ombudsman news

essential reading for people in the financial services and consumer advice sectors

Financial Ombudsman Service

settling financial disputes, without taking sides

issue 59

the head ruling the heart

An especially poignant letter in my in-tray this week accuses me of being '*heartless and unfeeling*'. Sent by a young widow, it asks how I can manage to sleep at night following a recent decision we made in an insurance dispute.

The insurance company in question had rejected the claim she made on her late husband's life insurance policy. Unfortunately, some of the information he had given the insurer was inaccurate, and of course it is now impossible to ask him why.

From her point of view, left on her own with young children, an ombudsman who can't understand her terrible plight is as worthless as that insurance policy now seems to be.

A large proportion of the disputes we are asked to settle involve life's tragedies: disability, death, bankruptcy or divorce. People turn to us in the most difficult and distressing of circumstances. And it's easy to understand their expectation that we'll naturally want to uphold their complaints and help them rebuild their lives.

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Of course, our natural instinct *is* to want to reach out and sympathise. However, we have to decide cases on a dispassionate analysis of facts. Rather like a court of law, we must set aside our emotions and settle disputes – however upsetting – by being impartial and sticking to the objective facts of the case. And we know that this can sometimes make us seem insensitive, even callous.

It doesn't always help that we operate at a distance, rarely meeting face-to-face the people directly affected by our decisions. And although we remind consumers that an adverse decision from us hasn't affected their legal rights, the truth is that for most people – litigation isn't a realistic option. If we turn them down, that's the end of the road. This makes us particularly mindful of the impact our decisions can have.

I'll be answering the letter, explaining why I can't overturn the decision in her case. But I rather doubt that my reply will seem at all convincing in the circumstances.

Walter Merricks chief ombudsman

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banking: a selection of recent case studies involving lending

A significant number of the banking and credit-related complaints we receive focus on lending. Underlying many of these disputes, whether they involve personal or small business lending, is the complaint that:

- the lender's decision *not* to provide credit was unfair *or*
- the lender provided a loan or credit when it should have realised the customer could not afford to pay the money back.

When considering customer complaints, lenders may find it useful to bear in mind the following general points, based on common themes that run through many of the cases we see.

- Obtaining information about a customer's financial position is not always the same as properly assessing the customer's ability to meet their potential repayments.
- Customers who are known to be vulnerable (for example, those with learning difficulties or debt problems) may put particular trust in the lender. This may place a greater than normal duty on the lender to act responsibly.
- Lending for a particular purchase or venture is not *normally* considered by us to be 'encouragement' by the lender – but this can change in certain circumstances.
- It is very helpful if lenders keep good internal records. However, such notes do not replace the need for clear communication with the customer.
- Lenders are not obliged to provide '*running-account credit*' (such as an overdraft), but they must act fairly when withdrawing a facility while the customer is making use of it.

case studies
banking: a selection of recent case studies involving lending

The following case studies represent a typical selection of the complaints about lending referred to us in recent months.

59/1

customers complained that after asking their lender for help with their debts, they ended up in a worse situation

Mr and Mrs A both worked in a local factory, earning modest wages. They were using the overdraft facility on their current account to its full extent. They also had a personal loan from their bank and had borrowed from various credit card companies.

In March 2004, realising they were in financial difficulty but unsure what to do about it, they visited their bank. They explained their situation to the lending officer, who told them the bank could give them a consolidation loan to cover all their existing debts.

... they were in financial difficulty but unsure what to do about it.

Mr and Mrs A were pleased with this suggestion and they took out the loan, which paid off all their existing debts and returned their current account into credit. But the bank left the couple's overdraft facility in place on their current account, and within a couple of months Mr and Mrs A had begun to go overdrawn again.

In June, having found they were unable to keep within the overdraft limit, Mr and Mrs A visited the bank to discuss the position. The bank's lending officer arranged another consolidation loan for them, to cover the overdraft debt.

Again, the bank left the couple's overdraft facility in place, and within a few months Mr and Mrs A were again in financial difficulties. When they visited the bank in November they were given a third loan. This covered the debts that the couple had acquired since taking out the consolidation loan in June. It also covered an additional £500. The bank agreed to lend them this because they had said they were worried about how they would pay for all the '*extras*' they would need over the Christmas period.

By early 2005, realising that they were unable to meet their repayment commitments, Mr and Mrs A complained to the bank. They said they had asked for help in managing their debts but – instead – it had made their situation worse.

... they said they had asked the bank for help but it had made their situation worse.

complaint resolved informally

We considered the bank's initial offer of a consolidation loan to have been helpful, as it re-financed Mr and Mrs A's existing debts into one lower-rate loan. At this point, the loan had been affordable.

However, we were concerned about the bank's response when the couple returned in June to discuss their continuing financial difficulties. The bank had interpreted the approach as a request to borrow more money. But, as the couple's testimony made clear, what they were really looking for (and what they thought they were being given) was guidance on how best to get themselves out of debt.

Mr and Mrs A thought that taking a further loan must be the best way of tackling the situation, since it had been suggested by the bank. It hadn't occurred to the couple to seek advice from anyone else on other ways of dealing with their predicament.

In our view, the bank should have made it much clearer that it was not in a position to advise the couple about their debts. Under the *Banking Code*, it should also have made them aware of organisations that *were* able to offer debt advice, free of charge.

We were particularly concerned about the bank's actions in providing Mr and Mrs A with an additional loan in November.
It should have been perfectly clear from the bank's knowledge of the couple's income and outgoings that they could not afford the repayments for this further loan.

... she felt the bank had actively encouraged her son to buy a powerful motorbike.

Mr and Mrs A readily agreed that they should bear some responsibility for their borrowing. We were able to settle the dispute by obtaining the bank's agreement to:

- reduce the couple's debt to its pre-November level
- deduct £250, in recognition of the distress and inconvenience caused by its poor response to Mr and Mrs A's request for advice
- refund any bank charges caused by the strain of November's loan repayments *and*
- accept repayment of Mr and Mrs A's remaining debt in affordable (interest-free) instalments.

59/2

bank accused of '*irresponsible lending*' when it gives a loan to a student so he can buy a motorbike

A 20-year old university student, Mr D, lived at home and worked full-time in a local supermarket during the vacations. He had a part-time job at the same supermarket during term-time.

Mr D applied successfully to his bank for a loan of £2,500, in order to buy and insure a second-hand motorbike. But as soon as he told his mother about the loan, she complained to the bank. She said its decision to lend her son the money had been '*ill-judged and irresponsible*' and that it had taken advantage of her son's inexperience.

Mrs D told the bank that her son had planned to go travelling for a year after he graduated. She was concerned that the loan repayments would not only prevent him from saving money for his travels, but also leave him short of cash. She also believed that, by lending him the money, the bank had actively encouraged her son to buy a powerful motorbike.

Mrs D thought the bank should write-off the loan and take the motorbike in exchange. The bank disagreed, so – with her son's knowledge and agreement – Mrs D brought the dispute to us on his behalf.

complaint rejected

It was clear that Mrs D wanted us to take a public position on the issue of lending to young people. We explained that we could not do that, as our role is simply to help resolve individual disputes.

When we looked into the details of this case, it was clear that the bank had made a proper assessment of Mr D's financial position before agreeing to lend him the money. We agreed with the bank's view that Mr D's regular employment and low outgoings meant he could easily afford the repayments.

We did not accept Mrs D's opinion that the lender had taken advantage of her son. He was an intelligent young man who clearly understood the commitment involved in a loan. Mr D had already decided to buy the motorbike before he approached the bank and the lender had no duty – or reason – to discourage him. There were no grounds on which we could fairly make the lender write-off the loan in exchange for the motorbike. We rejected the complaint.

59/3

lender gives loan to vulnerable customer who was unlikely to be able to meet the repayments

Mr J was a young, single man with some learning difficulties. He lived independently but relied on his family and his community support worker, Mrs Y, for help in managing his finances.

Mr J had only been in work for a few months – as a warehouse assistant – when the factory that employed him closed down. He realised there was no real likelihood of finding immediate employment, so he decided to start his own business as a handyman. He approached his bank and asked for a loan in order to buy a small van and some tools.

As his literacy skills were limited, Mr J had not prepared any kind of business plan. However, the lending officer told him this would not be necessary and that the computer showed he was '*good for the credit*'. So the bank gave Mr J £4,000 as a personal loan.

Excited by the prospect of his new venture, Mr J went ahead and bought a small second-hand van and some tools.

Unfortunately, however, he was unable to find any work as a handyman. His current account quickly became overdrawn and he was unable to meet the loan repayments. Without any prior discussion with Mr J, the bank passed his details to its debt recovery section, who in due course wrote to him.

... he believed the lender had encouraged him to take the loan and set up a business.

Extremely alarmed by the tone and content of this letter, Mr J panicked. Within a couple of days he had managed to sell his van – at a significant loss – to try and pay back some of what he owed.

Mr J then asked his community support worker, Mrs Y, for advice. With Mr J's consent, she complained on his behalf to the bank, saying it should not have lent the money in the first place. When the bank refused to uphold the complaint, Mrs Y referred it to us.

complaint upheld

We were satisfied that the lending officer was fully aware that Mr J had only a limited understanding of financial matters. Mr J had relied on the lending officer and believed that being told he was '*good for the credit*' was an assurance that he could afford the loan. We agreed with Mrs Y that, in the circumstances, it was reasonable for Mr J to have believed the lender was encouraging him to take the loan and set up in business.

Mr J had made it clear when he asked for the loan that his only income came from state benefits. He had no savings or other assets to fall back on, and had not been working for long enough to be entitled to any redundancy payment.

When discussing the possibility of the loan, Mr J had freely admitted to the bank's lending officer that he had no relevant skills or experience as a handyman – and had not given any thought to how he would obtain work.

It was clear that the lending officer had gathered information about Mr J's financial position and his reason for seeking a loan. But there was nothing to suggest that he had considered how Mr J would afford the repayments. We found it difficult to see how any reasonable lender, faced with the same facts, would have agreed to the loan.

We upheld the complaint and told the bank to:

- write-off the remaining loan debt
- refund the charges that had built up on Mr J's current account because of the failed loan repayments *and*
- pay Mr J £300 for the distress and inconvenience it had caused him.

59/4

lender allowed customers a personal loan for a business venture that later proved unsuccessful

Mr and Mrs N lived in a coastal resort town. Although neither was in permanent employment, they managed on a fairly continuous series of seasonal and part-time jobs.

After seeing a demonstration of a new funfair attraction, the couple thought they could turn it into a profitable venture. Keen to buy and set up the attraction as quickly as possible, they prepared a business plan and applied to their bank for a business loan.

... it was difficult to see how any reasonable lender would have agreed to the loan.

The couple were extremely disappointed when their application was turned down and they asked the bank to reconsider. After they were again refused a business loan, Mr and Mrs N asked their branch manager if there was some other way in which they could get the money they needed. Initially, the branch manager said the bank could not help. However, the couple were very persistent and he eventually agreed to arrange a personal loan.

Although Mr and Mrs N ordered the attraction right away, there was quite a long delay before the manufacturers were able to deliver it. So it was already halfway through the summer season before the couple were able to open for business. Even then, they experienced unexpected setbacks – the town had its wettest summer for years.

Because they had not made the profits they had hoped for, Mr and Mrs N soon found themselves unable to meet their loan repayments. When the bank contacted them about this, the couple said the bank was partly to blame. They said it should never have encouraged their venture by agreeing to lend them money. So, in their view, the bank should be prepared to accept a share of the losses.

complaint rejected

The bank's initial response to their business plan made it clear that it did not regard the proposed venture as a particularly good lending risk. So we did not accept that the bank had encouraged the couple to borrow. Mr and Mrs N had clearly understood that the bank thought this was a highly speculative venture. But they had been insistent that they wanted to go ahead anyway. ····›

Because Mr and Mrs N had taken out a personal loan, the bank was not an equity partner in their business. So, in the same way that it would not have been entitled to a share of the projected profits, it was not obliged to accept a share of the losses.

We concluded that the bank was not liable to Mr and Mrs N for their losses, and we rejected the complaint. However, we reminded the bank of its duty (under the *Banking Code*) to treat cases of financial difficulty sympathetically and positively.

59/5

customer withheld information when applying for a loan, but said the lender should have realised she was unable to afford the repayments

Ms G, an assistant manager in a department store, applied successfully for a loan from the bank where she had a current account. But within a few months she was finding it a struggle to make the loan repayments.

She complained to the bank, saying it should have made sure she could afford the loan before it agreed to give her the money. She believed it should have looked closely at the outgoings from her current account before approving her loan application. And she said that if it had done so, it would quickly have realised that she had not revealed all of her existing debts on the application form.

... she admitted she had not revealed all her existing debts.

complaint rejected

Ms G freely admitted that she had not disclosed all her existing debts when asked to do so on the loan application form. We considered that she was fully capable of understanding both the application process and the risk (if she gave inaccurate information) of being given a loan that was beyond her means.

We were satisfied that the bank had not suggested it would base its decision on any information other than the details provided on the form. It was true that the bank could have investigated the outgoings on Ms G's current account. However, we did not think it would be fair to say that it had a duty to do so.

We rejected the complaint, but reminded the bank of its duty (under the *Banking Code*) to treat cases of financial difficulty sympathetically and positively. Ms G later told us she had approached a not-for-profit debt counselling agency for help with her overall financial situation. The bank had agreed to co-operate with the agency.

59/6

customer's credit facility withdrawn by his lender in a way that he felt was unfair

Mr Y was self-employed and ran a number of small business ventures. He often used the overdraft facility on his personal current account but the account was normally in credit for part of the month.

However, over a period of six months, Mr Y became increasingly reliant on the overdraft facility. Eventually, he reached the stage where his current account was not operating in credit at all.

The accounts for Mr Y's business ventures were all held at another branch of the same bank, so the bank knew these ventures were were not doing at all well. It decided to withdraw the overdraft facility on Mr Y's current account.

Mr Y complained that the bank had not given him any notice, so he had not had the chance to put his affairs in order. He said he had only known about the withdrawal of his overdraft facility when the bank had caused him the embarrassment of having his debit card refused when he tried to pay for his shopping in the local supermarket.

Mr Y also complained that the branch holding his personal account had – improperly in his view – discussed his financial affairs with the branch holding his business accounts. He thought it was this that had caused it to '*jump the gun*' when deciding to withdraw the overdraft facility.

complaint rejected

We established that the bank had written to Mr Y on three separate occasions in the months before it withdrew his overdraft facility. Each time, it had said it was unhappy with the way he was operating his current account. It had also warned him that the overdraft facility was intended to provide temporary credit, not a permanent loan.

So we believed it would have been perfectly clear to Mr Y that the bank was not prepared to allow his overdraft to continue indefinitely.

In normal circumstances, we would still expect a bank to give a customer specific notice that it intended to withdraw an overdraft facility. On this occasion, however, we were satisfied that it had been reasonable for the bank to remove the facility without notice. On the day in question, a cheque (from one of Mr Y's business accounts) that he had paid in to his personal current account was returned unpaid, marked '*refer to drawer*'. Since paying in the cheque, Mr Y had made several business-related purchases against its value, using the debit card on his personal account.

When the cheque was returned, the branch holding Mr Y's current account had telephoned the other branch to ask if there was any chance of the cheque being paid, if it was re-presented. The answer was '*no*'.

The returned cheque had caused Mr Y's current account to become substantially overdrawn – far in excess of its limit. So we thought the bank's decision to withdraw the overdraft was a legitimate exercise of its commercial judgement, and did not breach the *Banking Code*. We rejected the complaint.

... the overdraft facility was intended to provide temporary credit, not a permanent loan.

59/7

customer's credit facility withdrawn by his lender in a way that he felt was unfair

... the bank should have given him a clear warning.

Mr F referred his complaint to us when he was unable to resolve matters with his bank. He had held a current account with the same bank for a number of years, and the overdraft facility had always been renewed automatically, without comment.

So Mr F said he had been furious when he discovered the bank had withdrawn the facility without giving him any notice. This had caused him some difficulties, since he had been overdrawn at the time. And although he managed fairly speedily to transfer his account to a different bank, in the meantime he had been charged substantial interest, at the rate for unauthorised overdrafts.

complaint upheld

The bank said it had made a number of (documented) telephone calls to Mr F about the difficulties on his account. And it said it could provide comprehensive internal notes on its concerns about his account, up to the point when it withdrew the overdraft facility.

It was clear from the bank's records that Mr F had been having considerable problems keeping his current account in good order. And his cheques had occasionally been returned unpaid. However, there was nothing to suggest the bank had ever made its concerns clear to Mr F, either during the telephone calls or at any other time.

We accepted Mr F's statement that the telephone calls had consisted of brief requests that he call at the branch for an '*account review*'. He had interpreted these requests as '*standard marketing calls*', made with the intention of selling him some new product or service, so he had ignored them. Nothing specific had been said in the calls about his account and he had been given no reason to suspect his overdraft facility was in jeopardy.

The bank's decision to withdraw the overdraft was a legitimate exercise of its commercial judgement. However, we did not believe this decision had been carried out fairly. In our view, the bank should have given Mr F a clear warning about what would happen if he did not run his account properly. And it should have given him a reasonable amount of notice before withdrawing the overdraft facility.

We accepted that the bank's failure to give a clear warning or any notice had caused Mr F stress and difficulty, because he had been forced to arrange a new account at short notice. So we said the bank should pay him £150 in recognition of the inconvenience it had caused.

We also thought it unfair of the bank to charge Mr F interest at its '*unauthorised*' rate, following its withdrawal of the facility. So we said the bank should refund to Mr F the difference between its normal rate of interest and the rate it had charged him.

the ins, outs and aims of FIN-NET

FIN-NET is the Europe-wide network of financial ombudsmen and consumer-complaints organisations – covering the 30 countries in the European Economic Area (or EEA – that's the European Union plus the European Free Trade Area). Its job is to help synchronise communications when a consumer living in one EEA country has a complaint against a financial services business based in a different EEA country.

The Financial Ombudsman Service was a founder member of FIN-NET and principal ombudsman, **David Thomas**, has been involved with FIN-NET from the start. He tells *ombudsman focus* all about it.

how did FIN-NET come into existence?

One of the principal tasks of the European Union is to develop the internal market – the cross-border trade between different member states. And it was back in about 1997 that the European Commission began to take an interest in ombudsman schemes.

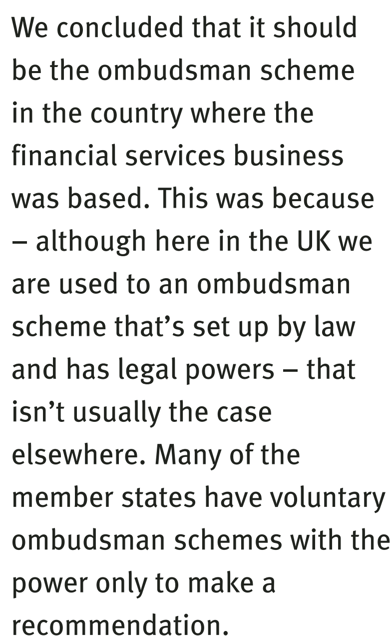
Of course, that was before the Financial Ombudsman Service had come into existence here in the UK. At that time the different areas of financial services had their own, separate, complaints-handling schemes. I was the banking ombudsman then, and I began being invited to meetings in Brussels. These meetings became more frequent and the remit gradually grew wider as representatives from the insurance and investment complaints-handling organisations started to join us.

The aim of the meetings was partly so that we could learn more about what was going on in Europe. But it was also to help the European officials find out more about how financial services complaints were dealt with in the different countries. We were also looking at how consumers could be given greater confidence to buy financial services cross-border. Clearly, if you buy anything from a different country you want to know what you can do should something go wrong.

Out of that arose the notion of FIN-NET – a network of the various financial ombudsmen and consumer-complaints organisations in Europe. Any scheme or body within Europe that deals with financial dispute-resolution can become a member of FIN-NET, provided it meets certain standards. Members agree to co-operate to assist consumers who have cross-border complaints.

what were the guiding principles agreed for FIN-NET?

The first issue was to decide which ombudsman scheme a consumer should go to, if they're based in one country and have a dispute with a financial services business based elsewhere.



We concluded that it should be the ombudsman scheme in the country where the financial services business was based. This was because – although here in the UK we are used to an ombudsman scheme that's set up by law and has legal powers – that isn't usually the case elsewhere. Many of the member states have voluntary ombudsman schemes with the power only to make a recommendation.

So we recognised that financial services businesses would be more likely to follow a recommendation from 'their' ombudsman, rather than from an ombudsman in another country.

That left the question of how the consumer would be able to identify which ombudsman they should contact. It was agreed that the ombudsman in the consumer's country would fill a 'signposting' role. So if you took your dispute to an ombudsman in your own country – but the dispute involved a financial services business firm based elsewhere in Europe – you'd be directed to the correct 'home' for dealing with the matter.

were there other practical problems with cross-border complaints?

Yes – and the next task for FIN-NET was to deal with those problems. It was agreed that the various European consumer-complaints organisations would co-operate with each other and exchange any necessary practical information.

So, for example, an ombudsman who was dealing with a complaint from a consumer living in another country – and who needed to know something about the law in the consumer's country – could contact the relevant FIN-NET member for that information. All members signed up to a '*memorandum of understanding*' – agreeing both to perform the signposting role and to provide practical co-operation.

do members have to work to the same standards?

Not necessarily. Each member of FIN-NET remains autonomous. But ombudsmen wishing to join FIN-NET have to satisfy the European Commission that they comply with certain minimum standards – or '*principles*'. These principles (independence, transparency *etc*) are laid down in a recommendation from the Commission. And the Commission relies on the relevant home-state government to know what to check.

So when the Financial Ombudsman Service joined FIN-NET, the Department of Trade & Industry (which is responsible for consumer affairs in the UK) was required to confirm to the European Commission that we complied with the necessary criteria.

Members of FIN-NET agree on how to deal with the cross-border referral of complaints, and about co-operation and information-sharing. But once they've actually received a complaint, they deal with it according to

their own country-specific rules – whatever they are. So issues such as whether the decision is binding, the financial limit for awarding redress – all these things will depend on which country's ombudsman scheme is dealing with the dispute.

what do you think is the main difference between the UK's Financial Ombudsman Service and other European financial ombudsman schemes?

The UK was the first country to have a single ombudsman scheme covering all financial services. Ireland and the Netherlands have since followed suit. But the arrangements for financial out-of-court redress vary from country to country – and there are some significant gaps as well.

Most other member states still have separate ombudsmen schemes for the various different areas of financial services. It can get quite complicated! In Belgium, for example, there are two banking ombudsmen, because they have a post-office bank as well as ordinary banks. But the most complicated is Germany, where they have four different types of banks with redress schemes at federal and regional levels. Altogether, they have 14 different banking ombudsman schemes. Although complaint-handling is generally quite well-developed for banking – it's often less so for insurance and investment. So it's in those sectors that there are still quite a lot of gaps.

There is a website, www.fin-net.eu, where consumers can get more information about the financial ombudsman schemes in the different countries.

what happens when a country in Europe has no ombudsman or similar scheme?

In some places the complaints-handling is done by the relevant regulatory authority. For example, banking complaints in Spain are dealt with by the banking regulator, the Bank of Spain. In Scandinavia they tend to have 'consumer-complaints boards' that deal with all types of consumer complaint, not just financial ones. The consumer-complaints board is usually a panel consisting of one industry person, one consumer person and an independent chairman. It's very different from an ombudsman scheme and clearly creates its own organisational challenges.

FIN-NET has been particularly involved in working with consumer-complaints organisations based in the countries that are new members of the EU. Some of these countries had ombudsman-type schemes and some didn't. And those that did usually had to alter their schemes in some way to comply with the Commission's criteria.

FIN-NET members are keen to share knowledge and experience with new members. For example, I've worked particularly closely with complaints-handling counterparts in Cyprus, Slovenia and Lithuania. And we are currently looking forward to meeting officials from Turkey, who are very interested in learning more about the UK's ombudsman service. ⇢

how do FIN-NET members work together on a practical level?

As well as co-operating in individual cases, we meet up every six months – usually in Brussels. In 2005, the international FIN-NET conference was here in London, and it's being held here again this autumn.

We've recently set up a steering committee to look at how FIN-NET can become more effective in the future. We have decided to work on enhancing its 'visibility'. There's no point in FIN-NET existing unless people know about it and can easily get access to it. So that was the first thing. The second issue we've been looking at is the comprehensiveness of the network – because of all of those gaps I've mentioned in what different member schemes do and don't cover by way of complaints.

Here at the Financial Ombudsman Service we work closely with the UK's financial regulator, the Financial Services Authority. But in some countries, the relationship between the regulator and the ombudsman scheme may be very distant. There are some countries where the regulator doesn't even seem to be aware of the dispute-resolution arrangements in place.

FIN-NET is sending a questionnaire to all the member states, asking for details of their ombudsman (or similar) arrangements. This is partly to gather information and partly to engage the relevant regulators' attention. Following this, FIN-NET will be trying to put some pressure on those countries where there are gaps, and encouraging officials in those countries to fill them – so that the FIN-NET network can become more effective.

and what about the future vision for FIN-NET?

Once FIN-NET is a more visible and complete organisation, we would like to become more influential as a kind of 'sounding board' for the European Commission, especially in the early stages of framing EU legislation. In the light of our experience, we can help foresee the sorts of problems that are likely to arise between consumers and the financial services industry. We can explain possible difficulties that the Commission might not necessarily otherwise hear about.

The real strength of FIN-NET is its potential as a learning and support network – in promoting cross-border co-operation and communication in the approach to dispute-resolution. FIN-NET does not, itself, resolve any complaints. It helps consumers across Europe – from Finland in the north to Malta in the south, and from Ireland in the west to Poland in the east – get to the right scheme to resolve their financial dispute. But then it's down to each individual scheme or ombudsman to resolve the complaint in its own way. ❖

insurance disputes involving subsidence

Disputes involving subsidence – and the damage it can cause – are among the most technically challenging of all the insurance cases we deal with. Here, we outline the main reasons for this. We also provide a selection of case studies illustrating our approach to some of the main types of subsidence disputes we see.

Typically, insurers take longer to settle subsidence claims than they do to settle any other type of claim made under buildings policies. A significant reason for this is that, with subsidence claims, identifying the nature of the damage and its cause is far from the end of the investigation. In many ways, it is only the beginning.

Even once the insurer is satisfied that subsidence caused the damage in question, it must then look carefully into how best to resolve the situation. Determining this can, in itself, be a lengthy process and will depend on a number of variables. These include:

- the make-up of the soil underlying the foundations
- the consistency of that make-up
- the nature of the foundations
- the trigger(s) for the movement *and*
- (once the situation is clear) the options for repair.

Part of the process may involve a period of 'waiting time' while the pattern and rate of movement is monitored. Unless this has been explained, policyholders may become impatient with what appears – to them – to be unwarranted delay on the insurers' part.

In quite a large proportion of the subsidence disputes referred to us, the policyholder complains of delay by the insurer in dealing with a claim. Our approach involves investigating whether the insurer took a reasonable and proportionate time to investigate and monitor the situation. If we consider there was an excessive delay before carrying out the necessary repairs, we look at whether the insurer was responsible for that delay.

Despite all the technical know-how that insurers, loss adjusters and other professionals devote to resolving the underlying situation, the need to maintain good communication with the policyholders can sometimes be overlooked. Communication has definitely improved over the years, but it's still not unknown for policyholders to be left very much in the dark about what is (or isn't) happening with their claim – and why.

Almost invariably, insurers will need to obtain reports from specialist loss adjusters and building surveyors/engineers. And it is not unusual for policyholders to commission their own reports. Progress can stall if differences of opinion then arise between the specialists reporting to the policyholders and those commissioned by the insurers. For policyholders, understandably anxious to halt the damage to their homes – and possibly already putting up with a considerable degree of inconvenience – the prospect of apparently-unending debate among the experts can often be the final straw.

Dealing with subsidence disputes can be a necessarily complex and lengthy business – for us as well as for insurers. We find that, on average, these cases take us longer to resolve than any other type of insurance complaint. The challenges often involve parties with exceptionally

entrenched positions, a variety of technical (and often discordant) opinions, and voluminous correspondence, sometimes stretching back years.

Our rate of progress will inevitably be affected by the timeliness of others, especially if there is a need for further expert evidence. And with some complaints we may need to await the outcome of ongoing monitoring programmes before we can proceed very far.

Settling subsidence disputes sometimes involves applying basic principles that have been overlooked along the way. The most basic, of course, is '*what is subsidence*?' To insiders, the answer is usually obvious, but all that most home owners know about subsidence is that they don't want it. And subsidence is rarely defined in policies.

Insurers sometimes turn down a claim on the grounds that the damage was not caused by subsidence but by 'settlement' movement – such as the compression of soil under the weight of a recently-constructed building. In our view, unless the policy provides a clear definition of subsidence, the term may reasonably be taken to mean any downwards movement of soil. So unless a policy expressly excludes damage caused by settlement, we consider that any damage caused by downwards movement of soil should be regarded – and covered – as subsidence damage.

Complications can arise if the policyholder changed insurers around the time when – as later becomes evident – subsidence movement and damage was already occurring (possibly without the policyholder's knowledge). In these circumstances we will take account of the ABI (Association of British Insurers) *Domestic Subsidence Agreement*. This says that one of the two insurers should deal with the claim, even if it includes damage that occurred during the other's period of insurance.

The following case studies illustrate some of the more common types of dispute we see involving claims for subsidence.

case studies
insurance disputes involving subsidence

■ 59/8
insurer denies liability for subsidence damage on the grounds that it occurred before its own policy came into force

Mr K complained to us when his insurer rejected his claim for subsidence damage. The insurer thought Mr K's house had been exhibiting cracks and distortions for many years, long before its own policy came into force. So it did not consider it had any liability for the claim.

Following our usual approach in such situations, we set about trying to establish whether the damage continued to occur after the start of the policy under which the claim was now being made. The evidence was that the movement (and damage) was progressive. That meant that the property had been damaged by an insured event during the period when Mr K was insured. As is the case under most policies, this triggered the insurer's liability.

Strictly, under most policies, the insurer's liability is to repair (or pay for the repair of) damage that occurred *after* the start of its policy. This does not include any damage that pre-dates the policy. If the insurer is able to distinguish between the two sets of damage, it is entitled to do that. However, it is often impossible to distinguish the two sets of damage. That was the situation here.

If stabilisation is necessary to stop a property moving, then we believe it is needed just as much to repair damage that occurred during the *insured* period, as it is to repair *earlier* damage.

complaint upheld

We said that in order to meet its liability for the damage that had occurred since it had started to cover the property, the insurer would have to pay for the repair of *all* the damage. This would include the cost of stabilisation if necessary.

59/9

insurer says it is not liable for subsidence damage that occurred before it took over responsibility for insuring the property

When Mr and Mrs E bought their terraced house in 1988, they took out buildings insurance through the bank that provided their mortgage. Ten years later, a different insurer took over the provision of insurance. The following year (1999), Mr and Mrs E made a claim for subsidence.

The insurer thought that most of the damage had happened before it started providing insurance for the property. It said that settlement/subsidence had been affecting the terrace as a whole for some years. This had caused long-term distortion and fracturing to the couple's house. And while there was some slight general continuing movement, subsidence movement of the floor had occurred before it had started to insure the property.

The insurer said it was liable only for damage that had occurred when its own policy was in force. So the schedule of repairs prepared by its engineers was restricted to damage thought to have occurred after 1998, and omitted general significant distortion to the property. The insurer considered this distortion to be historic, rather than the result of the recent subsidence. It said the fact that 'corrections' had been made in the past confirmed this.

Mr and Mrs E said that substantial movement had occurred since they bought the property, and it had caused considerable distortion. They said that cosmetic repairs and decorations had been carried out from time to time, when damage and distortions became visible. They were aware that floorboards and joists had been replaced in 1980, before they bought the house – but they understood that this work had been carried out because of woodworm and rot.

The insurer did not consider the ABI's *Domestic Subsidence Agreement* to be relevant in this case, because it excluded damage that had '*occurred before an insurer took on an insured risk*'.

complaint upheld

We established that there was no relevant period when the property had not been covered by buildings insurance. While some of the distortion was thought to have occurred *after* 1998 – when the insurer changed – it seemed likely that much of it had occurred *before* 1998, but after Mr and Mrs D first moved in and took out insurance.

We therefore said that the ABI's *Agreement* was relevant in this case. The property had been continuously insured, so we said the insurer should deal with the entire claim and could not exclude damage that pre-dated its own policy.

59/10

insurer refuses to pay for stabilisation because it says it is not liable for any preventative work

The insurer agreed that subsidence was the cause of the damage Mr C claimed for under his buildings policy. However, it refused to pay for any stabilisation work. Mr C felt this work was essential to put matters right and prevent future problems.

The report prepared by the insurer's engineers stated that minor movement would probably continue unless the foundations of the house were stabilised. The insurer said it would pay for any superstructure repairs and redecoration that might be necessary, as and when further movement occurred. But it argued that stabilisation was not strictly part of its liability, since its policy only covered the cost of repairs and it considered stabilisation to be '*preventative, not restorative*'.

complaint upheld

After complaining unsuccessfully to the firm, Mr C referred the matter to us. Following our usual approach, we considered the insurer's contractual obligation under the terms of its policy. As is usual in buildings policies, the insurer was obliged to repair (or pay the cost of repairing) the subsidence damage.

In our view, the proper repair of a building requires something more long-lasting than a temporary patch-up. Filling cracks and repainting cannot properly be regarded as repairing subsidence damage if, within a relatively short time, those same cracks are likely to reappear. The expert evidence had indicated that, without stabilisation, the movement that had caused the damage would continue. So we said the insurer should meet the cost of stabilisation.

59/11

difficulties in dealing with subsidence claim from owner of a semi-detached house – when the entire house is affected, but the owner of the other half refuses to co-operate with remedial work

Mrs B, who lived in a semi-detached house, put in a claim for structural damage. Her insurer confirmed that subsidence was the cause of the damage – and that it affected the entire property, not just her half of it.

Mrs B's insurer did not cover the other half, owned by a Mr J. And Mrs B was unable to persuade Mr J even to discuss the situation with her.

After obtaining expert advice, the insurer decided to proceed with the normal remedy in cases where both sides of a semi-detached property are affected. This involves carrying out work to the foundations of both parts of the property.

... the insurer argued that stabilisation was not strictly part of its liability.

If the insurer treated only half of the house, then any future movement between the two parts might result in a recurrence of the damage to Mrs B's property. Future movement might also create new damage to her property – or indeed damage her neighbour's property, leaving open the possibility that he would then hold her responsible.

The insurer spent a number of months trying to persuade Mr J to cooperate with the planned works. It even threatened him with legal action. Meanwhile, frustrated that nothing was being done to remedy the problems in her own part of the property, Mrs B complained – first to her insurer and then to us.

complaint upheld

This was a difficult situation all round. Persuading Mr J to co-operate represented the best hope for a solution that was both structurally sound and likely to maintain neighbourly relations. But there seemed little likelihood of obtaining Mr J's agreement.

Mrs B was contractually entitled to have the damage to her property repaired properly. The insurer had insisted that its proposed course of action was the only viable solution. However, the expert evidence that we obtained confirmed there was an alternative approach. This would not require access to Mr J's property. And it would stabilise the building – in a way that would probably prevent the subsidence causing further damage.

This alternative approach was technically much more difficult than the insurer's preferred solution. It was also very much more expensive. However, we told the insurer that, in the circumstances, it was the only reasonable and realistic way to settle the matter.

... she was contractually entitled to have the damage repaired properly.

claims management regulation

an independent financial adviser emails...

Q Back in December 2005, you said in *ombudsman news* that claims management companies were to be regulated by law. What progress has been made towards this?

A At the ombudsman service, we prefer to hear direct from consumers, in their own words. And our statistics show that whether a consumer comes to us direct or uses a claims management company – there's no difference to the outcome of the disputes we settle.

But consumers who use a claims management company should be aware that the company may charge them – usually by means of an upfront fee or a share of any compensation. Some consumers have not had a fair deal when using claims management companies – and to deal with this, the government passed the *Compensation Act* last year.

This new legislation will regulate companies and individuals that provide claims management services in areas such as personal and industrial injury, criminal injuries compensation, employment matters, and financial products and services. The Department for Constitutional Affairs will be the regulator. And from 6 April 2007, it will be an offence to provide claims management services without specific authorisation (or exemption).

An authorised claims management business will have to comply with a strict code of conduct, covering areas such as advertising and marketing, handling client money, and dealing with complaints. There is more information about authorisation for claims management businesses on the Department for Constitutional Affairs' special website (www.claimsregulation.gov.uk).

bound by the law ...

a consumer adviser emails...

Q My client has filled in the ombudsman's acceptance form, saying she accepts his final decision on her dispute with a financial business. But now the business is saying that before it pays her the money awarded by the ombudsman, she'll have to sign its own, separate, agreement as well – with various conditions and small-print clauses. What's the position here?

A Once a consumer has accepted an ombudsman's decision, it is binding in law on both parties. The firm cannot make anything else a requirement on the consumer – either by way of conditions set out in a letter accompanying its cheque, or by any other separate agreement.

extended mortgage remit

a consumer advice centre asks...

Q Can you please confirm what types of mortgage the ombudsman service covers these days.

A We have always been able to deal with mortgage disputes involving banks and building societies – including complaints about advice and administration. These were previously covered by our predecessor ombudsman schemes (the former banking and building societies ombudsmen).

In October 2004, the statutory regulation of mortgages began, with the Financial Services Authority (FSA) as the regulator. Since then we have also covered mortgage disputes involving brokers and mortgage firms other than banks and building societies.

From 6 April 2007 our remit over mortgage-related disputes will extend again, reflecting the increased regulatory role of the FSA from this date. We will be able to deal with complaints about '*home-reversion schemes*' sold after that date. Technically, these are not mortgages at all. They are property deals that allow older homeowners, in particular, to release cash ('equity') from their homes without taking out a mortgage. The other main '*equity release*' scheme for older people involves '*lifetime mortgages*' – which we already cover.

From 6 April the FSA will also start regulating home purchase plans – sometimes called '*Islamic mortgages*' – and these will also come under our remit from that date.

ombudsman news gives general information on the position at the date of publication. It is not a definitive statement of the law, our approach or our procedure. The illustrative case studies are based broadly on real-life cases, but are not precedents. Individual cases are decided on their own facts.