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AFM Response to FOS consultation on 2022/23 plans and budget

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the proposals, and their consequences for AFM members and their customers.
 - Reinforce our concerns about the proposed reduction in free cases.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of £19.6 billion, and employ nearly 30,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

¹ ICMIF, <https://www.icmif.org/publications/market-insights/market-insights-uk-2016>

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

³ <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

AFM comments on the proposals

4. We welcome the opportunity to respond on this consultation. As the introduction makes clear, FOS considers this is a pivotal year for the organisation, and for those of us that have worked with the Service throughout its 20 years, it is fair to say that this is not the first pivotal moment it has experienced.
5. The challenge though is not to set a budget to ensure that the financial consequences of change are felt as little as possible, but to establish the right size for the organisation for the future, and to re-set finances to fit that. Also, we see signs in the budget of a shift away from the polluter pays principle in some of the proposals, and we regard this as a source for concern.

Reducing the number of free cases

6. This is best evidenced by the proposal to reduce the number of 'free' cases, from 25, to three. We consider that this will penalise firms who have a strong regulatory focus, and who in the course of processing many thousands of customer interactions or transactions each year, unavoidably receive a small number of complaints, most of which are not upheld. As well as penalising compliant organisations, we also consider that this proposal would result in an unintended change in behaviour in organisations, which may not always be good for consumers.
7. The monetary value of many products offered by AFM members is low, though their value in providing reassurance, and in helping to attain a better future is significant, as the focus of the sector is on serving less affluent consumers. This is recognised by the FCA, who in its recent fees consultation, confirmed that it was retaining a special concession of the minimum fee for small mutuals (and credit unions), due to their social purpose. In the case of many AFM members, the social purpose means having lots of small value policies, minimum premiums below £10 a month, and supporting members at times of hardship, not just when they need to make a claim.
8. To illustrate, most complaints relating to health cash plans concern disputes over claims, most of which are less than £100 in value: it does not make commercial sense to defend a complaint, where the amount at dispute is less than a tenth of the adjudication fee. As a result firms are likely to simply settle the claim regardless of its merits; therefore the number of claims and complaints will increase, and the costs of the business and therefore the premiums of the customer will increase,

intensifying the risk that more people in deprived circumstances fail to protect themselves.

9. From the FOS perspective, this is likely to reduce the number of simpler complaints it is asked to adjudicate on, invalidating some of your budget assumptions, and potentially increasing the future cost of cases further. We responded on this proposal previously, and suggested that the lack of modelling on the effects of the proposed changes meant that the case for reduction was unproven and not persuasive.
10. We do not see any stronger case made now, and we suggest that the reduction is shrunk, to say, 10 free cases, and that the gap in funding is made up by reducing the number of free cases for Groups, to zero, since for most groups the volume of complaints means the free cases have no noticeable financial impact.

Complaints trends

11. We have not seen an increase in the likelihood of complaints in the product areas (mainly insurance) offered by our members. Some of the factors put forward in pages 11 and 12 may take some time to come to fruition, or given the pace of economic recovery, fall away. As mentioned above, the reduction in free cases will cause firms to settle issues early, and we think this will reduce complaints volumes in insurance.
12. From experience, inflationary risks in the economy may affect a range of product areas, including banking and credit products, as people's finances come under pressure, and investments, if performance is affected.

Comments on the draft Budget

13. The inexorable increase in the cost of FOS is a result of many things, mostly outside the control of the Service. We also recognise that today's budget is being subsidised by reserves built up in the past, and this approach is not sustainable for the long-term. We therefore welcome the change programme, where an increase in productivity of 25% is planned by 2023/24: this is the most significant factor in achieving a more balanced budget in the future, especially if it resolves the very heavy reliance retained by FOS on expensive contractors (£50 million in 2022/23).
14. Whilst case numbers are expected to reduce slightly, total spending is expected to increase from around £250 million, to £294 million, an 18% increase. That results in an expected 20% increase in the unit cost of

complaints, to £1,270: which means FOS is now a long way from the 'cheap and cheerful' service it was intended to be 20 years ago.

15. The levy increase is significantly ahead of inflation, and the change in the number of free cases is predicted to see three times as many firms pay for cases in 2022/23. Overall therefore, more firms will be seeing larger bills for FOS, and with other regulatory cost increases, we expect this might hasten the demise of some, otherwise viable, businesses.

16. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,



Martin Shaw
Chief Executive
Association of Financial Mutuals