cases.
- Could a 'fast-track' approach could be considered in relation to complaints that are more likely than not, to result in a D&I payment only. This is not to downplay the importance of such disputes, rather to consider some of the practical challenges the FOS currently faces in relation to backlogs and limited resources.

Conclusion 6: Legal precedent did not a form a significant part of the decisions reviewed

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- Only 1% of the cases reviewed specifically cited case law – 8/840.
- At the heart of this research was the hypothesis that the ombudsman's ability to depart from legal precedent was widely applied and consequently there was a risk that (typically) the respondent was at a disadvantage when defending a complaint.
- However, the data analysis showed that legal precedent in the form of case law was rarely cited by any of the parties involved in the process. In the few cases where case law was cited, it was not followed where the respondent cited the case, but was used in a handful of cases by the FOS in support of their decision.
- This was a surprising conclusion as the author expected more widespread reference to case law, especially by the respondent. It is contended that (in particular) respondent firms understand the 'inquisitorial' approach adopted by the FOS and that firms also understand that typically the ombudsman's view is unlikely to be swayed by prior case law.
- That said, this research data identified that the inclusion of case law, by either party, is a relatively new phenomenon with most cases being cited within decisions from 2017 onwards. It will be interesting to observe whether case law will be cited more frequently, linked to the increasing monetary award limits as arguably the stakes involved with an adverse FOS decision are becoming higher.

Conclusion 7: Increasing use of 'soft letter' law – FCA rules and guidance

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- While not widespread in the review period – 20/840 decisions - reference to FCA rules and guidance was made by the FOS in reaching its decisions.
- This seemed more skewed to the end of the review period and was more prevalent in investment cases rather than banking and insurance where there are more prescriptive legal regulations (such as the Consumer Credit Act 1975 and insurance disclosure regulations). When settling disputes, the investment (and pensions) sector has to rely more on the FCA principles, rules and guidance.
- This includes referencing both formal regulatory rules and guidance, such as the FCA's Handbook rules and guidance, along with thematic reviews and other regulatory informal guidance. Allied to this is the ombudsman's reference to high-level regulatory rules, such as the 'acting in the client's best interests' rule and the FCA's eleven Principles, albeit it tends to be a core three Principles that are most often referred to, namely: i) acting with skill, care and diligence; ii) deploying proper management and control; and, iii) treating customers fairly.
- The FOS's reference to COBS 2.1.1R (client's best interest rule) is covered in more detail in the thesis.
- The regulator could assist the FOS process by attaching more detail for firms and consumers, and therefore the FOS, as to what the FCA envisages in practice for some of the more high-level principles, rules and guidance.
- Could the detail provided to firms in relation to the Consumer Duty Principle provide some clarity for both firms and the FOS, meaning less regulatory infilling by the FOS as is currently the case.

Final thoughts

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- The hypothesis of this paper was that while accepting the FOS was not compelled to follow legal precedent established through case law, the FOS frequently overrode case law; and, that this lead to uncertainty.
- In fact, case law rarely featured in the ombudsman decisions; instead, 'soft-law' through the interpretation and application of FCA rules and guidance more frequently applies, this being an increasing trend. The research therefore followed this tangent.
- While the FOS is entitled to include these factors when making its decision, it often does so by filling in gaps within the FCA's rules and guidance.
- This places an unfair burden on the FOS and leads to uncertainty among regulated firms subject to the FOS's jurisdiction.
- This is a weakness in the FOS process.
- The introduction of a new Consumer Duty obligation on regulated firms may assist in providing greater clarity for both respondent firms and the FOS.
- There is a responsibility on the FOS to ensure their interpretation of the new Principle is consistent with the FCA's intent.

Future study/collaboration?

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- This research covered the period up to the end of 2020.
- There was some evidence of increasing use by the FOS of FCA rules and guidance; and, case law, when reaching their decisions, especially on more complex cases. This may also be a consequence of higher redress limits that can be awarded by the FOS – in short, there's more at stake.
- It will be interesting to see how the Consumer Duty Principle impacts on FOS decisions – will it provide more certainty of regulatory expectations for both respondent firms and the FOS; or, will it be a case of more reasons to find against a firm?
- If there are any organisations wishing to collaborate/sponsor further study, please do let me know. Contact details on the next slide.

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