

Pensions complaints and the Financial Ombudsman Service

Summary

The present institutional review by the Department of Work and Pensions (DWP) of the organisations involved in the regulation and protection of pensions has invited contributions from interested parties. This paper from the Financial Ombudsman Service (FOS) examines a range of factors that may be relevant to future judgements about how and where redress schemes in the pensions sector could be provided.

Powers of the Financial Ombudsman Service

FOS was established under the Financial Services and Markets Act 2000 (FSMA) as an independent body to resolve disputes between consumers and financial firms quickly and with minimum formality. It has replaced 11 previous statutory and voluntary redress schemes, and also extended redress to new areas. It currently has three jurisdictions, set up respectively under sections 226, 226A and 227 of FSMA (as amended by the Consumer Credit Act 2006):

- Compulsory jurisdiction. This applies compulsorily to around 21,000 financial services firms authorised by the Financial Services Authority (FSA), and includes consumer complaints about acts or omissions by these firms in relation to certain of their pension activities.
- Consumer credit jurisdiction. This opens on 6 April 2007 and will apply compulsorily to around 100,000 businesses licensed by the Office of Fair Trading (OFT) under the Consumer Credit Act 1974 (as amended), and covers consumer complaints about these businesses' consumer credit activities. However, if the licensee is also authorised by the FSA, its consumer credit complaints are covered instead by the compulsory jurisdiction.
- Voluntary jurisdiction. This applies voluntarily to financial businesses and activities that are not covered by the compulsory jurisdiction or the consumer credit jurisdiction, and covers consumer complaints about certain of these businesses' financial activities. This jurisdiction includes National Savings & Investments, among others.

The FOS thus covers businesses regulated by two different regulators – FSA and OFT – as well as covering some businesses (in the voluntary jurisdiction) covered by no regulator. One regulator – FSA – has statutory oversight of FOS and appoints its chairman and directors, but FOS is operationally independent and this has allowed FOS to take on wider jurisdictions that cover businesses which are not FSA-regulated.

Overlaps with the Pensions Ombudsman and gaps

There are currently overlaps and gaps between the jurisdictions of FOS and the Pensions Ombudsman (PO):

- FOS, under its compulsory jurisdiction, deals with consumer complaints about the regulated pension activities of firms authorised by FSA. These activities potentially

concern the sale or administration of personal pension schemes and related investments, and in some circumstances investments of occupational schemes.

- PO deals with complaints and disputes concerning the management of both personal and occupational pensions against the body responsible for management (including employers) regardless of whether the body is subject to regulation – by either FSA or the Pensions Regulator (TPR)).

The most significant overlap is that FOS and PO can both deal with complaints from individual consumers about the management of personal pensions by a provider firm. In an attempt to make matters simpler for consumers, a memorandum of understanding has been agreed between the two bodies. This states, in broad terms, that the PO deals with complaints predominantly about management of personal and occupational schemes and FOS deals with complaints predominantly about sales or marketing.

The memorandum of understanding has not provided a complete solution, as it removes neither the lack of clarity for consumers seeking redress nor the confusion amongst firms. Although the majority of complaints come initially to the right ombudsman, many do not. Each regulator requires signposting of complaints, but the requirements are not themselves consistent with the memorandum of understanding. The system thus relies on the wrongly signposted ombudsman transferring the case to the other. This does not imply unsatisfactory performance on the part of the signposting firms, as interpretation of the jurisdictional boundaries is complex.

The most significant gap relates to complaints about advice on transfers within and between occupational pension schemes. This gap exists because:

- FOS cannot deal with such complaints because (even if the advice was given by an FSA-regulated firm) the activity is not an FSA-regulated activity.
- PO cannot deal with them because they relate to advice about (rather than management of) a scheme.

Drivers for change

The existence of two distinct ombudsman schemes dates back to a time when occupational pensions (commonly, defined-benefit) and personal pensions (commonly, defined-contribution) were clearly distinguishable, and the market for each was different.

Now, employer-sponsored schemes are often group personal pensions (including stakeholder pensions) and are often defined-benefit. If, as seems likely, occupational scheme liabilities are increasingly sold to specialist insurers regulated by FSA, the distinction between the two types of scheme will become further blurred.

The current pension reforms, including the proposed introduction of personal accounts, are likely to complicate the situation still further. No doubt the review will be considering how future institutional arrangements in the pensions sector would be capable of resolving the issues outlined above as well as absorbing any new functions.

Capacity and capability

A number of additional factors may be relevant in considering the possible future arrangements:

- Expertise. FOS has 1,000 staff with a wide range of financial services expertise, ranging from the management of investments to their sale and marketing, as well as to other financial services areas such as insurance and banking. Some staff have professional linkages to the pensions institutions: FOS's lead ombudsman for pensions was formerly the casework director at PO, while another FOS ombudsman is currently a non-executive director at the Pensions Advisory Service (TPAS).
- Caseload: In 2005/6, FOS handled more than 600,000 enquiries and more than 110,000 cases. 4,053 of the cases related to personal pensions. Overall workload, however, is expected to decline in the coming years, as FOS's largest current commitment (mortgage endowment cases) declines significantly. There will, therefore, be capacity within FOS to absorb new work in the years ahead.
- Functions: FOS carries out triage and mediation functions as part of its normal case-handling process. In the workplace pensions sector these functions are often carried out by TPAS, after which cases are transferred to PO for investigation, so that consumers deal with two organisations rather one.
- Outreach: FOS's external liaison work in 2005/6 included: answering more than 20,000 enquiries to our technical advice desk (for businesses providing financial services and for consumer advisers); publishing ten copies of *Ombudsman News*; speaking at more than 130 conferences and training workshops; dealing with 3,500 calls from the media; and issuing more than 2,500,000 leaflets and other publications.
- Unit cost. The wide remit and high caseload of the FOS brings economies of scale. In 2005/6 the average cost of the 119,431 cases closed by the FOS was £433. This unit cost figure includes the cost of FOS's outreach work and of the triage and mediation work that the PO does not carry out. This figure is expected to rise gradually in the coming years as the mortgage-endowment workload declines. The FOS's pension cases are probably more resource-intensive than the FOS average.
- Service standards. In 2005/6, the FOS resolved 74% of non-mortgage endowment cases within six months and 89% within 12 months, and is looking to improve on this in 2006/7.

The economies of scale at the FOS enable it to deliver a range of services and a unit cost that smaller ombudsman schemes are inherently unable to deliver.

Taking into account all these factors, and the greater clarity it would provide for consumers and for pension providers and advisers, it could be argued that there is a public interest case for the merger of the pension functions of the FOS and the PO into a single "pensions jurisdiction" alongside FOS's other three jurisdictions.

This would be consistent both with Hampton principles (which encourage the joining up of service providers) as well as with the Transformational Government agenda (which encourages sharing the delivery of public services). It could also include the transfer of the triage and mediation functions of TPAS into the FOS, thus ensuring consistency in the business processes between the pensions jurisdiction and other jurisdictions, and single-point access for users.

Detailed issues

There are a number of differences of detail between the current statutory arrangements for FOS and PO. Creation of a unified pensions jurisdiction would require those differences to be considered, and suitable solutions or compromises reached. Although some of the current differences seem significant, they are all potentially capable of resolution or compromise.

There is a recent precedent for this under the Consumer Credit Act 2006 which amended FSMA in order to establish FOS's consumer credit jurisdiction. Although many elements of that jurisdiction resemble FOS's compulsory jurisdiction, certain elements of it are unique in order to reflect differences in the consumer credit landscape. The same principle could apply in the creation of a bespoke pensions jurisdiction.

The table in the Annex outlines the main differences between the current statutory arrangements for the FOS and the PO (in rough order of significance), and suggests how solutions might be reached for each under a unified pensions jurisdiction.

Transition

Primary legislation would be needed to deliver a unified pensions jurisdiction, both to repeal certain dispute-resolution provisions in the existing Pensions Acts and related statutory instruments and to create a pensions jurisdiction under FSMA. A suitable primary-legislative vehicle is likely to arise in the second pension reform Bill expected in the Queen's Speech later this year. It is likely, however, that many of the detailed issues outlined above could be resolved in subsequent delegated legislation and regulator's rules.

In the meantime, there is potential for an FOS ombudsman to be appointed as successor to the current Pensions Ombudsman when he retires in autumn 2007 and, if needed, for secondment of case-handling and managerial staff. This would follow the precedent established with National Savings & Investments, where an FOS ombudsman was appointed as Adjudicator until that statutory post could be abolished, at which point National Savings & Investments joined FOS's voluntary jurisdiction.

Conclusion

There appears to be an arguable case in the public interest for the merger of the pension functions of FOS and PO into a bespoke pensions jurisdiction within FOS – provided this does not involve changes to the successful and efficient business model already operated by FOS's existing three jurisdictions.

Although there are currently some differences between the FOS and PO in the way that their respective schemes are constituted, the differences are potentially soluble. If the review were to conclude that a merger would be appropriate, some further work would be needed on the potential solutions before consultation took place and legislation to deliver this was drafted.

**Financial Ombudsman Service
February 2007**

Annex:

Pensions complaints and the Financial Ombudsman Service: detailed issues

The following table outlines the main differences between the current statutory arrangements for FOS and PO (in rough order of significance), and suggests potential solutions for each under a unified pensions jurisdiction.

<i>Difference</i>	<i>Potential solution</i>
Regulation	
<p>Financial services firms subject to the FOS's compulsory jurisdiction are regulated by FSA.</p> <p>Many bodies covered by PO are unregulated: there is no relationship between regulation and PO jurisdiction, though some bodies are regulated by either FSA or TPR.</p>	<p>The current jurisdictions of FOS are already wider than the regulatory functions of FSA.</p> <p>The consumer credit jurisdiction covers businesses regulated by OFT rather than FSA. The voluntary jurisdiction covers some businesses regulated by neither FSA nor OFT.</p> <p>PO jurisdiction is also detached from regulation.</p> <p>Thus decisions on which bodies should regulate pensions in future need not affect, nor be affected by, a decision to create a unified pensions jurisdiction.</p>
Governance	
<p>FSA currently:</p> <ul style="list-style-type: none"> ○ appoints FOS's chairman (with Treasury approval) and directors, and approves FOS's annual budget; ○ makes rules on the scope of, and complaint-handling by firms covered by, the compulsory jurisdiction; ○ approves FOS rules on the scope of, and complaint-handling by businesses covered by, the consumer credit and voluntary jurisdictions; ○ approves FOS rules on the procedures applied in all three jurisdictions. <p>DWP ministers appoint the Pensions Ombudsman. The scope and procedures of PO are set by statute under the responsibility of DWP ministers.</p>	<p>If there were a unified pensions jurisdiction, it would be important to retain relatively streamlined governance arrangements, including a single Board for FOS.</p> <p>FOS's chairman and directors could, as now, be appointed by FSA. Rules on scope could be set by FSA, or by FOS with FSA approval. It is for consideration whether there should be some input by DWP or TPR in relation to these appointments and/or rules.</p> <p>Detailed rules on FOS procedures could, as with the FOS's three current jurisdictions, continue to be set by FOS with FSA approval.</p>

Difference	Potential solution
Funding	
<p>FOS's compulsory jurisdiction is funded partly by an annual weighted levy on FSA-regulated firms (collected by FSA) and partly by case fees charged to firms with more than two complaints per year resolved by FOS (collected by FOS).</p> <p>FOS's consumer credit jurisdiction has a similar case fee system, although it has a five-yearly flat rate levy collected by OFT from standard licensees.</p> <p>FOS's voluntary jurisdiction has a similar case fee system, coupled with a yearly levy (collected by FOS).</p> <p>PO is funded by DWP grant in aid, with pension schemes subject to a levy collected by TPR.</p> <p>PO funding counts as public expenditure, but FOS funding does not.</p>	<p>There may be attractions in excluding the funding of a unified pensions jurisdiction from the definition of public expenditure.</p> <p>There may, in principle, be public interest attractions in introducing a "user pays" element through case fees – though that would not be an essential.</p> <p>That said, as with the existing three jurisdictions, any funding system for a pensions jurisdiction could reflect the particular needs of the sector.</p> <p>The position of certain non-profit making pension bodies (e.g. trustees) would need to be catered for and appropriate derogations provided – as they are for analogous bodies under FOS's existing jurisdictions.</p>
Judicial review/external appeal	
<p>FOS has a two-stage decision process. If either party does not accept the adjudicator's decision they can ask for it to be reviewed by an ombudsman, who will reconsider the evidence from the outset together with any additional evidence and arguments provided – in effect, providing an internal appeal stage.</p> <p>FOS ombudsman decisions are binding if accepted by the consumer, but can be judicially reviewed on the usual grounds – including alleged error of law. The consumer retains the theoretical possibility of rejecting the decision and pursuing the complaint through the courts, but this is a very rare occurrence.</p> <p>PO determinations are automatically final and binding on both parties, but are subject to external appeal to court on points of law (or judicial review otherwise).</p>	<p>In relation to FOS, the issue of external appeals was considered by the government when FSMA was enacted and was also considered as part of the FSMA two-year review.</p> <p>The conclusion was that judicial review (which can deal with errors of law and of procedure) provides an adequate safeguard, and benefits from a 'leave' stage which acts as an early hurdle to fanciful applications.</p> <p>A 'test case' procedure was also introduced, so that the ombudsman could agree to a significant and purely legal issue being referred to court.</p>

Difference	Potential solution
Awards	
<p>FOS can award compensation up to a limit set by FSA (currently £100,000) plus interest and/or direct the business to take specified steps in relation to the consumer (no financial limit).</p> <p>PO can make unlimited awards, and many awards do significantly exceed £100,000.</p>	<p>Although the nature of pensions arguably makes it fair that awards can be made significantly higher than £100,000, an increase in this limit for FSA-regulated firms not already covered by PO's jurisdiction would be controversial.</p> <p>Compromises for a unified pensions jurisdiction might involve, for example:</p> <ul style="list-style-type: none"> ○ application of a compensation limit (whether of £100,000 or some higher figure) in combination with the power to make directions; or ○ additional formalities attending an ombudsman's decision that involves an amount above a specified limit (whether of £100,000 or some higher figure).
Basis of decision	
<p>FOS decides complaints on the basis of what is "fair and reasonable in all the circumstances", although it is required to take into account the law, relevant regulations, regulator's rules and guidance and good industry practice.</p> <p>PO decides complaints of maladministration and points of law – there is no "fair and reasonable" test.</p>	<p>The "fair and reasonable" test does not in practice produce a different result in pension cases where the law is clear. The "fair and reasonable" test – also proposed by the government for the new statutory Office of Legal Complaints – could therefore be applied across all cases with little difference.</p>
Parties	
<p>FOS deals with complaints by consumers (which can include very small businesses) against financial businesses. The consumer is often a customer of the financial business, but FOS deals with a range of other relationships.</p> <p>PO deals with disputes involving a wider range of parties and relationships e.g. among schemes, trustees, employers and consumers.</p>	<p>Complainant eligibility rules for a pensions jurisdiction could be created that differ from those for FOS's existing jurisdictions in order to include all the types of dispute that are currently dealt with by the PO.</p> <p>There are already differences between those eligible under the three existing jurisdictions.</p>

<i>Difference</i>	<i>Potential solution</i>
Time limits	
<p>FOS has a time limit for complaints of six years from the event or (if later) three years from awareness of a cause for complaint. The complaint must be referred to FOS within 6 months of the business sending the consumer a final response to the complaint, which must tell the consumer about the 6-month time limit and enclose an FOS complaint form.</p> <p>PO has a time limit of three years from the event or (if later) awareness of it, and has no “final response” provisions.</p>	<p>Harmonisation of these provisions would improve transparency for consumers and be administratively preferable were a pensions jurisdiction to be created.</p> <p>A change from three to six years from the event for PO cases would align more closely with the position in court. In practice, it is often the limit of three years from awareness that is relevant.</p>
Enforcement	
<p>FOS awards are enforceable in the courts. Additionally, in practice, the relevant regulator can take enforcement action.</p> <p>PO decisions are enforceable in the courts, but there is no equivalent possibility of regulatory action.</p>	<p>In both instances, awards are enforceable through the courts.</p> <p>Whether decisions under a pensions jurisdiction could also be the subject to enforcement action by a regulator would depend on wider decisions about the regulatory regime.</p>

The handling of pension complaints involving FSA-regulated firms would need to be considered. These could be handled in one of two ways.

- One way would be to limit the existing compulsory jurisdiction to non-pension cases and make FSA-regulated firms subject to the pensions jurisdiction for their pension cases.
- The other way would be to subject them solely to the compulsory jurisdiction, which would be extended to include all an FSA-regulated firm’s pensions cases.

The choice between the two would depend on how significant the differences were between the compulsory jurisdiction and the pensions jurisdiction. It would, for example, be inappropriate for a consumer’s pensions complaint to be subject to a different award limit simply on the basis of whether the respondent was, or was not, an FSA-regulated firm.

This issue was recently considered analogously in relation to the consumer credit jurisdiction. In that case the differences between the two jurisdictions were small, and so it was considered simpler for both firms and consumers to cover all an FSA-authorized firm’s complaints (consumer credit or otherwise) within the compulsory jurisdiction alone.

It would be important to ensure that there were consistency and transparency for the users of a unified service and that businesses do not pay two levies for the same activity.