ombudsman news

September 2002

Financial Ombudsman Service

essential reading for financial firms and consumer advisers

bringing you news from the Financial Ombudsman Service and focusing each month on complaints about investment, insurance or banking & loans

in this issue

about this investment issue of *ombudsman news*

In this issue we provide an update on the treatment of windfall benefits in mortgage endowment cases. The regulator's recent publication of its guidance on the matter, after a period of consultation, means that firms can now finalise any unsettled pension review cases that include windfalls.

Still on the subject of mortgage endowment cases, and in response to requests from a number of firms, we outline how – when we calculate redress – we treat any 'top-up' endowment policies that the customer may have.

Finally, as always, we include a selection of some of the wide range of cases we have dealt with in the last few months.

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principal ombudsman
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Edited and designed by the communications team at the Financial Ombudsman Service

1 the regulator's guidance on the treatment of policy enhancements as a result of windfall benefits

In the February 2002 issue of *ombudsman news,* we explained how we approach any windfall benefits when we calculate compensation in mortgage endowment cases. This followed the High Court decision in the case of *Needler Financial Services v Taber* and the publication of the Financial Services Authority's (FSA's) Regulatory Update 94.

We said that, during the consultation on that regulatory guidance, we would follow the principles established in the Taber case when we dealt with relevant cases. We were concerned to ensure that the delay while the consultation took place did not:

- prevent customers whose complaints had been upheld from receiving the compensation they were due; *or*
- mean that these customers continued to be locked into an inappropriate product that had been mis-sold to them.

This was particularly important because the result of the consultation would, in any event, have only a minor effect on any compensation payable.

In the light of this, some firms chose to ignore windfalls when they calculated redress, and/or to deduct the value of any policy enhancements or augmentations from the value of the investment before they calculated compensation. Some firms took account of windfalls but promised to review their calculations when the final regulatory guidance was issued.

As the FSA has now published the guidance (in its *Consultation Paper 126*), firms can go ahead and finalise any unresolved pension review cases that involve windfalls. The treatment that we currently apply to these cases is in line with the treatment set out in the guidance.

In essence, the guidance confirms that windfall benefits should not normally be taken into account when working out the compensation due to a customer who has been 'mis-sold' a product. So firms should use the principles established in the Taber case to work out whether a benefit from a corporate event is a windfall benefit.

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The FSA's Complaints Sourcebook defines a windfall benefit as follows:

DISP 2.5.14 G A windfall benefit arises where:

1. *there has been a demutualisation, distribution or reattribution of the inherited estate, or other extraordinary corporate event in a long-term insurer; and*
2. *the event gave rise to 'relevant benefits' as defined in DISP App 2.5.15G.*

'Relevant benefits' are those that fall outside what is required in order that policyholders' reasonable expectations at the point of sale can be fulfilled.

The guidance also states (in paragraph 2.15.16G) that windfall benefits include free shares or cash given to customers when a firm demutualises, plus any bonuses and policy top-ups given to customers to encourage them to agree to a re-attribution or distribution of an inherited estate.

There is a rare situation where a windfall benefit *should* be taken into account. That is where the firm expressly recommended and sold a product to a customer on the basis that the customer would receive a windfall benefit, or would be likely to do so. However, in dealing with compensation for such cases, the firm will need to be able to produce documents from the time of the sale that show this was the situation.

We now expect firms to review all cases where they have said they would make good any windfall benefits that they took into account when they calculated compensation. This applies whether these cases were referred to the Personal Investment Authority (PIA) Ombudsman Bureau or to the Financial Ombudsman Service. Firms should then make any appropriate payments without delay. Those firms that did not take windfall benefits into account need take no further action.

2 top-up mortgage endowment policies

When we recommend or award redress in mortgage endowment complaints, we follow the approaches to redress set out by the FSA in its final version of the *Guidance on Mortgage Endowment Complaints*, published in May 2001.

This guidance sets out how firms should deal with redress in upheld mortgage endowment complaints, in essence by putting customers back in the position they would have been in if they had been correctly advised. The redress is formulated on the basis that, in the vast majority of cases, customers would have taken out a capital repayment mortgage if they had not been advised to take out a mortgage endowment policy instead.

An issue that firms often raise with us is how redress should be calculated when the customer has taken out a top-up mortgage endowment policy. It is for the FSA, not us, to answer any specific queries about interpretation of the guidance. However, we can explain how we have applied the guidance in cases we have dealt with.

The top-up endowment is usually a separate contract with a separate policy number, sometimes with another product provider. Where the customer has taken out the top-up policy in connection with an increase in the mortgage borrowing, we believe it is essential to perform a separate redress calculation for each policy, taking account of the particular mortgage advance that it relates to.

However, we have sometimes seen firms performing a single calculation in this situation, offsetting 'gains' in respect of one policy against 'losses' on the other. We do not believe that this is the correct interpretation of the guidance.

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3 a selection of recent cases

complaints about mortgage endowment policies

■ 20/01

Mr and Mrs W complained that their adviser had incorrectly assured them that their unit-linked mortgage endowment policy would provide enough to pay off their mortgage. The couple also said that, without any explanation and before they had even made the first payment, the firm had increased the amount they had to pay each month.

The firm denied that the couple had been given any assurance about the amount the policy would produce. It said that the product literature made it clear that there was no guarantee the mortgage would be repaid in full. It explained that the premium had increased because Mr W had had a birthday after completing the proposal form but before the start of the policy. This had put him into an age group where life assurance cover was more expensive.

Mr and Mrs W asked us to look into the matter. We rejected the main crux of the complaint, since it was clear from the policy documents and other literature that the firm had not given any guarantee. We also noted an explanation of the premium increase in the policy documents.

However, when we looked into whether the plan was suitable for Mr and Mrs W, we found no evidence that the adviser had assessed their overall attitude to risk at the time of sale. Mrs W had previously had a with-profits mortgage endowment policy, but the couple had no savings or joint pre-existing endowment plans. And after further examination, we established that they were 'cautious' investors.

We told the firm that its advice to the couple to take out a unit-linked product had not been appropriate. The firm refused to accept this, saying that it only provided unit-linked products so had not been in a position to offer any other options.

We told the firm that the fact that it was only able to offer one type of product did not make this particular sale suitable. We decided it should pay compensation to the couple in accordance with Regulatory Update 89.

■ 20/02

Mrs F complained to the firm when she found that her mortgage endowment policy might not produce the amount she had expected. She said that only nine months earlier, the adviser had given her a 'formula' to enable her to work out the policy's maturity value. According to this formula, she expected approximately £6,250 when the policy matured. So she was disappointed when the firm told her that the maturity value was approximately £5,600.

The adviser strongly denied providing any formula. He said he had only indicated what the maturity value would be if the firm continued to pay bonuses at the current rate. Mrs F was adamant that the adviser *had* provided a formula, although she said he had refused to put it in writing.

Unable to reach agreement with the firm, Mrs F brought her complaint to us. We thought that Mrs F should have concluded from the agent's unwillingness to write down the formula that there was nothing official about it and that it had not been approved by the firm.

We also noted that the firm had sent Mrs F previous estimates of the policy's maturity value, as well as annual bonus notices. These documents had all contained warnings that the maturity value could not be known in advance and was not guaranteed. We did not uphold her complaint.

■ 20/03

Mrs A was alarmed when the firm wrote to tell her that her mortgage endowment policy might not produce enough to pay off her mortgage.

A few years earlier, acting on the firm's advice, she had changed her fairly new repayment mortgage to an interest-only mortgage with a mortgage endowment policy. Her only income was in the form of maintenance paid by her ex-husband. This was due to stop before the mortgage endowment policy matured. She had no previous experience of investments or mortgages and her ex-husband had previously dealt with all their financial affairs.

The firm told us that Mrs A had agreed to take this type of mortgage because it was the cheapest alternative. However, we established that she could have afforded a repayment mortgage over a shorter term, which she would have repaid by the time her maintenance came to an end.

We therefore upheld Mrs A's complaint and recommended that the firm should calculate redress using Regulatory Update 89. This would put her back in the position she would have been in if she had taken out a repayment mortgage that matured when she stopped receiving maintenance.

■ 20/04

Mr and Mrs H took out two separate mortgage endowment policies. Together, the policies were intended to repay the amount the couple had borrowed to buy their house. There was also life assurance linked to the endowments. Each life assurance policy provided sufficient death benefit to pay off the entire mortgage, not just the individual partner's part of it.

Some years later, the couple contacted the firm to borrow money to pay for home

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improvements. They met a different adviser from the one who sold them the first two policies. He assumed that the death benefit of the two existing policies (combined) was also the target benefit. So, believing the couple were over-insured, he told them that they need not take out any further endowment policies.

Mr and Mrs H later discovered that they were significantly under-insured. After complaining unsuccessfully to the firm, they came to us. The firm accepted our view that the adviser should have found out exactly what policies the couple had, and why, before making his recommendations.

We thought that the most appropriate redress would have been for the firm to issue Mr and Mrs H with the endowment policies that they *would* have taken to cover their additional borrowing, if the adviser had been aware of the true situation.

However, the firm could not do this as it was not a product provider. So we looked at how much capital the couple would have repaid if they had taken out a repayment mortgage to repay their additional borrowing.

This showed that the couple had made significant cost savings by not having paid the additional mortgage endowment premiums. We therefore took account of these savings by reducing the amount of redress awarded to the couple, in line with Regulatory Update 89.

■ 20/05

Mr and Mrs L complained about a mortgage endowment policy that they had taken out on the firm's advice in 1991. They were concerned that recent projections forecast a shortfall when the policy matured.

In addition, they claimed that:

- the charges had not been properly explained;
- the firm had told them it was only prepared to offer them this kind of mortgage; *and*
- the fund performance was unsatisfactory.

We rejected the complaint. We found that the policy met the couple's requirements at the time of the sale and that the firm had fully explained the nature of the policy, including the fact that it might not produce enough to pay the mortgage. The firm had made Mr and Mrs L aware of the charging structure and there was no documentary evidence to show that the firm would only have offered a mortgage on an endowment basis.

The only aspect of the complaint we were unable to look into was the couple's disappointment with the fund performance, since such matters do not fall within our remit.

■ 20/06

Mr C, a first time buyer, was advised to take out a mortgage endowment policy. He later complained that the firm had not told him of the risk that the policy might not produce enough to pay off his mortgage.

The firm rejected his complaint. It said that:

- the product literature had set out the risks very clearly; *and*
- the policy's review procedure ensured that, as long as any necessary changes were made at the time of each review, the policy would meet its target amount.

When Mr C brought the complaint to us, we found that the firm had not established his attitude to risk at the time of the sale. We therefore asked it to calculate compensation, in accordance with Regulatory Update 89.

The firm refused to do this. It said that it had already paid redress on another mortgage endowment policy taken out for the same property, but in the name of Mr C's partner, Miss G.

The firm said it believed that – as Mr C had not mentioned this – he was deliberately attempting to mislead us and to defraud the firm. Mr C was so dismayed by what the firm said that he told us he was considering taking legal action against the firm for defamation, once the immediate problem of his mortgage had been settled.
After much correspondence, we established that Miss G had covered the total amount of borrowing for the property with two mortgage endowment policies, both in her name. The policy with the firm covered only £8,550 of the total. The policy for the remainder was with a different firm. Miss G had taken out both policies before she met Mr C. When Mr C moved in with her, he wanted to 'buy into' her mortgage arrangement and it was at this point that he consulted the adviser.

Rather than suggesting that the existing arrangement was converted to joint policies, or advising Mr C to take out term assurance in his own name, the adviser told Mr C to take out a mortgage endowment policy for the whole amount. Mr C's policy was therefore totally unnecessary as far as paying off the mortgage was concerned.

We asked the firm to refund the premiums Mr C had paid (less that part of the premiums representing the cost of life cover) and to pay him £200 for distress and inconvenience.

20/07

Mr and Mrs P complained to the firm when they discovered that their mortgage endowment policy might not produce enough to repay their mortgage, and that it extended for six years after Mr P retired.

The firm upheld the complaint but told the couple that no redress was payable. This was because they had not suffered any loss as a result of having the mortgage endowment policy rather than a repayment mortgage. The current encashment value of the mortgage endowment policy was more than they would have repaid over the same period if they had taken out a repayment mortgage.

Dissatisfied with the firm's response, the couple brought their complaint to us. The firm had calculated redress in accordance with Regulatory Update 89. However, in comparing the couple's actual position with the one they would have been in if they had taken out a repayment mortgage, the firm overlooked the fact that the term of the mortgage endowment policy had been inappropriate. The firm had used as a basis for its calculations a repayment mortgage over a 25-year term (the same length as the endowment policy).
To coincide with the date when Mr P retired, the repayment mortgage needed to extend over 19 years. We therefore asked the firm to recalculate.

It did this and found that Mr and Mrs P had indeed suffered a loss. It therefore offered the appropriate amount of redress, which the couple accepted.

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complaints about other investment matters

■ 20/08

When Mr F was diagnosed with a terminal illness, he asked his wife to telephone the firm to find out what to do about his personal pension plan. Mrs F said that the customer service adviser had told her that if Mr F left his pension plan in force, the whole fund value would be paid out to his estate as a lump sum when he died.

Mr F died just a few months later. Mrs F was shocked when the firm told her that the death benefit amounted only to a refund of his original contributions, together with interest. This sum was substantially less than the fund value.

Mrs F assumed this was a mistake, but when she complained to the firm, it told her that the amount of death benefit it had paid was correct. It apologised for the misleading information she had been given by its customer service adviser. But it said that as she had not suffered any actual financial loss, it would not be appropriate to pay her any redress. However, it did offer her £500 for any distress and inconvenience caused by its mistake.

Mrs F brought her complaint to us, saying that the firm's advice had resulted in the family being worse off than it would otherwise have been. At our request, the firm provided a transcript of the telephone conversation between Mrs F and its customer service adviser. It was clear from this that Mr F had based his decision to leave the fund intact on the information the firm gave his wife in the course of that conversation.

We asked the firm to let us know how much the policy would have produced if Mr F had taken the benefits from the pension before his death. The lump sum was approximately £12,500 more than the amount his wife received when he died.

The firm agreed with our view that Mr F would have acted differently if he had been advised correctly. It therefore agreed to pay the difference of £12,500, together with £500 for distress and inconvenience, plus interest.

■ 20/09

Mr M was advised to transfer his preserved benefits from an occupational pension scheme to a personal pension policy. At the time of transfer, the firm wrote to tell him that he had been contracted back into the State Earnings Related Pension Scheme (SERPS).

However, when Mr M retired, the Department of Social Security (DSS) sent him some documents that seemed to indicate that he had *not* been contracted back into SERPS. Mr M tried without success to get an explanation from the firm, so he took legal advice and began court proceedings.

These proceedings were stopped when it came to light that the adviser *had* made a payment to the DSS. However, it turned out that this had been an Limited Revaluation Payment. This has a similar effect as a transfer back into SERPS, but is not quite the same.

The court proceedings were then discontinued, with no order for costs. However, Mr M had incurred legal costs of approximately £1,000, which he asked the firm to reimburse. He said he would not have needed legal advice if the firm had explained the situation to him. When the firm refused to pay, he brought his complaint to us.

We felt that if Mr M had wanted to claim costs, he should have done so at the time the court proceedings were discontinued. However, we asked the firm to make a payment of £300 for his distress and inconvenience because it had failed to explain matters properly.

■ 20/10

Mr D traded shares on-line. After checking the closing price of T Ltd's shares, he placed an order via the firm's website to buy 75,000 shares the following day, at a maximum price of 26 pence.

The next day he telephoned the firm and was told that the shares had been bought at 23 pence each. His on-line account also showed this price as the one at which he had bought the shares.

However, when Mr D checked his on-line account later that day, it showed that he had bought the shares at 25.975 pence each. He contacted the firm and was told that 25.975 pence was the correct price. The firm said that it had made an administrative error earlier, which resulted in his being told, incorrectly, that he had paid only 23 pence per share. When the firm realised its error, it had corrected the entry on his account.

Mr D complained about this. He thought the firm should pay him the difference between the price he actually paid and the price the firm had initially told him that he had paid. The firm refused, so Mr D came to us.

In response to our enquiries, the firm provided evidence to show that Mr D could not have bought the shares at 23 pence each. This price had not been available at the time he gave his instruction to buy.

We explained to Mr D that, for his complaint to succeed, he would need to demonstrate that he had suffered an actual financial loss. In this case, his loss was one of expectation only. The firm had apologised to Mr D and offered to carry out his next deal free of any commission charges. This seemed to us a fair and reasonable means of resolving the matter, so we did not uphold his complaint.

■ 20/11

Mr T complained about the advice he was given to take out a personal equity plan (PEP) as a means of repaying his interest-only mortgage. He claimed that, at the time of the sale, he had stressed he did not want a mortgage endowment policy. However, he later reached the conclusion that the policy he was sold was – in essence – the same as an endowment mortgage.

The firm rejected Mr T's complaint. It said it had provided him with all the relevant product information, risk warnings and illustrations, so he could have been in no doubt about the nature of the mortgage. He had, in addition, signed the adviser's 'report' to say he understood the nature of the contract he was entering into.

When the complaint reached us, we looked at the 'fact find' given to Mr T at the point of sale. Part of this said that Mr T was prepared to: *'accept the risk that there may not be sufficient money to fully repay your mortgage on time without an increase in your payments'*. We felt that while this statement established that Mr T was prepared to take some risk with his investment, it did not establish the degree of risk. And after looking at Mr T's circumstances at the time of the sale, and at his previous investment experience, we concluded that the degree of risk made this policy unsuitable for Mr T.

The firm had correctly provided Mr T with product information that spelled out the risks. But a risky product was unsuitable in Mr T's case. The adviser had therefore failed in his duty to ensure he sold a suitable product.

We upheld the complaint and asked the firm to pay redress in accordance with Regulatory Update 89. Initially, the firm refused to do this, insisting that the statement on the 'fact find' proved that it had not mis-sold the policy. However, it eventually agreed to pay redress, together with an additional £200 for the inconvenience caused to Mr T.

■ 20/12

Mr W, a merchant seaman, took out what he believed to be a with-profits endowment policy in 1970. When the policy matured recently, he complained to the firm about the low level of payment he received. The firm told him the policy had not been set up on a with-profits basis and that he had no grounds for complaint.

Mr W then came to us, claiming that the application form had been altered after he had signed it. He said the word '*out*' must have been added, so that the policy was described as '*with**out**-profits*'. He told us that as he had gone to sea immediately after taking out the policy, he had not seen any further documents about his investment other than a bonus notice he received in 1983.

If, at the outset, the firm had sent documents to Mr W stating the terms of the policy, then we would not have been able to look at his complaint. It would have been time-barred because of the length of time that had passed since he could reasonably have been aware of the problem. Unfortunately, the firm had not kept the maturity papers and had no record of having sent Mr W any documents when he first took out the policy. So we could not check what – if anything – he had been sent.

We found no evidence that the application form had been altered, as Mr W claimed. The firm said that the bonus notice Mr W had received (the only bonus notice ever issued under the contract) had been produced in error.

We found it hard to accept that an investor would continue paying premiums for 31 years without question, when there was so little paperwork to prove the existence of a contract. Mr W might not initially have realised that he should have been sent bonus notices for a with-profits policy. But after he received the one for 1983, we thought he should have questioned why he had received nothing else before or after that date. We did not uphold his complaint.

■ 20/13

Mr B had held a regular annuity contract (a regular premium pension) with the firm since 1976. In 1985 he arranged to increase his regular premium. He ticked a box on the application form to indicate that he wanted the new *'improved'* benefits to be applied to all future contributions, as well as to the fund he had already accumulated.

There was no explanation on the application form of how the plan benefits had been 'improved'. This was only explained in a post-sale document, which set out the amended policy conditions. The allocation rates were enhanced as part of the improved benefits, but Mr B lost his rights to a guaranteed annuity when he retired.

Mr B only realised the implications of the amended policy conditions when he was nearing his retirement. After complaining unsuccessfully to the firm, Mr B came to us.

We considered that the application form was misleading. It did not set out what the improved benefits were and it did not explain the disadvantages. We asked the firm to restore guaranteed annuity rights to Mr B's fund as it stood in 1985, and to allow the improved allocation rates to apply to the contributions he had made since then.

■ 20/14

Mr and Mrs G each had a 'whole of life' policy. In April 1997, at the time of the policies' 10-year review, the sums assured were reduced by 62% and 45%.

The couple were unhappy about this and they claimed that they told their adviser they did not want to continue with the policies if there were any further reductions. They said the adviser had told them the level of cover would not be reduced any further.

Some time later, they found out that Mr G's policy was to be reviewed every five years and his wife's policy every 12 months. They complained to the firm but it denied making any agreement to fix the level of cover and it rejected their complaint.

Mr and Mrs G then came to us. We noted that the documents the firm had given the couple at the time of the sale contained a clear warning that there would be a review after 10 years, and further reviews after that.

However, Mr and Mrs G showed us letters from the firm, dated 29 April 1997, that they considered to be guarantees that there would be no further changes. These letters said that the revised level of cover was '*£22,701, for life'* (Mr G) *and '£7,717, for life*' (Mrs G). Presumably, the firm had intended the words '*for life*' to mean '*for life cover*'. But we could see how the couple had reached the conclusion they did.

The firm said it had not intended the letters to provide guarantees and it was not prepared to treat them as such. However, it offered 'on an ex-gratia basis' to maintain Mr and Mrs G's cover at the level fixed in 1997, or to refund their premiums with interest. The couple chose to have the refund.

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