

FSA consultation paper 12/9

Consumer redress scheme in respect of unsuitable advice to invest in Arch cru funds

Response from the Financial Ombudsman Service

Glossary

- 1 In this response:
- Arch cru funds = CF Arch cru Diversified Funds and CF Arch cru Investment Funds
- Capita = Capita Financial Managers Limited
- FSMA = Financial Services and Markets Act 2000 (as amended)
- HSBC = HSBC Bank plc
- Mellon = BNY Mellon Trust & Depositary (UK) Limited
- ombudsman service = Financial Ombudsman Service
- payment scheme = a payment scheme established on 31 August 2011 by voluntary variations of permission in respect of Capita, Mellon and HSBC.
- section = a section in FSMA

Summary

- 2 FSA has consulted the scheme operator of the ombudsman service about the proposed consumer redress scheme as required by section 404(9). The ombudsman service has no objection to the proposed consumer redress scheme. Its approach is not significantly inconsistent with that adopted by the ombudsman service.
- 3 The ombudsman service draws particular attention to three particular issues that may cause problems in practice. There are also some technical drafting points in the appendix to this response.
- § The first particular issue is the complexity of the inter-relationship between redress payable under the proposed consumer redress scheme and redress payable under the existing payment scheme – especially if the closing date of the existing payment scheme is not extended and some consumers experience a deduction for money they have not had.
- § The second particular issue is the potential that significant number of consumers will have to refer cases to the ombudsman service to secure the appropriate outcome under the consumer redress scheme, if FSA is unable to ensure that firms faithfully follow the terms of the consumer redress scheme.
- § The third particular issue is the provision that, if the firm is unable to contact the investor, the investment falls outside the scope of the scheme (and hence outside section 404B) even if the investor later comes forward – raising the potential for alleged inconsistency of outcomes.

Existing payment scheme

- 4 The payment scheme provides £54 million to reduce the loss by investors in the Arch cru funds. Other than in exceptional circumstances, investors in the Arch cru funds have until 31 December 2012 to apply to the payment scheme.

- 5 If investors accept a payment under the payment scheme, they must do so in full and final settlement of any claim against Capita, Mellon, HSBC and their respective groups – but investors are not prevented from seeking redress from others.
- 6 FSA chose to use its powers under section 404F(7) to apply section 404B, so that the ombudsman service is required to follow the rules of the payment scheme when assessing complaints made to it after 31 August 2011 against Capita, Mellon and HSBC concerning the Arch cru funds.

Proposed consumer redress scheme

- 7 FSA's April 2012 consultation paper CP12/9 consults about a proposed consumer redress scheme under section 404 affecting distributor firms that made a personal recommendation to consumers to invest in the Arch cru funds.
- 8 One effect of the proposed consumer redress scheme would be to automatically apply section 404B, so that the ombudsman service would be required to follow the rules of the consumer redress scheme when assessing complaints within the scope of the scheme.

Cases against distributors

- 9 Cases received by the ombudsman service are recorded against the identity of the firm involved, not the investment involved. So it has been necessary to collate manually data relating to cases against distributors in respect of the Arch cru funds. So the following data are approximate:
 - § 316 such cases have been received by the ombudsman service.
 - § 62 of these were passed on to the Financial Services Compensation Scheme.
 - § 35 were upheld in favour of the consumer.
 - § 5 were not upheld in favour of the consumer.
 - § 214 remain under investigation and consideration.
- 10 The ombudsman service considers each case on the basis of its individual merits. But we invite FSA to note the example ombudsman final decision that we have published in order to illustrate for consumers and firms our likely approach to such cases.*
- 11 We consider that the approach taken by the proposed consumer redress scheme is broadly in line with the approach the ombudsman service has taken to determining liability (including our view of the risks associated with the Arch cru funds) and to assessing loss – though there are some differences in the precise method of calculating compensation.

Implications of the proposed scheme

- 12 The ombudsman service confirms that FSA has consulted the scheme operator as required by section 404(9). The ombudsman service has no objection to the proposed consumer redress scheme.
- 13 In calculating loss and redress, there is a complex inter-relationship between the proposed consumer redress scheme and the existing payment scheme. This may cause practical issues in resolving cases. That is especially so if the closing date of the existing payment scheme is not extended beyond 31 December 2012, as the consumer redress scheme is to run on after then – and consumers may experience a deduction for money they have not actually received.
- 14 The effectiveness of the scheme is likely to depend upon FSA being in a position to deploy sufficient supervisory resources to ensure that firms faithfully follow the terms of the proposed consumer redress scheme. Otherwise, a significant number of consumers may have to refer

* www.financial-ombudsman.org.uk/publications/technical_notes/archcru-final-decision-feb12.pdf

complaints to the ombudsman service to secure the appropriate outcome under the consumer redress scheme.

- 15 The draft rules provide that, if the firm is unable to contact the investor, the investment falls outside the scope of the scheme. This means that, if the investor later comes forward and refers a complaint to the ombudsman service, section 404B does not apply – raising the potential for alleged inconsistency of outcomes.
- 16 Additionally, there are some technical drafting points in the appendix to this response.

Appendix

- A CONRED 2 Annex 1R and CONRED 2 Annex 7 section 10; definitions of 'suitable investment':
To avoid uncertainty and dispute, it would be helpful to amend along the lines of "an investment, identified under paragraphs 10.9R to 10.12G, in which the Consumer would have invested if the Firm had complied with the Suitability Requirements and other requirements applicable to it at the time in the Redress case."
 - B CONRED 2 Annex 7: 10.4R(2)(d) and 10.13G(3):
We understand FSA's policy intention is that these provisions should apply where: the consumer did not receive the offer under the existing payment scheme; and where the consumer is not eligible because he/she rejected (or failed to accept in time) the offer under the existing payment scheme. To avoid uncertainty and dispute, it would be helpful to make these explicit.
 - C CONRED 2 Annex 7: 10.9R(4):
It would be helpful if this required the firm to record its reasons for selecting an alternative to one of the benchmarks. As well as assisting in resolution of cases that are referred to the ombudsman service, this would encourage the firm to take the matter seriously and would help minimise evasion.
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