Financial Ombudsman Service: Our 2025/26 Plans and Budget Consultation

Responsible Finance Response

29th January 2025

Introduction

Responsible Finance welcomes the opportunity to respond to this consultation and is grateful for the Financial Ombudsman Service's (FOS) increased positive engagement with the CDFI sector over the last few months. The FOS is vital in driving better consumer outcomes through ensuring that consumers can have their complaints resolved fairly and impartially, and gain redress where appropriate.

Responsible Finance's response to this consultation focuses on case fees for CDFIs, which relates to both questions 8 and 10, therefore our response covers both of these.

About CDFIs

CDFIs are non-profit organisations which make small value, short-term loans to individuals who face a poor choice of options when they need to borrow – including very high-cost and illegal lenders.

As one quarter of UK adults have less than £100 in savings[1], the need for short-term, affordable loans to cover unexpected costs will continue to be high. Credit is not right for everyone, but fair and affordable access is often crucial to enable households to smooth expenditure.

Despite this there is shrinking provision in consumer credit for low-income borrowers as many lenders have exited the market. Those who are left have shifted to serving prime and near prime borrowers. An estimated 16 to 17 million adults in the UK are financially underserved. The unmet credit need among this population is estimated to be around £2 billion[2].

CDFIs offer access to affordable credit and are scaling to fill this gap. Their lending is targeted to those who are often hardest to reach, yet they get good outcomes with the majority of customers repaying loans in full. Last year 66% of loans were made to women and 11% to those belonging to a minority ethnic group. CDFIs' customer characteristics closely mirror those found to be using illegal lenders, therefore in some cases they may be a safe alternative.

Giving people affordable options from lenders like CDFIs supports better financial decision making. It enables people to get back on their feet quickly and avoid getting into a spiral of debt, putting their ability to work and their health at risk. CDFIs save their customers an average of £340 per loan compared to a high-cost lender (CDFI customers saved £29m in total last year). In the absence of access to affordable credit, many households face a poor choice of high cost or illegal lenders, or being pushed into unacceptable hardship when presented with an unexpected or high expense.

[1] Money and Pensions Service (2022) One in six UK adults have no savings
[2] Fair4All Finance (2024) Access to credit and illegal lending

Access to credit allows an individual to replace a broken washing machine, or repair a car, without needing to cut back on their food or fuel budgets. A lack of access to affordable credit exacerbates the poverty premium; for example, the high long-term cost of using a laundrette compared to purchasing a new washing machine.

Through their lending to support the financial resilience of low-income households, in 2023 CDFIs lent £66 million to over 85,000 households.

CDFIs embrace innovation and fintech, harnessing it to produce better outcomes for consumers:

- CDFI Moneyline recently won the FCA's 'Eureka' prize for the most original tech adaptation at the Financial Inclusion Tech sprint for its Money Toolkit. The Toolkit uses loan application data to refer those it declines directly to emergency support.
- CDFIs use Open Banking to make a thorough assessment of their applicant's financial situations; a level of detail not possible with traditional credit reference bureaus. For example, recent research by CDFI Salad Money has found that credit scores are ineffective at identifying a person's gambling propensity, and it declines the same proportion of applications for gambling with sub-prime (low) credit ratings as super prime (high) credit ratings[3].

CDFIs are exemplary in putting the FCA's outcomes-based Consumer Duty into practice:

- CDFIs aren't just lenders; they provide wrap-around support to improve outcomes for their applicants. They have embraced the FCA's Consumer Duty with ongoing extensive analysis, monitoring and improvements to consumer outcomes.
- The educational role of CDFIs includes supporting people to maximise their income (for example, benefits they are eligible for), to make appropriate decisions about accessing credit, to negotiate longer payment periods with suppliers, and to access debt advice.
- In 2023 they identified an average of £4,200 in unclaimed benefits for over 660,000 people totalling £600 million. This translates as £350 per person per month, helping people build up their wealth and in some cases not need to take out credit.
- They signposted 660,000 applicants to additional support.

Consultation response

Responsible Finance welcomes the proposed introduction of fees for professional representatives to drive up higher standards in this industry and ensure that it retains its 'polluter pays' model.

Responsible Finance welcomed last year's case fee and levy reduction and the decision for case fees to remain at this level for 2025/26. However, as per our response below we recommend extending the exemption for Community Finance Organisations from payment of this case fee.

Responsible Finance welcomes the FOS's transformation programme, and in particular the measures to increase clarity and transparency for consumers and respondent businesses through publishing a decision framework for key case types, and creating and rolling out consumer and respondent business portals. We also welcome the commitment within the transformation budget to implement a more sophisticated billing system based on robust data points.

[3] Salad Money (2024) Credit Fuelled Harmful Gambling

Question 8. What other areas should be consider in our transformation programme?

Question 10. Do you support our proposed budget for 2025/26?

Responsible Finance welcomes the investment in the 2025/26 transformation budget to implement an updated billing system. As part of this commitment, we recommend reviewing the treatment of fee charging for Community Development Finance Institutions (CDFIs).

At the same time, whilst we support the proposed budget for 2025/26, in light of the rising case numbers and wide margin of uncertainty, particularly relating to professional representative activity and the potentially extensive impacts coming from the motor finance commission issue, we ask that fee charging for CDFIs is reviewed as a matter of urgency.

Recommendation

Responsible Finance recommends that the current exemption for Community Finance Organisations from payment of case fees – introduced in the FOS's 2023/24 Plans and Budget – is redrafted to apply to all Community Finance Organisations, regardless of whether they are subject to the minimum levy in an industry block.

The consultation paper states that total complaint levels for 2024/25 are set to be 39% higher than anticipated, driven by complaints about motor finance commission and unaffordable/irresponsible lending, in addition to an increase in activity by professional representatives. Whilst the FOS is expecting to receive 18% fewer cases in 2025/26, it notes that the number could range to as high as 275,000 complaints due to motor finance commission and professional representative activity. This wide margin of uncertainty impacts CDFIs confidence and their provisioning, particularly as they are already working within extremely tight margins given their social impact focus, and goal to lend to their customers as low cost as possible whilst also remaining sustainable.

CDFIs are particularly wary of a potential uptick in professional representative activity prior to the case fee for this sector being introduced, therefore we ask that you review our recommendation with urgency.

Responsible Finance welcomed the rationale behind the 2023/24 exemption from case fees for Community Finance Organisations in its 2023/24 Plans and Budget. However, as we highlighted previously, the wording of the exemption only applied to one known Community Development Finance Institution (CDFI) which makes personal loans to individuals as an alternative to high-cost and illegal lenders. This meant that the exemption has not delivered the expected impacts.

Responsible Finance is the only UK trade body for Community Development Finance Institutions, and only one out of Responsible Finance's five Community Finance Organisation (CFO) members[4], which

[4] 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. Fair For You CIC
3. East End Fair Finance Limited (Fair Finance)
4. Lancashire Community Finance
5. Adage Credit

There are other small CFO lenders which make personal loans for business purposes, including organisations such as Purple Shoots and Trust Leeds.

specialise in making personal loans as an alternative to high-cost and illegal lenders, has consumer credit income below £250,000, and is therefore subject to the minimum levy.

The FOS's 2023 Plans and Budget stated that there are 35 CFOs which pay the minimum levy, and said that showed that the majority of CFOs are covered under the exemption in its current form. Unfortunately we have been unable to gather details of this and it is therefore unclear who these organisations are, and in particular there was no details shared on their lending activity except for the fact their income is under £250,000. It would be helpful to share details of these organisations and their lending activity to understand the true impact of the case fee exemption for CFOs in its current form. Very small-scale lending, despite being very important, is unlikely to be able to be scaled to fill the £2 billion unmet credit need that is so vital we seek to fill, as was the rationale for the exemption stated in the 2023/24 Plans and Budget consultation:

'Positive public policy impact on the credit market, especially for vulnerable customers.'

We therefore propose that the exemption is redrafted to apply to all Community Finance Organisations, regardless of whether they are subject to the minimum levy in an industry block.

This small amendment to the existing exemption would:

1. **Support the shared policy agenda of HM Treasury and the FCA to improve access to affordable credit through a scaled community finance sector**
2. **Align with the approach taken by the Financial Conduct Authority (FCA) in respect of CFOs**
3. **Align the approach with that of credit unions**
4. **Minimally impact other fee payers and the FOS**
5. **Simplify the administration of the exemption for the FOS**

1. **Support the shared policy agenda of HM Treasury and the FCA**

- Access to affordable credit has been a long-term priority within the Government. The growth of the affordable credit sector, for which CFOs are a key part, as a tool for increasing financial inclusion is a policy priority for the Government and the FCA.
- 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 and credit unions. This money is being deployed by Fair4All Finance.
- In 2024 the Labour Government committed to implementing a Financial Inclusion Strategy. In December 2024 it set up a Financial Inclusion Committee with a mission 'to tackle barriers to individual and households' ability to access affordable and appropriate financial products and services.' A key focus area for the committee is 'affordable credit and problem debt', with an 'access to credit' sub-committee being Chaired by Fair4All Finance.
- The then Economic Secretary to the Treasury, Tulip Siddiq, said:

  'Being able to open a bank account, build savings for a rainy day or access affordable loans is vital to helping people across the UK manage their money.
  I want to make the system fairer and more accessible – and that's what this work is all about.[5]'

[5] Gov.uk (2024) Help for vulnerable Brits to access banking and credit in spotlight.

- 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)

- This small amendment to the FOS's existing exemption would compliment this policy agenda.
- In its current form, without information on the lending activity of the CFOs subject to the minimum levy that the exemption covers, it is unclear whether it contributes to this policy agenda as per the original aim stated in the 2023/24 consultation.

2. Alignment with the FCA's approach to CFOs

- In 2019 the FCA extended its fee exemption for Community Finance Organisations and credit unions (CUs) to include all CFOs and CUs regardless of income, in order to explicitly support the government's policy of increasing access to affordable credit for vulnerable consumers, and in addition to remove the 'inefficient additional administrative procedure' of charging fees based on income.
- The FOS's Plans and Budget 2023/24 stated that the FCA removed the financial thresholds determining CFO and credit union exemptions due to administrative costs alone, which isn't the case.
- Prior to the FCA's change, Community Finance Organisations with a consumer credit income greater than £250,000 were subject to FCA fees, similar to the FOS case fee exemption in its current form.
- The FCA set out its position in a 2018 consultation:

'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.

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 consumers.'***

- The 2019 FCA 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 process****.'*

3. Alignment with the approach to credit unions

- We recognise that the FOS's current case fee exemption for CFOs was drafted to match the wording of the exemption for credit unions. However, due to differences in the regulation of credit unions and Community Finance Organisations it did not apply in the same way or deliver the desired impact set out in the 2023/24 Plans and Budget Consultation:

  'Rationale:
  - *Credit unions (CUs) and CFOs are exempt from paying consumer credit fees to the FCA in recognition of the social purpose these types of lenders serve (e.g. making credit available to vulnerable consumers). CUs subject to the minimum levy in an industry block are also exempt from paying our case fees.*
  - *We are aligned with the FCA on the treatment of CUs and consider it is appropriate to extend our case fee exemption to CFOs.*

  Impact:
  - *Positive public policy impact on the credit market, especially for vulnerable customers.*

- *Minimal impact on our cost base as we receive minimal numbers of cases from CFOs and almost all cases from CFOs within the last five years have been within the free case limit.'*

- 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 activity***[6]*.'*

- 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.'*

- 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, the exemption for CFOs does not apply to most of them.
- Removing the requirement for CFOs to be subject to the minimum levy in an industry block would align the approach to CFOs to that of Credit Unions.

4. Minimally impact other fee payers and the FOS

- As stated in the FOS's Plans and Budget 2023/24: '*Complaint volumes against CFOs have remained consistently low over the past few years, meaning that the impact of this on other levy payers will be minimal.*'

[6] https://www.fca.org.uk/firms/credit-unions/consumer-credit

- Responsible Finance's CFO members lend approximately £22 million each year in 50,000 loans[7]. Between 2018 and 2022 they received a total of 58 complaints submitted to the FOS for their personal lending[8].
- Without an exemption a £650 case fee is payable to the FOS after the first three cases each year regardless of the outcome.
- The average loan size for CFOs is £440.
- The surplus income after all expenses (cost to serve, bad debts) on a £500 loan made by an average CDFI is approximately £13.
- A £650 case fee therefore wipes out the income from around 50 loans, so has a tangible impact on CFO's financial sustainability as small not-for-profit lenders.
- 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 critical for the stability and continuity of these small yet important lenders that the extension includes all CFOs, regardless of consumer credit income.
- 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, fair approach and robust implementation of the Consumer Duty).
- 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.
    - 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.
    - 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.

[7] Responsible Finance 2024 Impact Data. Please note the Published sector impact report includes data from personal lending CDFIs which do not meet the definition of a CFO, therefore are not relevant to this consultation response.

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

5. Simplify the administration of the exemption for the FOS

- This would remove the requirement for the FOS to take additional administrative steps to ascertain the income level of the CFO business.
- As stated by the FCA when removing the £250,000 cap for CFOs' exemption from its regulatory 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 process.***[9]'

[9] FCA Handbook notice