



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to the FSA consultation CP 10/21 Consumer Complaints

December 2010

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland. We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers and aims to give people a stronger voice.

We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

Our response

In its recent review of complaint handling in five banking groups the Financial Services Authority (FSA) has demonstrated beyond doubt that the issue of quality needs urgent attention. It suggests 36 per cent of all complaints suffered poor quality handling.¹ In particular, the FSA spotted systematic abuses of the two tier complaint handling process, weak mechanisms for firms to learn from Financial Ombudsman Service (FOS) decisions, or FSA guidance, and limited or no root cause analysis. This supports our own evidence from consumers that shows over two in five consumers (42%) are unhappy with the way banks have dealt with their complaint.²

Therefore, we welcome the work stream *Better deterrent and consumer redress* upon which the FSA has embarked, of which improved complaint handling forms an important part. There is clearly a commitment by the FSA and FOS in this paper and in DP 10/1 to ensure complaints are handled well, promptly and effectively. As part of that, it is right that firms build institutional capacity to deal with complaints and then learn from complaints data to feedback into their practices and policies.

The underlying premise of this complaints paper is that many firms lack the institutional capacity to meet their obligations to achieve the goal of treating customers fairly in complaint handling. In essence therefore, this consultation presumes failure to comply with their obligations stems from weak institutional capacity. The FSA expects that by further prescribing the nature of the complaint handling processes firms will improve the quality of their responses.

Any firm that does not have mechanisms to learn from FOS decisions and FSA guidance, and that does not have a board member responsible for complaints, is unlikely to demonstrate a real commitment. Yet, those structural changes by themselves will not realise a change in culture without changing the wider incentives which create that culture, an important point that the FSA itself recognises

Firms show a wide variety of attitudes towards their customers and that culture cannot be predicted by purely looking at whether the appropriate structure is in place. With regard to root cause analysis, many firms already have the processes in place to analyse, learn from and incorporate decisions from the FOS and yet they continue to treat customers poorly. Lastly, the propositions for a member of senior management or board member to be responsible for complaint handling are unlikely to produce large changes since the cost-benefit analysis shows 70 per cent of firms already have this structure in place.³

The complaints data published by the banks and from the FOS reveal that most complaints come from a small number of very large firms. Each firm regulated by the FOS receives three 'free cases' under its levy. Only 1 per cent of all businesses covered pay any case fees.⁴ Thus, it is likely those firms who suffer large volumes of complaints will have the appropriate learning structures in place but will lack the commitment to ensure good consumer outcomes.

¹ FSA, *Review of complaint handling in banking groups*, April 2010, p11

² Gfk, *Omnibus Survey on complaint handling for Consumer Focus*, December 2010

³ http://www.fsa.gov.uk/pubs/cp/cp10_21.pdf P26

⁴ <http://bit.ly/eAgtKR> (PDF 81KB)

One must question whether these institutional failings are the cause of firms' failure to handle complaints appropriately or symptomatic of larger problems. The FSA identifies a two tier complaint handling processes as creating an inherent potential for the poor treatment of consumers. Yet, the FSA found two of the five banks surveyed and 18 of the 31 insurers who used a two tier complaints process were not systematically treating customers unfairly. It would appear that some firms utilise the two tier process without systemic unfair treatment of customers.

In short, there appears limited evidence that processes and procedures are the primary cause of differing firms' ability to treat customers fairly. Consequently, we believe these structural reforms cannot themselves end the culture of firms resulting in systemic unfairness. Those firms that do treat customers poorly and amend their processes may continue to not treat customers fairly under the revised structure. The abuse of the two tier process reflects larger failings that may well continue.

However we recognise that a one tier process is better for customers of banks with poor processes because it will limit the time and effort spent trying (and failing) to resolve a complaint before they are able to refer it to the FOS.

Building on the FSA's approach to outcome-focused regulation, we believe the FSA should devote equal time and resources to incentives that lead to the poor treatment of consumers.

Our response is organised to respond to the specific questions the FSA asks in the consultation before moving on to our wider perspective about how best *credible deterrents* can be realised. This wider perspective is important to bear in mind. Joined-up action by the various branches of the regulator are important to avoid a silo mentality. These reforms, that strengthen Management Information (MI), and make firms obligations clearer, should now be utilised by strong enforcement for failure to comply.

Part 1: Questions

Q1. Do you agree with our proposal to increase the ombudsman service's award limit for its compulsory jurisdiction, for any complaint referred to the ombudsman on or after 1 January 2012? If not, what analysis or evidence do you have that it should be higher or lower than the proposed amount?

We agree with the proposal as set out. This links the award with inflation but in a way that minimises disruption for firms, since they do not have to make annual adjustments.

Q4. Do you agree with our proposal to remove the two-stage process for complaints handling?

We welcome the removal of the two tier process. This will speed up and simplify the complaints process for consumers. Our research indicates over two in five consumers are not satisfied with the way their bank has dealt with their complaint yet nearly two thirds of those do not pursue their complaint any further.⁵

Under the revised proposal it will make it more likely that dissatisfied consumers will take their complaint to the FOS if they are dissatisfied. This has the potential to result in banks improving their processes as they will wish to avoid both the added expense incurred from FOS complaint handling and the negative impact on the reputation of large numbers of upheld complaints.

⁵ Gfk, *Omnibus Survey on complaint handling for Consumer Focus*, December 2010

We would call for close monitoring of quality of complaint handling moving forward to assess whether the migration to a one tier process works as the FSA expects. The FSA should consider using a range of benchmarks to ascertain whether firms are committed to reform, such as continued mystery shopping, consumer surveys, FOS case studies and whether the number and percentage of cases upheld by the FOS is dropping. If the FSA fears certain firms remain uncommitted then it should more readily use enforcement action.

As suggested in the introduction, reforming culture is exceedingly difficult and these reforms of the complaint handling process must be backed up by wider efforts to change firms' incentive structures. See part 2 of our response to this consultation for further elaboration.

Q5. Do you agree with our proposal for additional guidance on the processes that firms should have in place to take account of ombudsman service decisions and other relevant material?

We support the reiteration of firms' obligations on root cause analysis and taking account of ombudsman decisions and other material. The guidance should be a useful addition to the regulatory process if it further clarifies firms' duties. As with the above this should form part of a wider strategy including enforcement action for firms continued failure to comply.

Q6. Do you agree with our proposals for additional guidance on root cause analysis and the processes that firms should have in place to undertake it?

See above answer.

Q7 .Do you agree with our proposals on senior management responsibility?

We believe it is appropriate for all firms to have someone in a senior management position responsible for complaints. We would add the real test of firms' compliance however, should be found in the consumer experience and not simply compliance with having a senior management person responsible. The consultation states 90 per cent of firms do have an individual responsible, and 70 per cent of all firms surveyed have a member of the board responsible. Therefore, these reforms are unlikely to affect many firms, particularly those responsible for the majority of complaints.

The cost-benefit analysis suggests the person responsible will only have to devote two hours a month to co-ordinating complaint handling. We would question whether that is sufficient time to co-ordinate the various duties under the FSA Dispute resolution handbook (DISP).

Additionally, we wonder why the FSA has not asked for that person's name and details to be passed on to the FOS or FSA under the revised DISP paragraph 1.3.8. We believe it would help the FSA and consumers gauge commitment and remove the burden of trying to find this name if and when there is a problem. It would also allow the FSA to form a stronger relationship around training, monitoring and management to ensure firms are committed and capable of delivering consumer-orientated complaint handling.

Q8. Do you have any comments on the proposed implementation dates for these proposals?

We question whether firms need to be given until 1 July 2012 to change their complaints procedures and we would prefer the new rules to be implemented earlier. We wish for extra resources to be put into enforcement as soon as possible.

Q11. Do you agree with the proposed additions to the rules to clarify that complaints can be made free of charge, and that summary details about firms' complaints processes should be made available free of charge?

Agreed, these are welcome changes. The principle that consumers know a complaint is free of charge is vital for consumers as a free fallback option when the banks fail them.

Q12. Do you have any evidence of the number of persons suffering detriment (and the size of the detriment) due to identity theft or mistaken identity, who are unable to complain?

We do not have this information. However, the FSA and FOS are right to investigate this issue further. Consumer Focus would be willing to work with the FSA/FOS to assess the scope of this problem. This issue has the potential to cause significant harm to consumers. Solutions should be sought to this regulatory and redress gap.

Part 2

Wider reforms to create 'credible deterrence'

What produces a culture that is impervious to consumer and the regulator's concerns about fairness?

a) Unfair products

This consultation is focused on the complaint handling processes, but complaints data shows that it is the fundamentals of unfair product design that needs to be challenged, since unfair products form the bulk of the complaints received by the banks and the FOS. The challenge is to tackle the source of the complaint (product design and charging) as well as the complaint process itself.

More than half of the cases ever referred to the ombudsman service, since it was formed, have related to just six financial products. Complaint contacts about personal current accounts (PCAs) are up 30 per cent year on year, they are higher than for all other products, and PCAs are the second most frequent cause of cases coming to the FOS for a decision behind Payment Protection Insurance (PPI), another product that various investigations have viewed as inherently unfair or missold.⁶

The FSA says it hopes these reforms may make firms re-think product design (3.43). Research shows that it is extremely difficult to make firms re-design products where significant revenue can be gained by their continuation. This is demonstrably clear when analysing the success of the Treating Customers Fairly (TCF) initiative. Independent research has shown that TCF has empowered those within each firm who promote placing resources into customer satisfaction and consumer experience. Banks have amended many processes, improving the overall customer experience. Such improvements include better communication, clearer factsheets and more concern about the customer interaction with the bank throughout the product life.

However the TCF programme has been less successful challenging more fundamental practices that we would consider are unfair in the basic design of revenue models, marketing and product design. Where banks make significant revenue out of disputes, complexity, mistakes or problems, the banks have incentives to continue these products and practices even though they are a significant source of complaints.

⁶ Financial Ombudsman Service, *Ombudsman news* February/March 2010, p18–19

The best example would be the complaint handling response to Unauthorised Overdraft Charges (UOCs) in 2008 which led to the ‘Dear CEO’ letter cited in this consultation.⁷

We do not believe poor product design and poor complaint handling derive from a lack of awareness. Instead, as the mixed results from the TCF initiative indicate, where the incentives inherent within the industry mean firms profit from treating customers poorly they continue to do so. We believe this to be a symptom of a wider problem – culture rather than the problem itself. Complaint handling rules can only be part of the solution where culture is wrong and cannot be relied upon to alter the products firms offer.

The FSA should not be relying on the goodwill of firms to re-design products – some of whom, by the FSA’s own analysis, have the wrong culture and limited commitment to change. Additional consideration needs to be given to getting rid of the cause of complaints and designating certain products, practices and selling structures as unfair and not fit to be sold. Philosophically, it appears the FSA now shares our view. Hector Sands recently stated:

‘Historically, the FSA’s approach to conduct was, as with Prudential, essentially reactive. Too often, it focused on high-level systems and controls analysis merely reacting to crystallized risk and consumer detriment. It also focused, as has been the approach across Europe, on disclosure, sales processes and suitability. Both elements thus avoiding product and price regulation. There are significant limitations to this approach. Critical among these was the inability to spot and prevent major risks from crystallising, resulting in damage to consumer and market confidence and ultimately consumer harm.’⁸

Recently, the FSA has moved towards an intensive supervisory approach. This makes judgements on firms’ processes and culture ‘horizon scanning’ for potential risks to consumers. The FSA must ensure that it follows through on these ideas to prevent products and practices that lead to complaints arising in the first place.

b) Greater enforcement action

This paper follows DP 10/1 and fits into the larger *Credible deterrence* workstream.

Consumer Focus has reflected on the nature of regulatory reform following the crash as part of its *Fresh thinking* publications. In *Regulating in the consumer interest*, we pointed out that in the wake of a crisis, regulators prefer writing new rules and regulations to better enforcement. Inevitably, this has high regulatory costs that are passed on to consumers. The proposals in CP 10/21 are in danger of following that model. This consultation makes it clear that many of the proposals simply re-state or re-affirm more clearly firms’ current duties and many already comply with the changes to DISP.⁹

As an alternative, we suggest regulators expend greater effort on enforcement activity using existing under-utilised powers. Beyond the current consultation we believe the FSA should consider whether it is entirely necessary to keep re-stating rules rather than taking action on the evidence of systematic unfairness it has already unearthed. In the April 2010 paper that detailed the results of the complaint handling review, the FSA stated two firms had been referred to the enforcement division.¹⁰ We have yet to see any outcomes of this referral.

⁷ FSA, CP 10/21, September 2010, p16

⁸ Hector Sants, *UK financial regulation: After the crisis*, Speech of 12 March 2010

⁹ FSA, CP 10/21, para. 3.32

¹⁰ FSA, *Review of complaint handling in banking groups*, April 2010, p4

Where there is evidence of industry wide misselling and poor product design the FSA should be willing to use its full range of powers much more quickly – including S404 of the Financial Services and Markets Act. Following amendments earlier this year there should now be greater clarity about its application. The FSA has never used its restitution power, and has been reluctant to use its own-initiative restitution power to vary a Part IV permission (also known as OIVOP), saying it needs to clarify powers, particularly in relation to historic unfair practices that firms have ceased. It is entirely arguable that it has price and product intervention powers under the current objectives and in line with TCF.

Stronger enforcement action on firms' poor complaint handling would produce incentives to limit unfairness for current and future consumers. Firms would be aware that unless they eradicate unfairness the FSA would be likely to punish such behaviour with a large fine at a future date. Thus, the lure of cutting corners or manipulation for short term profits would wane. That in turn would provide the credible deterrence or incentives the paper sets out to achieve through altering the complaint handling rules. That is the best means to change culture and ensure regulation focuses on outcomes and not processes.

c) More effective wider implications process linked to enforcement

Consumer Focus set out its proposals for the *Wider implications process* in its response to DP 10/1. We await the FSA/FOS/Office of Fair Trading (OFT) response to this discussion paper. Effective enforcement action would involve feeding complaints data back into the regulatory and enforcement system in a much more systematic, speedy and thorough manner than is currently the case. For example, the PPI case has taken years of investigations from a super-complaint by the Citizens Advice Bureau in 2005 and a Competition Commission referral, through to the current judicial review brought by the British Bankers Association (BBA). The FSA should now devote resources to improving this mechanism.

As an example of stronger action we would like to see:

- any firm which has more than 50 per cent of cases upheld against it at the FOS (and shows no sign of improving) should be subject to enforcement action
- immediate enforcement action where the FOS continues to see cases that show firms consistently failing to incorporate its decisions (for example on PPI). (We would hope the extra clarification for firms on their duties on root cause analysis and incorporating FOS decisions and FSA guidance under DISP should mean any breaches should immediately lead to enforcement action by the FSA)
- greater enforcement action on failure to comply with timelines that are explicit in DISP as the FOS continues to report many cases where consumers have failed to get a final response within eight weeks¹¹

d) Wider consumer engagement

According to the FOS, many consumers are actively put off by the attitude of, information from and delay by the banks which have an explicit incentive to actively discourage complainants. FOS data shows that of the consumer contacts it received as initial enquiries and complaints where consumers did not pursue their complaints, 41 per cent let the matter drop due to the difficulty of dealing with the financial firm involved.¹²

Credible deterrence means increasing the likelihood that this aspect of unfairness by the banks will be picked up by the regulator. It is clear many consumers fail to proceed with their complaint and therefore the FSA needs to think how else it can ensure fairness for consumers who suffer unfairness but do not pursue their complaint.

¹¹ Financial Services Ombudsman, *Annual review*, 2010, p24

¹² *Ibid*, p21

Research shows complaints are simply the tip of the iceberg when it comes to problems experienced by consumers. Personal experience, socio-economic status, empowerment etc all play a role in determining if consumers feel a complaint is worthwhile. According to Van Oseel around 9 per cent of all those who are dissatisfied complain, while Goodman and Grimm suggest between 4 per cent and 2 per cent of those with problems pursue a complaint.

According to Lunt, in a report for the OFT, a major reason for low complaint numbers is the negative psychological effects to complainants of complaining. Other research shows that those from lower socio-economic groups complain far less on average. Both the Scottish Consumer Council (one of our predecessor bodies) and the European Commission have found the likelihood of making a complaint is increased with the level of education. Thus, relatively few who are affected complain at all.

In the absence of continual monitoring of firms' behaviour in each and every case other means are needed to ensure compliance to DISP rules on complaint handling (in this case root cause, incorporating FOS decisions and remedying problems without consumers having to complain).

The problem is how to capture the difficult issue of consumer detriment. We also addressed this question in our recent report on *Regulating in the consumer interest*.¹³ Regulators should be proactive in capturing information through a range of analysis – including social science, social psychology, behavioural economics and mainstream data gathering.

Specifically, we believe the FSA needs to put greater effort into capturing consumers who have had problems but who have not pushed the decision through the established processes. Proactive research on these problems and consumers' view of the complaint process would achieve two things. Firstly, it would allow consumers to access fair, impartial and prompt redress if, after due consideration, their cases have merit. This could involve proactive contact using the FOS or bank data on complaint cases left unresolved to assess the quality of the complaint handling and decisions about the substance of the complaint in these cases. Secondly, it would provide the regulator with a fuller picture against which to assess the banks' compliance with their TCF duties and new and emerging risks.

Good communication between consumers and regulators and analysis and use of information available are essential in order to properly utilise these early warning mechanisms, as well as to ensure balance in the market and improve standards. Greater consumer engagement in customer charters; development and monitoring of complaint handling process; policy development; consumer research; monitoring and reviews informed by consumer views and experience; and consumer representation on internal (institutions and regulators) decision-making bodies are all areas where consumers can play a role.

However, it is likely that consumers will need to be assisted, encouraged and supported to do this and there are significant blockages at the regulators' level, particularly in the FSA, to this participation. The OFT utilises:

- broad stakeholder groups
- working groups between industry and consumers/consumer groups
- a consumer research base including qualitative market surveys
- and regular monitoring and review systems such as that used in the licensing process

¹³ Consumer Focus, *Regulating in the consumer interest*, Fresh thinking series, March 2010

The FSA is considerably more limited in its consumer engagement, information gathering and participation and is often regarded by consumer groups and consumers alike as impenetrable. The recommendations of the consumer engagement review need to be implemented as a matter of priority to reflect and reinforce the FSA's changing role.

As well as capturing information regulators also need to analyse it effectively and then act upon it through enforcement action to challenge systemic failures in the banks' processes. It is abundantly clear from this description that attempting to ascertain consumer detriment is no easy task and is extremely resource intensive. We would prefer the FSA to devote resources creating credible deterrence through greater knowledge of the detriment consumers' face and then enforcement action for poor practices rather than any further prescribing complaint handling procedures. We believe this offers the best means to alter the incentives firms face.

e) **Improved transparency to allow consumers to purchase financial products based on an assessment of firms commitment to TCF in complaint handling**

i) **Credible deterrent** – Consumer empowerment through *reputational regulation*

The FSA should provide more information during the course of an investigation about whom it is investigating and the reason for the investigation. Reputational regulation is a useful tool and incentive as well as providing information to consumers to guide their choices. The FSA should attempt to use section 349 of the Financial Services and Markets Act (FSMA) more proactively. If it still feels constrained it should proactively strive for greater freedoms as the FSA's responsibility on consumer protection migrates into the body provisionally called the Consumer Protection and Markets Authority (CPMA).

ii) **Make competitive pressure a driver for TCF**

Competition remains weak in the retail banking sector – meaning consumers are unlikely to shop around following a problem or a complaint. Lack of competition is currently failing to pressurise banks into taking complaints and their causes more seriously. Weak competition stops consumers 'voting with their feet' and switching in retail banking is too low to exert an influence as it has with other financial services.

Moves are afoot to improve competition which includes complaint handling data. This offers hope that information about firms' complaint handling could be taken into account when consumers make their purchasing decisions. The current results show that there is a great disparity between differing providers and even within banking groups. We hope consumers will take note of good and bad performers. Effective and comparable publication of complaint data could well be a determining factor when consumers shop around for a new provider and could therefore hit the bottom line of financial services providers.

Interpreting the data over time remains difficult due to how it is presented, with critical information missing. Moving forward the FSA and FOS can do far more to improve the data for both consumers and policy-makers alike to understand, in fine detail, how complaints and complaint handling are evolving.

We would like to see the following changes to the data to provide:

- information against market share to make better comparisons of performance. Calculate complaints based on the brand and not the legal entity so that consumers have data based on what they see offered on the High Street
- a comparison of each product and/or each cause of complaint and not general categories like 'credit and banking' that are simply too vague

- an average complaint handling time. A first step would be the publication of the percentage of complaints resolved at four weeks that the FSA already collects
- an understanding of the time-lag for complaints at various stages of the consumer journey, so changes in particular categories can be matched with actual events
- total redress paid per firm
- consistency of information, across the FOS, FSA, and the data published by the firms themselves
- complaints data at one day – we see no reason why information is not collected on those matters resolved by close of business on the business day following receipt (DISP 1.3.3 (2)). We do not have figures for the numbers of complaints that are not reported to the FSA, but the recent FSA review of complaint handling in banking groups found that the banks assessed resolved 60–80 per cent of all complaints within this timetable. Thus, these complaints do not show up on either the FSA or the FOS figures. This could be useful information with regard to overall complaints and the ability of firms to respond proactively to complaints. It would detail how well firms are meeting their duties to be responsive

Improving competitive pressures on banks is no easy task. As long as consumers remain reluctant to switch or complain, only strong and active regulatory pressure and enforcement action on unsafe products sold and unfair complaint handling can change the status quo. Otherwise the banks will continue to gain significant revenue from the unfair treatment of their customers and the majority of complaints will simply not be handled fairly.



Consumer Focus response to the FSA's review of complaint handling

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