

Responsible Finance Response

Financial Ombudsman Service: Our 2023/24 Plans and Budget Consultation

31st January 2023

Responsible Finance's submission to this consultation relates only to the proposed exemption from case fees for Community Finance Organisations (CFOs). For a detailed overview of the social impact of Community Finance Organisations please see our previous submissions to the Financial Ombudsman Service (FOS), also available on Responsible Finance's [website](#).

Consultation key question 4: Do you agree with our funding proposals?

Responsible Finance welcomes the proposed exemption from case fees for Community Finance Organisations. However, we **recommend the exemption from FOS case fees is made to all CFOs, regardless of whether they are subject to the minimum levy in an industry block.**

For example, the wording of the exemption could take the following form:

"A [credit union](#) which is subject to the [minimum levy](#) in an [industry block](#), and a [community Finance organisation](#), is not required to pay any case fee in respect of [chargeable cases](#) relating to that [industry block](#)."

This small amendment to the exemption will:

- align the approach of the Financial Ombudsman Service (FOS) to that already adopted by the Financial Conduct Authority (FCA) in respect of CFOs
- align the approach of the FOS to that of credit unions
- simplify the administration of the exemption for the FOS

Only one out of Responsible Finance's six Community Finance Organisation members¹ has consumer credit income below £250,000, and is therefore subject to the minimum levy. This means the impact of the exemption in its current form is very limited. It would not enable the benefits of unlocking more affordable lending and therefore fewer consumers filing claims for poor practice on affordability.

The remainder of our response is broken down into the following sections:

- Impact on Community Finance Organisations of FOS Case Fees
- The Case for the Proposed Exemption:
 - Alignment with the FCA's approach to community finance organisations
 - Alignment with the FOS's existing approach in practice to credit unions
 - Additional rationale
- Policy Case in Support of Community Finance Organisations

¹ The Community Finance Organisation members of RF which make small, short-term personal loans as an alternative to high-cost credit are:

1. East Lancashire Moneyline (Moneyline)
2. Scotcash CIC
3. Fair For You CIC
4. Street UK
5. East End Fair Finance Limited (Fair Finance)
6. Lancashire Community Finance

The Impact on Community Finance Organisations of FOS Case Fees

- Responsible Finance's CFO members lend £25 million each year in 64,000 loans. Over the past 5 years they have received a total of 58 complaints submitted to the FOS for their personal lending².
- Without an exemption a £750 case fee is payable to the FOS after the first three cases each year regardless of the outcome.
- The average loan size for community finance organisations is £400.
- The surplus income after all expenses (cost to serve, bad debts) on a £500 loan made by an average CDFI is approximately £13.
- A £750 case fee therefore wipes out the income from around 60 loans, so has a tangible impact on CFO's financial sustainability as small not-for-profit lenders.
- The median number of loans a Responsible Finance member CFO makes per year is 4,400, so 1 or more additional case fees creates a significant financial impact.
- A December 2022 survey by Responsible Finance found that most CFOs rate the operational threat of FOS case fees as four or five out of five, five meaning a significant threat to their organisation and ability to serve their customers.
- It is therefore critical for the stability and continuity of these small yet important lenders that the extension includes all CFOs, regardless of consumer credit income.

The Case for the Proposed Exemption

Alignment with the FCA's approach to Community Finance Organisations

In 2019 the FCA simplified its fee exemption for community finance organisations and credit unions to remove the 'inefficient additional administrative procedure' of charging fees based on income. Prior to this change, Community Finance Organisations with a consumer credit income greater than £250,000 were subject to FCA fees, similar to the currently proposed FOS case fee exemption.

The 2018 consultation contained the following wording:

'Community finance organisations and credit unions

5.9 We are proposing to extend our concessions for CFOs and CUs by exempting them from all payment of consumer credit fees. This proposal affects FCA fees only but, in the light of the consultation responses, we would welcome views on whether similar concessions should be considered for the other levies we collect.

5.10 CFOs provide alternative finance. They are defined as community benefit societies, registered charities or community interest companies limited by guarantee. The term includes some community development finance institutions (CDFIs), though not all CDFIs are also CFOs. When we began regulating consumer credit in 2014, we exempted CFOs and CUs from payment of minimum fees up to £250,000 of credit-related income. Above that threshold, they pay on the same basis as all other consumer credit firms - £1,095 minimum fee in 2018/19 plus the variable rate.

² Covering the period 2017/18 to 2021/22. Based on a survey of Responsible Finance's members conducted in January 2023.

We explained in our first CP on consumer credit fees that **we were introducing this concession to support the government’s policy of improving the range of socially responsible choices available to vulnerable consumers³.**

The Handbook notice alerting firms of the change said:

‘Exempting CFOs and CUs from fees

3.32 CFOs and CUs are identified through robust definitions based on compliance with statutory requirements outside FSMA. This gives us (and other fee-payers) comfort that the concessions we have given them are targeted on firms which genuinely have a social purpose. Nonstatutory arrangements do not provide sufficiently robust guarantees against firms reinterpreting their mission statements to downgrade the importance of their social purpose.

3.33 We are therefore of the view that restricting the concessions to CFOs and CUs meets our requirement for the criteria to be objective, consistent, transparent and simple, whilst also allowing us to continue to support the government’s policy of improving the range of socially responsible choices available to vulnerable consumers.

3.34 CFOs and CUs with annual income under £250,000 are currently exempt from consumer credit fees. **The process of exempting them in this way is an inefficient additional administrative procedure and we believe that exempting them fully from consumer credit fees is justified in terms of the streamlining of processes and removing a relatively inefficient cost. All fee-payers would benefit from us streamlining our administrative process⁴.**

Alignment with the FOS’s existing approach in practice to credit unions

The proposed FOS case fee exemption has been drafted with the exact same wording as for credit unions, but due to differences in the regulation of credit unions and community finance organisations, it would not apply in the same way, or deliver the desired impact as set out on page ten of the consultation paper.

Credit unions are only required to pay a fee on cases which relate to an activity for which they pay more than a minimum fee towards the FOS General Levy. For their core lending business – which does not count as consumer credit and makes up the vast majority of credit union activity – credit unions are only required to pay the minimum fee. As stated on the FCA’s [website](#):

‘Most credit unions lend money direct to borrowers where the interest rate charged does not exceed the statutory cap. **This type of lending is exempt and is not a regulated consumer credit activity⁵.**

In practice this means the vast majority of credit unions, and all of credit unions’ core lending are exempt from all FOS case fees. In contrast, as currently drafted, the proposed exemption would not apply to the vast majority of community finance organisation lending.

³ <https://www.fca.org.uk/publication/consultation/cp18-34.pdf>

⁴ <https://www.fca.org.uk/publication/handbook/handbook-notice-63.pdf>

⁵ <https://www.fca.org.uk/firms/credit-unions/consumer-credit>

The Financial Ombudsman sent the following clarification of its position on case fees in 2022:

‘Credit unions are only required to pay a fee on cases which relate to an activity for which they pay more than a minimum fee towards the FOS General Levy. **For core business, credit unions are only required to pay the minimum fee.** However, credit unions with full consumer credit permission are also required to pay levy fees for the credit-related activities industry block. These credit unions would still only pay a minimum fee for this industry block, unless their annual income from consumer credit lending is over £250,000, the threshold at which they would also start paying a tariff-rate levy fee for consumer credit activities.

In terms of how this works with the free case allowance, the allowance only applies to cases that the firm is liable to pay for, meaning that non-consumer credit related cases would not count towards a credit union’s free case allowance. As a result, a credit union would need to have over £250,000 annual income from consumer credit lending *and* have at least four FOS cases directly related to consumer credit lending in order to pay the £750 case fee.’

Additional rationale for the amendment to the proposed exemption

- The definition of a community finance organisation is robust and based on compliance with statutory requirements outside FSMA, ensuring only firms with a social purpose fall under the definition.
- The growth of the affordable credit sector as a tool for increasing financial inclusion is a policy priority for the Government and the FCA.
- It removes an inefficient additional administrative procedure for the FOS.
- For small individual CFOs the impact of additional case fees is high, but for the FOS, the relative income impact is small given the low levels of complaints CFOs have received over the past 5 years (due to their social impact focus and fair approach).
- Without the full exemption, the impact on non-profit community finance organisations and the supply of affordable credit to the market is:
 - CFOs may need to increase the interest rates they charge customers to generate more income to mitigate the risk of claim fees, at a time when consumers are already extremely squeezed.
 - a. CFOs may adjust their risk profile so they are no longer serving some of the most excluded consumers, possibly meaning they will go to less scrupulous or illegal lenders. The profile of CFO customers is identical to that of victims of illegal moneylending, so this means CFOs will not be able to re-route people away from these forms of credit.
 - b. The reduced sustainability of CFOs and regulatory risk of more claims impedes their ability to raise more capital to support more customers. If the CFO sector is unable to scale, consumers may continue to seek out loans from unaffordable lenders which may continue to drive high levels of complaints to the FOS.

Policy Case in Support of Community Finance Organisations

- The Government has directed £96 million of dormant assets funding towards financial inclusion. This is primarily aimed at increasing the supply of affordable credit by making investments into CDFIs (including 3 of our 6 CFO members) and credit unions. This money is being deployed by Fair4All Finance.
- In the 2018 Budget the Chancellor announced a package of measures to support affordable lending, which included a change to credit broking legislation designed to encourage the growth of partnerships between registered social landlords and providers of affordable credit.
- The FCA's Woolard review recognised the value of CFOs and the need to increase their lending capacity.

'CFOs and CUs are identified through robust definitions based on compliance with statutory requirements outside FSMA. This gives us (and other fee-payers) comfort that the concessions we have given them are targeted on firms which genuinely have a social purpose... We are therefore of the view that restricting the concessions to CFOs and CUs meets our requirement for the criteria to be objective, consistent, transparent and simple, whilst also allowing us to continue to support the government's policy of improving the range of socially responsible choices available to vulnerable consumers.' – FCA Handbook Notice No. 63 relating to the FCA fee exemption for CFOs (2019)

'As with credit unions, community lenders offer a valuable alternative to high-cost credit. They should be encouraged to grow... The FCA, the Treasury and Responsible Finance should report on ways to increase the lending capacity of Community Development Finance Institutions (CDFIs)...' – The FCA's Woolard Review (2021)

'The Government are desperately keen, and have taken steps, to ensure that low-income consumers can access safe, affordable and sustainable credit.' – John Glen MP, Chief Secretary to the Treasury (2018, Hansard)