

STATES OF JERSEY



FINANCIAL SERVICES OMBUDSMAN SCHEME: REPORT

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by the Minister for Economic Development**

STATES GREFFE

FINANCIAL SERVICES OMBUDSMAN SCHEME – REPORT

1. Introduction

- 1.1 For some time, consideration has been given to the introduction of a Financial Services Ombudsman Scheme in Jersey. This was one of the recommendations made in 1999 in the 1999 Edwards Review, and was a matter consulted upon by the Jersey Financial Services Commission (the **Commission**) in March 2000.
- 1.2 Since then, progress on the introduction of an Ombudsman Scheme has been sporadic. In October 2002, the Commission drew up proposals for an Ombudsman Scheme and in 2004, the Economic Development Committee made a bid for law drafting time for the introduction of an Ombudsman Scheme within the 2005 Law Drafting Programme. This bid was unsuccessful. In September 2005 Deputy Alan Breckon lodged an Amendment to the States Business Plan 2006-2010 in which he sought to make time available in the 2006 Law Drafting Programme for legislation introducing an Ombudsman Scheme. At the time that matter was placed before the States, the President of the Economic Development Committee undertook to consider the matter further and report back to the States.
- 1.3 The purpose of this Report is to describe in broad terms the likely nature of an Ombudsman Scheme and the options that are available should the States wish to implement an Ombudsman Scheme. The Report then makes some tentative recommendations in relation to how this issue should be progressed. If the States is of the view that it would wish to explore the option of an Ombudsman Scheme further, a public consultation should then be carried out to better determine the appetite for, and preferred scope of such a scheme, before a final decision is made whether to progress the scheme and if so, in what manner.
- 1.4 There are perhaps two matters that should be emphasised by way of introduction. Firstly, should the States decide to introduce an Ombudsman Scheme, complete freedom exists to design that scheme in a manner appropriate to Jersey. Although a number of other jurisdictions have similar schemes, the Island would begin with a blank sheet of paper when designing its own Ombudsman Scheme. There has perhaps been an assumption that such a scheme would be limited to matters broadly in the sphere of financial services. There is, however, no *prima facie* reason why a scheme needs to be limited in such a manner, though this report will largely confine itself to considering the introduction of a scheme limited to complaints arising in relation to financial services.
- 1.5 Secondly, an Ombudsman Scheme will require ongoing funding. Potential sources and estimated levels of funding will be discussed in this report. However, every decision made in relation to the structure of an Ombudsman Scheme will have a funding implication.

2. The Purpose of an Ombudsman Scheme

- 2.1 The purpose of an Ombudsman Scheme is to provide an alternative form of dispute resolution to those offered by the courts. It is often argued that an Ombudsman Scheme offers three advantages over legal redress sought through existing litigation procedures: it should be cheaper, quicker and more accessible.
- 2.2 The UK Financial Ombudsman Service is established by statute, which describes it as “a scheme under which certain disputes may be resolved quickly and with minimum formality”. A more cynical observer might suggest that another key aim of such schemes is to restrict the scope for one party to a dispute – usually the wealthier party that is the subject of the complaint – to obstruct the speedy resolution of the complaint through the use of “tactical” litigation.
- 2.3 The scheme operates by allowing disputes that meet certain criteria to be adjudicated by an Ombudsman, an individual appointed for his or her knowledge and experience within the field in which the dispute arises. One of the chief advantages of an Ombudsman Scheme is the experience of the Ombudsman in his or her chosen field and in relation to similar disputes. Before a matter is referred to the Ombudsman, however, it is usual for such schemes to include processes designed to find a negotiated settlement

between complainants. The experience of other Ombudsman Schemes suggests that the majority of disputes are resolved without formal adjudication.

- 2.4 It should also be noted at the outset that an Ombudsman Scheme has limitations. There are a number of disputes that it would not be appropriate to refer to an Ombudsman. High value disputes and disputes that raise novel or difficult questions of law should more properly be considered by courts. There is, however, no doubt that for claims in relation to moderate or relatively low sums of money, particularly where the claims arise in areas of a technical nature, Ombudsman Schemes have, in other jurisdictions, proved popular with complainants who otherwise might feel that redress would be impractical or unaffordable.
- 2.5 An Ombudsman Scheme would complement, but in no way duplicate, the work carried out by the Commission. The Commission is a regulator, and its function is to regulate those providing certain defined financial services from within the Island. It will license and supervise financial services businesses and may investigate claims made against such businesses. In investigating such complaints the Commission's focus will be on the governance of the financial services business, and whether the complaint reflected a failure in the management or processes of the business that should be addressed in order to protect the Island's reputation. The Commission's function is not to act as an adjudicator or mediator between a complainant and a financial services business, and the Commission has no powers to order a financial services business to offer redress to a customer in respect of a specific complaint.
- 2.6 It has been argued that an Ombudsman Scheme has the effect of increasing confidence in the provision of financial services generally, and thus indirectly leads to growth of the financial services sector. It is hard to find any evidence to either support or disprove this proposition, suggesting that any impact is unlikely to material.
- 2.7 The degree to which any particular Ombudsman Scheme succeeds in providing a form of dispute resolution that is quicker, cheaper and more accessible than other remedies depends upon the design and efficiency of that scheme. The advantages offered are also dependent upon the cost, speed and accessibility of existing litigation and court procedures. In short, the value of an Ombudsman Scheme is equivalent to the degree to which it offers a form of dispute resolution that is more attractive to complainants than that currently offered by the established legal system (comprising the legal profession and the courts). This is a matter discussed in further detail towards the end of this report.

3. The Scope of an Ombudsman Scheme

- 3.1 The scope of an Ombudsman Scheme can be defined as the criteria which a claim must satisfy in order to be eligible for referral to the Ombudsman. By widening the scope of an Ombudsman Scheme, the number of claims referred to the scheme is likely to increase, as is the likely cost of funding the scheme. This raises an inherent friction that exists in any scheme of this nature: the success of the scheme (judged by the number of complaints it receives and resolves) and the costs of the scheme will tend to rise and fall together. Assuming that it is necessary to restrict the costs of the scheme, it is necessary to ensure that the scheme is restricted to resolving those disputes that are most in need of a form of alternative resolution.
- 3.2 There are at least three obvious ways in which the scope of an Ombudsman Scheme can be regulated:
- by reference to the subject matter of the complaint;
 - by reference to the amount that the ombudsman can award in compensation; and
 - by reference to the degree to which the complaint is connected with Jersey.
- 3.3 As mentioned in the introduction to this report, most comment in relation to the establishment of an Ombudsman Scheme in Jersey has focussed on the creation of a financial services ombudsman. Careful consideration is needed as to whether this is appropriate. In general, an Ombudsman Scheme will be attractive in circumstances where there is a significant disparity in the financial resources available to each side of a complaint. This is certainly the case in disputes between a private individual and a financial

institution. It could equally be argued that the same disparity exists in disputes between private individuals and utility companies or States departments, and there may be any number of other areas where an Ombudsman Scheme may be attractive.

- 3.4 “Financial Services” encompasses a wide range of commercial activity, and consideration must be given to which areas of financial services should be capable of providing the basis of a claim to the Ombudsman. In practice, limiting the maximum amount the ombudsman can award in compensation is likely to lead to few claims being made in relation to certain areas of financial services activity – such as disputes relating to securitisation or commercial lending.
- 3.5 As well as determining the type of subject matter that can be the subject of a complaint, careful consideration should be given to whether a specific Ombudsman Scheme should be created for a defined class of subject matter, or whether the legislation should facilitate the creation of Ombudsman Schemes generally, so that additional schemes could be subsequently created if it was felt desirable to extend the subject matter of complaints that could be made to an Ombudsman.
- 3.6 A further way of regulating the level of complaints is to exclude claims above a certain amount from access to the Ombudsman Scheme. There are several reasons for this approach: the larger a dispute, the less likely it is that legal costs will prove a barrier to litigation, the more likely it is that the complainant will be able to fund such litigation and the more important it is that each side to the dispute feels able to have the matter resolved by the formality of a court hearing.
- 3.7 In the UK, the Financial Services Ombudsman Scheme is only able to make compensation awards up to £100,000 in value. The same restriction applies in the Isle of Man. This restriction appears to operate without comment, and it is suggested that there is no reason why a similar approach should not apply in Jersey. Clearly, such a restriction means that disputes in relation to a sum exceeding this value are not referred to the ombudsman.
- 3.8 Limiting access to the scheme by reference to degree to which the complaint is connected with Jersey is the final obvious way of limiting the scope of the scheme. It is clear that the Ombudsman should only adjudicate complaints that have some form of connection with Jersey. The precise degree of connection that is sufficient to bring a matter within the Ombudsman’s ambit is not so clear.
- 3.9 The connection with Jersey is strongest in circumstances where a complaint arises between two Jersey residents in relation to a matter governed by Jersey Law. The nexus is weaker when only one of the parties to the complaint is Jersey resident. When neither party to the complaint is resident but the complaint is governed by Jersey law, the connection is still weaker. Finally, it is clear that disputes between two non-residents in relation to a matter that is not governed by Jersey Law would be expected to fall outside of the scope of the scheme.
- 3.10 There are other ways in which the scope of the scheme could be limited, such as subjecting complainants to a form of means-testing so as to ensure that they are unable to fund litigation themselves. Such approaches could be explored further in any subsequent consultation paper.

4. Models in other jurisdictions

- 4.1 There are two clear models for establishing an Ombudsman Scheme: those provided in the Isle of Man and in the UK. Guernsey has formally confirmed that it does not intend to introduce an Ombudsman Scheme in the foreseeable future.
- 4.2 The UK model is of limited assistance when considering a potential Jersey scheme. The reason for this is simply that the financial services industry in the UK is vastly bigger than that in Jersey and is broadly aimed at servicing the domestic market. The scheme receives over 100,000 complaints a year, has over 950 staff, around 30 ombudsmen, and is funded by a combination of levies upon financial services products (for example, around 0.3p per bank account), and by fees levied upon firms that are the subject

of complaints. The sheer size of the UK scheme, the economies of scale that exist and the degree to which its financial services industry primarily serves a large resident population, makes it difficult to draw conclusions from the UK model that could assist in the creation of a Jersey scheme.

4.3 The experience of the Isle of Man Financial Services Ombudsman Scheme is more relevant. Like Jersey, the Isle of Man is an island with a financial services industry that caters primarily (in financial terms) for an international market. Nevertheless, the financial services industry in both Jersey and the Isle of Man also provide services to residents, and the importance of this aspect of the industry should not be overlooked. Although it is difficult to give precise comparisons due to the different areas of financial services in which Jersey and the Isle of Man are each particularly strong, the industry in Jersey is generally regarded as being about three times the size of that in the Isle of Man, suggesting that if the Isle of Man approach was followed, a comparable Ombudsman Scheme would be about treble the size.

4.4 One difficulty with drawing lessons from the Isle of Man Ombudsman is that the last annual report published by the scheme was for the year 2003/4. Since then, the Ombudsman has published information as part of the Isle of Man Office of Fair Trading. Unfortunately, this information is nowhere near as complete as that published in the 2003/4 report, so this has been the main source of information used in respect of the Isle of Man scheme.

4.5 The Isle of Man scheme is open to individuals, partners of partnerships and sole traders (but not companies) with a complaint against financial services supplied by a firm operating in or from the Isle of Man. According to the 2003/4 report, of the complaints made to the Ombudsman, 6% were made by Isle of Man residents and 94% by international clients of the Island's financial services industry. The number of initial contacts received by the ombudsman increased by 32% between 2002 and 2003, and the number of formal complaints by 41%. In a press release issued on 14th April 2003, the following summary of the schemes first year is included:

“In 2002 the Ombudsman Scheme received 400 initial contacts which resulted in 273 potential complaints...”

Of the complaints received, 54 were outside the jurisdiction of the Scheme and a total of 57 complaints were completed in the year. The majority of the complaints were resolved at the first stage of mediation and conciliation by the Office of Fair Trading Staff and 22 received full determination by an Adjudicator (or ‘ombudsman’). While most of the 22 were upheld either in full or part, most of the sums awarded were usually modest (£600 or less), and in nearly every case included an element in respect of distress and inconvenience suffered...”

4.6 In the Isle of Man Office of Fair Trading Annual Report 2004 the following comment is made in relation to the failure of the Ombudsman to reach its target of completing mediation within 6 months in 90% of all cases referred to it:

“During the year the office received 521 enquiries of which 316 became formal complaints...the Office concluded 350 complaints during this year compared with 117 in the previous year but, as a consequence of the carry-over from the previous year and the increased number received this year, only 60% of complaints resolved were completed within the six month target. The target has not been met and with increasing numbers of complaints it will have to be reviewed as it is considered unattainable with current staffing numbers.”

4.7 There is a clear disparity between the number of claims concluded in 2004 (350) and the number that received full determination by the ombudsman in 2002 (22). Part of the difference is explained by an increase in the number of complaints received between those years. The greater part of the difference results from the large proportion of complaints that are resolved or withdrawn during the mediation stage prior to a matter being referred to the ombudsman for final determination.

4.8 It is clear from the above that the Isle of Man Ombudsman, which at that time comprised a panel of five adjudicators and around two full time case officers, was struggling to keep pace with the level of cases

referred to it. It is difficult to ascertain the precise costs of the Isle of Man scheme, as it is accounted for as part of the OFT's general budget, and the costs of staff and premises in the Isle of Man are unlikely to be directly comparable with those in Jersey. It is important to emphasise that the Isle of Man scheme is centrally funded by the Isle of Man Government.

4.9 Nevertheless, the following important facts emerge from consideration of the Isle of Man Scheme:

- 94% of complaints were received from non-residents;
- the average compensation award was small (in 2003, around £600 on average)
- the number of complaints received by the scheme was increasing
- the costs of running the scheme were increasing.

5. Alternatives to an Ombudsman Scheme

5.1 The purpose of an Ombudsman Scheme is to provide an alternative to existing methods of resolving disputes. Whether there is a need for an Ombudsman Scheme therefore depends upon whether existing methods of resolving disputes are unsatisfactory.

5.2 The Isle of Man scheme shows that the average compensation resulting from a decision made by the ombudsman is comparatively small. The legal costs of any dispute that goes to litigation are likely to significantly exceed the amount of the dispute. The obvious conclusion is that litigation is likely to be an inefficient approach to solving the "problem" of disputes of a size that are typically referred to the Ombudsman. Indeed, the costs of litigation are likely to prevent complainants seeking to pursue their claims in this way.

5.3 These concerns are not new. In March 2002 the Bailiff initiated a pilot project into the Petty Debts Court introducing into the court process a system of mediation, whereby that court may adjourn matters for mediation on such terms as it thinks fit. Mediation encourages people to represent themselves in a relatively informal environment where proceedings could be managed by an accredited mediator. The pilot project was successful, and mediation was subsequently established as a part of the procedure for small claims disputes before the Jersey Courts.

5.4 Mediation is not necessarily a direct replacement for an Ombudsman Scheme. In particular, it should be noted that whereas the Isle of Man and UK Ombudsman may make awards of up to £10,000 in value, the jurisdiction of the Petty Debts Court is limited to disputes of up to £10,000 in value. Nevertheless, even with this limit, mediation is likely to provide a quick and cost-effective alternative to litigation for the majority (by number) of cases that could be referred to an Ombudsman.

5.5 One key advantage of mediation compared to an Ombudsman Scheme is that mediation is established as part of the existing court processes. Indeed, the Master of the Royal Court commented in a presentation made in September 2004 to the Commonwealth Magistrates and Judges Association:

"In my view, it is quite clear that a key reason for the success of mediation has been the invaluable support provided by the Court administrative staff to litigants."

5.6 Further, the strength of the finance industry in Jersey means that the Island is not short of professionals with the technical expertise that an Ombudsman Scheme would offer. Provided sufficient persons of experience can be persuaded to act as accredited mediators, there is no reason why this aspect of an Ombudsman Scheme could not be replicated in the mediation process.

5.7 There may be weaknesses in the current systems of court access and mediation. However, it is clear that mediation replicates many of the features one would expect to find in an Ombudsman Scheme. In utilising the court infrastructure, mediation is likely to provide a more cost-effective way of addressing many of the needs that an Ombudsman Scheme would seek to address. It is therefore recommended that,

prior to making any binding decision to introduce an Ombudsman Scheme, consideration should be given to whether the existing system of mediation could be changed in such a way as to address all of the needs that an Ombudsman Scheme would be expected to meet.

6. Likely costs of an Ombudsman Scheme

- 6.1 Estimating the likely costs of an Ombudsman Scheme at this stage are very difficult: the final figure will largely depend upon the design of the scheme and the demand for the scheme once it is in place.
- 6.2 If the scheme and experience of the Isle of Man were to be mirrored in Jersey, on the assumption that the finance industry in Jersey is around three times the size of that in the Isle of Man, it is likely that the scheme would require between 6 and 8 full time case officers and be able to draw upon a panel of between 10 and 15 adjudicators. The cost of the adjudicators could potentially be relatively small, if it was possible to use the same community-minded persons that one would need to act as accredited mediators under a mediation scheme. It is likely, however, that a principal ombudsman would be required to represent and provide general oversight of the scheme. Together with the costs of premises, it is reasonable to suggest that an initial annual budget of between £500,000 – £750,000 would be required.
- 6.3 Funding could be provided from two sources: from a levy imposed on the financial services industry (as in the UK) or directly from government (as in the Isle of Man).
- 6.4 If the costs were to be recouped directly from the finance industry, this would clearly place a direct financial burden upon the industry which does not exist in Guernsey or the Isle of Man. Imposing a direct levy in the UK is practical on the basis that the UK itself represents a large and lucrative market, and institutions will be willing to pay that levy in order to access that domestic market. The same principle does not apply to jurisdictions such as the Crown Dependencies from which the financial services industry primarily serves the international market.
- 6.5 It should be noted that Jersey is an expensive place from which to carry out financial services businesses. Already, such businesses pay a large proportion of the direct taxes received by the States, as well as paying for the cost of the Jersey Financial Services Commission and making significant additional contributions to tax revenues through company registration fees. The finance industry also indirectly funds a large proportion of the Island's legal aid scheme through providing the majority of work to the Island's law firms, and has recently shouldered the burden of ensuring that the Island meets up to a number of its international commitments.
- 6.6 Clearly, any additional cost imposed upon the financial services industry, especially a commitment to provide year on year funding at a level that – if the Isle of Man experience was to be repeated – is likely to increase beyond the rate of inflation, will act as a disincentive to financial services businesses considering whether to set up in Jersey or to expand existing operations in the Island. It is always possible to overplay the argument that an additional cost would be “the straw that broke the camel's back”. However, a proposal that the costs of an Ombudsman Scheme should be borne by the financial services industry is likely to give rise to significant unrest and opposition within the industry.

7. Recommendations

- 7.1 The chief weakness with the Isle of Man Ombudsman Scheme is that it overwhelmingly benefits international customers of that island's financial services industry. It could be argued that such persons are not necessarily those in most need of assistance, and that the scheme therefore represents an inefficient use of resources. Such persons may prefer a cost-free alternative to litigation, but are likely to be able to afford to instruct a lawyer in respect of any complaint of substance. It would also be interesting to compare the total value of awards made by the scheme with the costs of running the scheme: it seems likely that the scheme costs as much to administer than it delivers to complainants by way of compensation. Again, it is not clear that this represents an efficient use of resources.

- 7.2 A better use of resources would be to ensure that any Ombudsman Scheme is focussed upon those who most need it. Experience has shown that there are meaningful numbers of Jersey residents who have complaints in relation to the financial services they have received in the Island. Many members will no doubt have personal experience of constituents that feel they have been ill-advised in relation to mortgages, pensions, personal finance and related matters. There is a compelling argument that such persons need a scheme that offers an accessible, cost-effective and timely resolution to their disputes.
- 7.3 An Ombudsman Scheme could achieve this fairly simply by limiting access to the scheme to complainants who are Jersey residents. If the experience of the Isle of Man were to be mirrored, this would reduce the volume of complaints by some 94%. It would also lead to the costs of an Ombudsman Scheme falling significantly, and those costs being focussed upon those most in need of assistance.
- 7.4 However, if an Ombudsman Scheme is to be established with the expectation of dealing with perhaps 50 cases a year (around one a week) made by Jersey residents against Jersey financial institutions, the infrastructure that the scheme is likely to require will almost certainly be under utilised.
- 7.5 Consideration of these factors leads to the recommendation that establishing an Ombudsman Scheme is unlikely to be an efficient use of resources. It would be more effective to ensure that the existing, apparently successful system of mediation, is supported and if necessary improved in order to ensure that the community has access to an effective and accessible system of dispute resolution for claims that it would not be appropriate to be the subject of full litigation. If it becomes apparent that such an improvement is not possible, then the possibility of introducing an Ombudsman Scheme should of course be reconsidered.