ombudsman news

March 2003 issue 26

essential reading for financial firms and consumer advisers

Financial Ombudsman Service

in this issue

edited and designed by the publications team at the Financial Ombudsman Service

about this issue – March 2003

With effect from 1 February 2003, there are three significant changes to the time limits for making a complaint to the ombudsman service. In this edition of *ombudsman news* we outline the changes. Two of them affect all complaints referred to us; the third relates solely to mortgage endowment complaints.

The Financial Services Authority has issued several warnings to consumers about the risks associated with high-income bonds (sometimes known as 'precipice' bonds). We are already dealing with complaints about the mis-selling of these bonds and in this edition we set out our approach to these disputes.

We look, too, at situations where a cheque has been intercepted in the post and paid in by a fraudster, using a false identity. In some circumstances we can deal with such cases, even though the person for whom the cheque was really intended is not a customer of the bank where the cheque was paid in. But the position is not always clear-cut and firms sometimes try to argue legal points why, in their view, we do not have the power to deal with a particular dispute.

... there are three significant changes to the time limits for making a complaint to the ombudsman.

Our selection of some of the banking cases we have dealt with recently includes two separate but similar complaints, each from a young man who visited a nightclub while abroad on holiday and then discovered a large number of transactions on his credit card that he could not remember making.

Disputes over customers' instructions to firms feature strongly in our investment-related case studies. Two of the cases involve instructions for a switch of funds (complicated in one of the disputes by the fact that the adviser had, quite improperly, asked the client to pre-sign a batch of blank forms, supposedly so that the firm could carry out any future instructions). In another complaint, a firm that was advising the trustees of a family trust ignored a written request not to take any risk with the trust's capital. And in a complaint involving a newly-separated couple who had a unit trust investment in joint names, the firm overlooked instructions from the wife to obtain two signatures before carrying out any transactions. Acting on the sole instructions of the husband, the firm then sold the entire investment and sent him the proceeds.

Finally, in an article about legal expenses insurance, we look at insurers' arrangements for handling claims under legal expenses policies. A recent High Court case highlighted some of the concerns that are sometimes raised about these arrangements. We summarise the factors we considered when reaching a decision on a recent legal expenses case and confirm our current thinking on this matter.

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1 high-income ('precipice') bonds

Since December 1999, the Financial Services Authority (FSA) has issued several warnings to consumers about what it refers to as 'precipice bonds'. These are high-income bonds where the income, or level of growth, is guaranteed.

However, the original investment is linked to the performance of an index/indices or a basket of stock, and there is a high risk that investors may not get back all of this capital. Indeed, in some cases, investors may not get back any of their capital.

The FSA is concerned that the complexity of these products, and the fact that investors may not understand that their capital is at substantial risk, mean there is a danger of mis-selling. Our experience tends to support this view. We are already dealing with complaints about the mis-selling of these bonds.

Firms offer high-income bonds in limited issues and the bonds are designed to be held for a specified period, typically three to five years. Income and growth are set at rates that exceed those of more traditional products. For example, some bonds offer annual income of over 10% for three years, or capital growth of 30% or more after 38 months – and these rates are guaranteed. However, the amount of capital that investors will get back usually depends on a complicated formula linked to the value of specific shares.

Typically in complaints referred to us, we find the firm has marketed the bonds as medium- to high-risk investments but sold them to customers who say they were led to believe the risk was low and their capital was secure.

In dealing with such complaints, our approach is to try to establish what the representative told the investor at the time of the sale, and what product literature and other documents the firm gave the investor.

The points we consider include whether:
- the risk was explained in a way that the investor could understand;
- the investor had experience of this type of investment, or of any type of stock market investment; and
- this choice of investment suited the customer's circumstances and sat comfortably with their other investments.

... in some cases, investors may not get back any of their capital.

... customers say they were led to believe the risk was low and their capital was secure.

The marketing literature for these bonds does sometimes contain a warning that the investor's capital is not secure. But we know that investors rely to a great extent on what the firm's representative tells them at the point of sale. And even where there is a warning in the product literature, this can be undermined by a representative's assurances to the investor that any shortfall is likely to be relatively small.

Very few investors appear to have any understanding of what 'attitude to risk' and the firm's relative ranking of their own attitude to riskactually mean. So we may not always consider the sale of these products to have been appropriate, even where there is clear evidence (from the 'fact find' completed by the firm at the time of the sale – or from the firm's report of recommendations to the investor) that the investor was prepared to accept a medium to high level of risk.

case studies – high-income ('precipice') bonds

■ 26/1

high-income bonds – inexperienced investor – firm's inappropriate advice

Mr M was 72 and living on a modest pension when he was advised to invest £5,000 in a high-income bond.

The firm's product literature for the bond warned that investors could lose a small amount of capital. The 'fact find' completed by the firm recorded that Mr M was '*seeking capital growth*' and was prepared to take a medium/high level of risk with his investment. However, Mr M had not signed the 'fact find' and there was no record that the adviser had discussed any alternative type of investment with him.

Several years later, alerted by press reports about some of the disadvantages of high-income bonds, Mr M contacted the firm. He discovered that the value of his investment had dropped considerably. Although the level of growth he had been promised was guaranteed, he now realised that the return of his original investment was not. So he complained to the firm.

complaint upheld

We noted that Mr M had little experience of stock market investment and had never had any medium/high risk investments before. At the time he was advised to put

... there was no record that the adviser had discussed any alternative type of investment with him.

his money into the bond, his capital was all in a deposit account, apart from £1,000 in premium bonds and £3,200 in a low-risk personal equity plan (PEP) that included some shares.

Although, after investing in the bond, Mr M still had some funds put by for emergencies, nearly 75% of his capital was in equity-based investments.

We upheld this complaint on the grounds that the firm's advice had been inappropriate and had exposed Mr M to too great a degree of financial risk, in view of his circumstances. We required the firm to give Mr M a refund of the full amount he had invested, together with interest.

■ 26/2

high-income bonds – experienced investors seeking capital growth – whether complaint was about performance of bonds

When they were advised to invest £50,000 in high-income bonds, Mr and Mrs C had recently retired and were aged 63 and 60 respectively. According to the 'fact find' that their adviser completed, they were looking for capital growth rather than income from their investment.

After reading critical press reports about some types of high-income bond, the couple complained to the firm that their investment had not performed as well as it should have done. The firm rejected the complaint, so they came to us.

complaint rejected

We felt that the firm's product literature understated the level of risk associated with these bonds. And although the 'fact find' recorded that the couple's attitude to risk was 'medium/high', it was unsigned. These factors gave us some concern, so we needed to try to establish whether the sale of the bonds had been suitable for the couple.

We found that Mr and Mrs C appeared to be reasonably experienced investors. In addition to having a sizeable amount in current and savings accounts, they had invested substantial sums in with-profits funds, as well as in PEPs and equity-based investment bonds.

So although the couple's investment in high-income bonds involved a greater degree of risk than the investments they had made previously, this was balanced by the substantial sum that remained in their current and savings accounts. We were satisfied that Mr and Mrs C understood the concept of risk and knew how the stock market worked. The fact that a stock market investment has not done as well as expected is not, in itself, grounds for complaint.

We rejected their complaint.

2 banking – the cheque is (lost) in the post

Suppose:

- Miss Jones banks with Multinational Bank.
- She writes out a cheque to her uncle, Mr Jones, and posts it to him.
- The cheque is intercepted in the post by Mr Sykes.
- Mr Sykes pays it into an account with Conglomerate Bank.
- Conglomerate Bank collects the money from Multinational Bank.

That is called 'cheque conversion', because Mr Sykes (deliberately) and Conglomerate Bank (innocently) have committed the legal wrong of 'converting' the cheque.

How does Mr Jones stand? Once the original cheque has gone through, Miss Jones will not want to pay her uncle a second time. There is little chance of Mr Jones getting the money back from Mr Sykes, even if he can be found. Can Mr Jones get the money back from Conglomerate Bank (which collected payment of the cheque) or Multinational Bank (which paid the cheque)?

Mr Jones is not a customer of either bank. So does the Financial Ombudsman Service have power to accept a complaint from him? The answer is that we cannot accept a complaint from him against Multinational Bank (the paying bank), but we can accept a complaint from him against Conglomerate Bank – if he is what the law calls the 'true owner', or 'the person entitled to immediate possession', of the cheque. Our rules cover 'non-customers' in some specified circumstances, and this is one of them.

Normally, the 'non-customer' will be the person to whom the cheque is made payable. But that is not so in every circumstance. The law on this is complex and financial firms sometimes try to argue legal points why, they say, we do not have power to deal with the complaint. Here are two examples.

the person who wrote the cheque ceased to be the true owner on handing it over

Mr A bought a second-hand car from B & Co, a partnership. He wrote out an account-payee cheque (one that can only be paid into the account of the payee named on the cheque) in favour of B & Co. Mr A handed the cheque to one of the partners – Mr W. But instead of paying the cheque into the account of the partnership, B & Co, Mr W paid it into the account of B & Co Ltd – a limited company he owned. The car turned out to be no good, and Mr A had problems getting his money back from B & Co. So he tried to claim against B & Co Ltd's bank, on the basis that the cheque had been 'converted'.

But Mr A could not bring a complaint to the Financial Ombudsman Service. When the cheque was paid in to the 'wrong' account, Mr A was not the 'true owner' of it. The cheque had been received by Mr W, who had authority to receive it on behalf of the partnership, B & Co. So the 'true owner' was B & Co.

the person to whom the cheque was made out became entitled to it when it was posted

Mr F was expecting a cheque, but it did not turn up in his mail. He eventually found out that the cheque had been intercepted in the post, and had been paid into a fraudulently-opened account. So Mr F brought a complaint against the bankthat had opened the account and allowed the cheque to be paid in.

The bankargued that we did not have power to deal with Mr F's complaint – because a cheque is actually a bill of exchange. The law says that a bill of exchange cannot be 'issued' until it is 'delivered'. The cheque was notactually delivered to Mr F, so it was never 'issued' and Mr F could not have become the true owner.

This is an area where the law is a little unclear. We preferred the view that posting a cheque to the payee constitutes delivery, if the payee has expressly or by implication authorised despatch by post. That is because the UK Post Office will not allow the sender to reclaim a letter once it has been posted, so the Post Office effectively becomes the agent of the payee.

What if the cheque had fallen off the back of a Post Office lorry, had been found in the street, and a court was required to say who was entitled to possession of it? We found it difficult to conceive that the sender of the cheque would have disputed it was Mr F's, or that a court would have ordered that it be given to anyone other than Mr F.

So we concluded that Mr F was entitled to immediate possession of the cheque – and, as a result, his complaint came within our jurisdiction.

... the bank argued that we did not have the power to deal with the complaint.

In our original example, Conglomerate Bank is liable to Mr Jones unless it can show that it acted in good faith and without negligence. It is for the bank to show this, not for Mr Jones to show the contrary. There is usually no question that the bank acted in good faith, so the case is likely to turn on whether the bank can show it acted without negligence.

Mr Sykes probably opened an account in the name of Mr Jones before paying in the intercepted cheque. But banks and building societies are required to check the identity of new customers – particularly in order to comply with the regulations designed to prevent money-laundering. What did Conglomerate Bankdo? If it did not check the fraudster's identity, it will have been negligent. If it *did* check the fraudster's identity, but was fooled by forged documents, it all depends on how carefully it checked and how good the forgeries were.

Remember that it is for the Conglomerate Bank to show it was *not* negligent. If it cannot produce copies of the documents, whether or not the money laundering regulations required it to keep copies, then it may not be able to show this.

Here is an example of where a bank failed.

true owner of cheque recovers compensation from collecting bank

Someone calling herself 'Ali Smith' opened an account. Shortly afterwards, she paid in a £6,000 cheque payable to 'Alison Jane Smith'. A week later, she drew out almost all the money – and then disappeared. It turned out that she had intercepted a cheque on its way to the *real* Alison Jane Smith, who tried to reclaim the £6,000 from the bank. It refused, saying it had acted in good faith and without negligence. But we upheld her complaint.

The bank said it had verified the fraudster's identity from a driving licence, and her address from a gas bill. But no one of that name lived at the address given, and the bank accepted the documents were forged. It said they must have been very good forgeries to have fooled its staff, so it had not been negligent in accepting them.

The name given by the fraudster differed from the name on the cheque. So the forged driving licence must have disagreed with one or the other, or both. It is one thing to accept a cheque in a nickname for a known customer. It is quite another thing to open an account for a new customer in a nickname and then to accept a cheque carefully made out in a full name. And the bank's own procedures required it to also check the electoral register if it was lending money (and so was itself at risk).

The bank had not kept copies of the documents, so we could not check whether the forgeries were convincing or merely crude replicas. It was for the bank to show it had not been negligent. It told us it was not practical for it to keep copies. We found it difficult to accept that the bank could not afford to make and keep photocopies. If it took the business decision to save costs in this way, it had to accept the associated risk that it might not be able to show it was not negligent when things went wrong.

We are not saying that financial firms have to keep copies of identification documents. That is for them to decide. But we are saying that, if they do not keep copies, it may be harder for them to show they were not negligent. They need to balance that risk against the costs involved.

... we found it difficult to accept that the bank could not afford to make and keep photocopies.

3 banking case round-up

This selection illustrates some of the complaints we have dealt with recently on a range of banking matters.

■ 26/3

credit card – no authority to charge hire-car repair costs

Ms B hired a car while she was on holiday in Kenya with her friend, Mr K. She used her credit card to pay the hire charges and, as she had no driving licence, she named Mr K as the driver on the hire agreement.

A couple of days into the holiday, Mr K had an accident, through his own fault, and damaged the car. Some weeks after they had returned to the UK, Ms B found that the car-hire company had charged £4,000 to her credit card, saying this was the cost of the repairs. Ms B queried this, saying that she had not authorised the charging of the repairs to her credit card, and that the amount claimed was excessive. However, the firm said that, in signing the car-hire agreement, Ms B had authorised the charge.

complaint upheld

We examined all the documentation, including the report of the damage to the car. We found that the car-hire agreement did not authorise the car-hire company to charge the cost of the repairs to the card. The firm should have checked this. And the amount charged was clearly excessive for the amount of damage recorded. We told the firm to re-credit Ms B's account. It was for the car-hire company to pursue her or Mr K direct for the cost of the repair.

■ 26/4

credit card – unauthorised nightclub bills

Mr G visited a nightclub one evening while he was abroad on holiday. He remembered signing for two credit-card transactions that night – and giving one duplicate signature after being told that his signature for one of the transactions was too faint.

But when his credit-card statement arrived several weeks after his return home, it showed a total of ten transactions for that one evening at the nightclub. When he queried the transactions, the credit-card firm sent him copies of ten transaction slips from the nightclub. He disputed eight of the transactions but the firm refused to refund his account.

... his credit-card statement showed a total of ten transactions for that one evening at the nightclub.

... he recalled arriving at the club and chatting to some 'friendly young ladies'...

complaint upheld

We examined the transaction slips. It was apparent that they had all been filled out by the same member of the nightclub's staff. But there were considerable variations in the way in which the signature had been written. The slips were numbered, and almost all the numbers were in sequence. This suggested either that Mr G had been virtually the only customer paying by credit card that night, or that he had made ten separate transactions, one after the other. We thought both possibilities were unlikely.

We also noticed that the authorisation codes were not in the approved format and were out of sequence with the numbers on the slips. We concluded that Mr G had been the victim of a fraud by the nightclub's staff. We required the credit-card firm to refund the eight transactions, and to pay Mr G £250 compensation for the inconvenience it had caused by failing to acknowledge the discrepancies, even when Mr G challenged the transactions.

■ 26/5

credit card – authorised nightclub bills

On the last night of Mr T's foreign holiday, he asked a taxi driver to recommend a nightclub. He arrived at the club around midnight and left at 6.00am, to catch a midday flight home. While he was at the club, it debited his credit card with nine transactions, totalling almost £1,000.

Mr T later said that he recalled arriving at the club and chatting to some 'friendly young ladies', but that he had blacked out after his first drink. He subsequently came round but said that, apart from three brief incidents that he recalled very clearly, his memory of the rest of the evening was very hazy.

On his way to the airport, he realised with horror just how much the credit-card transactions added up to. He concluded that he had been the victim of fraud and thought that someone at the club must have drugged him. Because of his imminent departure, he did not report his concerns to the police at the time. But as soon as he returned to the UK he contacted the credit-card firm. When it refused to refund the disputed transactions, Mr T brought his complaint to us.

complaint rejected

The transaction slips were numbered but none of the numbers were in sequence and the disputed transactions had clearly taken place over a period of hours. Mr T appeared to have been given carbon copies of all the slips he had signed and he still had most of them. These factors together all suggested to us that the transactions were genuine.

If the club had tried to defraud him, as he claimed, we thought it unlikely that it would have done this by first drugging him (as he alleged) and by then carrying out a number of transactions on his credit card, spread over the course of six hours. And it seemed unlikely that it would have given him copies of the signed slips, all with an apparently genuine signature.

We concluded that Mr T had received the hospitality for which he had paid, and that this accounted for the haziness of his memory.

■ 26/6

transfer abroad – the receiving bank's funds frozen by court order

Mr C asked the firm he banked with to transfer money to his elderly mother in the Balkans. The transfer was expected to take less than two weeks. But Mrs C had still not received the money a year later.

The firm established that the money had arrived at Mrs C's bank within three days. However, the assets of the Balkan bank had been frozen by a court order.

The firm offered to refund to Mr C the fee he had paid for the transfer. But it would not refund the amount he had transferred.

complaint settled

It was not the firm's fault that the money was frozen, and we agreed with the firm that there was no way in which it could have known about the court order. We explained the position to the lawyers who had taken out the court order against the Balkan bank, and they arranged for the sum involved to be released to Mrs C.

... he had blacked out after his first drink.

4 changes to the time limits for making a complaint

With effect from 1 February 2003, the time limits for making a complaint to the ombudsman service have changed.

The Financial Services Authority (FSA) consulted on these changes in December 2002 and the results of that consultation were published in January 2003 in the FSA's policy statement, '*Mortgage endowment complaints: Changes to time limits for making a complaint – Feedback on CP158 and made text*'. Full details are on the FSA's website [www.fsa.gov.uk] but we summarise here the three key changes. The first two affect all complaints made to us; the third relates solely to mortgage endowment complaints.

The first change affects the rules at DISP 2.3.1R (1)(c) that say that the ombudsman cannot normally consider a complaint if the complainant refers it to us:

- more than six years after the event complained of; *or*
- (if later) more than three years from the date on which they became aware (or ought reasonably to have become aware) that they had cause for complaint.

... the time limits for making a complaint to the ombudsman service have changed.

This rule has now been amended so that a complainant who might otherwise be out of time when they come to the ombudsman will be *in time* if they:

- referred their complaint to the firm concerned within the time limits; *and*
- have a written acknowledgement or some other record that the firm received the complaint.

The second change amends the rules at DISP 2.3.1 R (2) so that the ombudsman can consider complaints outside the time limits if the firm has not objected to this.

In view of this, if firms wish to assert that a complaint falls outside one of the time limits laid down in the rules, we will expect them to do this as early as possible in the complaints process. We will remind them of the need to do this in our initial letter that tells them we will be dealing with the complaint and asking for their files on the case. Even where a complaint is referred outside the time limits and a firm raises an objection to our investigating the case, we may still do so if the complainant's failure to comply with the time limits was, in our view, the result of exceptional circumstances.

The third change relates only to mortgage endowment complaints. New rules have been inserted (mainly at DISP 2.3.6 R (1)).
In essence, these say that the time limits (at DISP 2.3.1 R (1)(c)) for mortgage endowment complaints start to run from the date the

... we would expect a firm to bring this to our attention at the earliest opportunity.

complainant receives a letter from the firm warning that there is a **high** riskthat when the policy matures, it will not produce a large enough sum to repay the target amount. These letters are known as 'red' re-projection letters.

The time limit is extended so that it ends six months from the date when the complainant receives a *second* re-projection letter from the firm, containing the same warning or other reminder of the need to act. The second letter need not, therefore, be a 'red' re-projection letter.

However, the rules envisage that there are still circumstances where it is possible for firms to assert that the time limits specified in the rules started *before* the complainant received the first 'red' re-projection letter. This may be because the complainant was previously sent a contractual review letter following, say, the tenth policy anniversary.

But if the firm does assert this, it will need to show that the complainant received an individualised calculation using the regulatory growth rates that were used for illustrations at the time. The calculation must have indicated that the policy was expected to produce a shortfall. And the letter must also have encouraged the complainant to take appropriate action.

If a firm wishes to rely on such evidence of a complaint being out of time, we would expect it to bring this to our attention at the earliest opportunity, before our investigations begin.

5 investment case round-up

This selection illustrates some of the investment complaints we have dealt with recently.

■ 26/7

mis-selling of mortgage endowment policy – firm's calculation of loss not straightforward – customer had paid off mortgage but retained the policy as a means of saving

Mrs B complained to the firm about the advice it had given her ten years earlier to take out a low-cost unit-linked mortgage endowment policy. She said that the firm had never made her aware of the risks associated with this type of policy, and that she would never have taken out the policy if it had done so.

At the time of the sale, Mrs B had a very low income, comprising her earnings as a care assistant and maintenance payments from her ex-husband for her two children. She had no savings or investments. Her previous mortgage, held jointly with her then-husband, had been on a repayment basis.

complaint upheld

The firm's recommendation of the policy had clearly been unsuitable. We told the firm it should compensate Mrs B in accordance with the regulator's guidance – Regulatory Update 89 – for the loss she had suffered as a result of its advice.

... we required the firm to restore the trust fund to its original value.

However, calculating the loss was not straightforward because, by the time she complained to the firm, Mrs B was using the endowment policy purely as a means of saving. After she had remarried a couple of years earlier, she had been able to sell her house and pay off her mortgage.

We told the firm that in calculating Mrs B's loss, it should include only the period when she had been using the policy as a means of paying her mortgage. We also told it to use the policy's surrender value as at the date she paid off the mortgage.

- 26/8

unsuitable investment advice in relation to family trust fund

After Mrs L's death, the trustees of her family trust complained to the firm, saying that the investment advice it had provided had been unsuitable and had caused a shortfall in the trust's capital.

The trust had been set up to preserve a capital sum for the use of Mrs L's children after her death. However, the value of the fund after Mrs L's death was lower than the amount that had originally been invested.

Some years earlier, the trustees had sought to increase the amount of income available for Mrs L, who had a life interest in the trust. At the time, the trust monies had been invested in a building society account. Acting on the firm's advice, the trustees had agreed to put the money into an investment product with a comparatively good rate of return.

complaint upheld

The firm rejected the trustees' complaint that it had provided inappropriate advice. It maintained that the advice had been suitable and it said that its representative had drawn the trustees' attention to the risks involved in this type of investment.

We saw clear evidence that the trustees had been well aware that they could not take any risks with the trust's capital. They told us they had stressed this to the firm's representative on several occasions during their meeting with him. And in a letter they sent the firm when first requesting advice, they had stated very clearly that their overriding objective was to 'preserve capital in the long term'.

So we concluded that the advice provided by the firm had been unsuitable. We required the firm to restore the trust fund to its original value.

■ 26/9

joint unit trust holding – firm's error in acting on instructions of one unitholder – offer to reinstate units superseded by legal agreement made as part of the unitholders' formal separation

After Mrs A and her husband separated, she contacted the firm and asked if it would change the mandate for the unit trust investment she had taken out jointly with her husband. She said that, in future, the firm should get both their signatures before selling any of the couple's units. The firm agreed to arrange this.

However, some months later, acting on the sole instructions of Mr A, the firm sold all the units and sent him the proceeds.

When Mrs A complained, the firm apologised and offered to reinstate half of the units, in her sole name. But before it could do this, it learnt that, as part of the proceedings for the couple's legal separation, Mrs A had agreed to her husband retaining all the proceeds of their unit trust investment.

So the firm told Mrs A that it could not now reinstate half of the units and put them in her name, as it had previously agreed to do. However, it offered her £150 in recognition of the distress and inconvenience that its error had caused. Dissatisfied with this, she brought her complaint to us.

complaint rejected

We agreed with the firm that Mrs A no longer had any legal claim to the proceeds of the units.

■ 26/10

switch of investment funds – customer claims firm acted without authority – whether customer gave instructions during telephone call to firm

Mr N, who made regular payments into an investment fund, complained that the firm had acted without his authority when it switched his payments into a different fund.

The firm did not accept that Mr N had any grounds for complaint. It said it had carried out the switch on Mr N's specific instructions, given in a telephone call to the firm's call centre.

... he complained that the firm had acted without his authority.

... he said he had been distracted at the time and had not heard all the questions put to him.

Mr N insisted that he had not asked the firm to switch his payments to a different fund when he had telephoned the call centre. He claimed to have called simply to find out how he would authorise such a switch, if he ever decided to make a change in the future.

Unable to reach agreement with the firm, Mr N came to us.

complaint rejected

The firm recorded all telephone conversations with its customers, so it was able to send us a transcript of the call in question. From this, it was clear that Mr N's intention had *not* been purely to obtain information in case he decided to switch funds in the future. The call-handler had explained to Mr N that the firm would accept an instruction over the telephone. From the conversation that followed, it was clear that he had then given such an instruction. And a few days later the firm had sent Mr N a letter to confirm that he had instructed it to carry out the switch.

Mr N agreed that the firm's transcript of his call was accurate. However, he said he had been entirely unaware that he had given instructions for the switch during the call. He said he had been distracted at the time and had not heard all the questions put to him.

Mr N accepted that the firm had sent him a letter of confirmation. But he said he had only glanced at it and had not realised its significance. He said that since his policy documents contained information only about how to send the firm *written* instructions to switch funds, it had never occurred to him he could do this by telephone.

We pointed out that although the policy document did not mention that the firm could accept instructions by telephone, the firm had acted perfectly properly in doing this. It was clear from the transcript that it had explained the procedure to him. And it was equally clear that Mr N had specifically requested an immediate switch. We rejected Mr N's complaint.

■ 26/11

telephone instruction for switch of funds – customer claims loss as a result of firm's delay – firm's representative had asked customer to sign blank forms 'to facilitate switches'

Mr H complained to the firm when he suffered a loss as a result of its delay in carrying out his telephone instructions to switch some of his funds. The firm had told him that it could not carry out his instructions until he had signed and returned a form authorising the switch.

Mr H could not understand why the firm insisted on posting him a form to sign. He believed it already had a supply of consent forms that he had signed. However, the firm was insistent that it could not act until he signed and returned a form that it said it would send him.

The firm was prompt in sending Mr H the form, but some days elapsed before he finally agreed to sign and return it. Stock market movements during this period meant that he suffered a small loss. When the firm refused to accept responsibility for this loss, he brought his complaint to us.

complaint upheld

We found that several months before Mr H requested the switch, the firm's representative, Mr B, had asked him to sign some blank forms. Mr H said he had agreed to do this because Mr B told him it would make it easier for the firm to respond quickly, should Mr H need to transfer funds in future. So Mr H had been particularly annoyed when the firm appeared not to have any knowledge of these pre-signed forms.

Mr B had been in breach of the firm's rules when he asked his client to sign blank forms. And even though Mr H had no reason to be aware of this, it had still been very unwise of him to have signed them.

We sometimes see disputes where a firm defends its actions by producing signed authorisation from the customer, but the customer alleges that the document was blank when they signed it. It can be very difficult indeed to establish the truth in such cases.

Unusually, in this instance, Mr H was able to produce as evidence a letter from Mr B asking him to sign a set of blank forms. It was clear that Mr H had acted in good faith and that he had given the firm instructions to switch his funds. We told the firm to make good Mr H's loss, and we awarded a further £250 for distress and inconvenience.

... the firm's representative had asked him to sign some blank forms.

6 legal expenses insurance

As well as being provided on a stand-alone basis, legal expenses insurance is commonly included in motor policies – and – increasingly in household policies. When it is sold as part of another policy rather than as a stand-alone product, it is often presented as a free (or low cost) addition.

Typically, cover is provided for the legal expenses that the policyholder may incur in most personal injury, consumer, property and employment disputes, as well as for any award of the other party's legal costs. Normally, there is a requirement that if a policyholder makes a claim for legal expenses, any legal action for which the expenses are incurred must have a reasonable prospect of success. The policyholder is also usually required to accept any reasonable offer of settlement.

When a policyholder puts in a claim under a policy of this type, most insurers will assess the dispute in-house (or perhaps with the assistance of one of their panel of solicitors), and will then determine whether there is an arguable case. If the insurer concludes that the case has little prospect of success, it may simply notify the policyholder that it is not prepared to accept the claim.

Where the case appears more complex, or seems to have a good chance of succeeding, insurers usually appoint one of their panel of solicitors to consider the matter. These panels are set up by insurers to deal with cases on commercial terms that are agreed in advance. The terms may be agreed on a 'no fee' basis (where the solicitors expect to cover their costs through the costs awarded against other parties, if their client is successful) or on the basis of a set fee per case. Only in exceptional circumstances will the insurer appoint a solicitor not on its panel.

Most cases handled under legal expenses insurance involve:

- car accidents;
- the recovery of uninsured losses from third parties;
- damages for minor injuries; *and*
- small consumer disputes.

However, legal expenses insurance covers a wide spectrum of other disputes, from medical negligence to property disputes.

Insurers' arrangements for handling legal expenses claims have at times given rise to concerns in some quarters, and a number of these concerns were raised in a recent High Court case, *Sarwar v Alam*. Some interested parties have suggested that, in the light of this case and other developments, they would welcome a statement of our own position on this matter (first established by one of our predecessors, the Insurance Ombudsman Bureau). This article confirms our current thinking and summarises the factors we considered when reaching a decision on a recent legal expenses case.

The case in question was a complex one, where the policyholder made a claim for legal expenses and disputed the insurer's insistence that the matter should be dealt with by one of its panel of solicitors, rather than by a solicitor chosen by the policyholder, Mrs G.

should 'freedom of choice of solicitor' be interpreted more widely?

First, we considered arguments that the policyholder's 'freedom of choice of solicitor' (as provided for, at the point when proceedings commence, in the Insurance Companies (Legal Expenses Insurance) Regulations 1990 – 'the Regulations') should be interpreted more widely than is traditionally the case. Should it perhaps include any significant legal enquiry (for example at the time when the claimant's solicitors embark on the 'pre-action protocol')?

We concluded that, in the absence of clear guidance from the courts in support of this alternative interpretation, we would not require an insurer to offer the policyholder a choice of solicitor at the start of the claim.

does the relationship between panel solicitors and the insurer disadvantage the policyholder?

We considered whether:

- the appointment by an insurer of panel solicitors, on a 'no fee' or a low 'fixed fee' basis; *and*
- the close relationship that panel solicitors have with insurers;

  might distort the panel solicitor's view of a case – to the policyholder's disadvantage (for example, when the solicitor assesses whether the case has a reasonable prospect of success).

We noted that solicitors appointed by an insurer have a duty to their client – who is the policyholder. And if there is any dispute about whether a particular case has reasonable prospects of success, it can be raised with us. In the particular case under consideration, we found no evidence that Mrs G had been disadvantaged. And, more generally, we have seen no clear evidence of any systematic distortion of the advice given by panel solicitors. So we have no reason to conclude that insurers' practice of using panel solicitors is inherently unreasonable or unfair to policyholders, as long as appropriate arrangements are made to handle cases that involve a potential conflict of interest.

is there a difference in quality between the work of 'panel' and 'non-panel' solicitors?

We noted that, in general, we have seen no evidence of any systematic difference in quality between the work of 'panel' and 'non-panel' solicitors. However, the insurer in the case in question accepted that in some (admittedly relatively infrequent and unusual) cases, its panel might not include solicitors with the relevant expertise or specialist knowledge.

Given these points, we concluded that in providing policyholders with legal services by selecting a solicitor for them, from a pre-arranged panel, insurers are not generally either in clear conflict with the Regulations *or* inherently likely to be providing an inappropriate service, or one that is less effective than the alternatives that are likely to be available.

So in our view, there is generally nothing objectionable, from the policyholder's perspective, in insurers requiring policyholders (in most cases) to use the legal services of:

- the insurer's own (appropriately-trained) staff; or
- a pre-selected panel of providers chosen by the insurer.

how clear is the policy document, and to what extent are policyholders prejudiced by any lack of clarity?

We had serious reservations about the way in which the details of the policy were described and set out in the policy document given to Mrs G. We thought that any policyholders, or prospective policyholders, given this document would have to refer and cross-refer to several different parts of the policy in order to find out what cover was offered.

And even if they overcame that difficulty, and successfully identified that, if they needed to make a claim, matters such as the choice of solicitor would have to be left to the insurer's discretion, they would still have little idea of how, in practice, the insurer would exercise its discretion. More precisely, even after a careful reading of the policy, most policyholders would have little idea that the insurer would generally object to funding claims handled by an experienced solicitor selected by the policyholder (at least until the later stages of the case, when court papers are issued).

Overall, we concluded that the terms of the policy that related to choice of solicitor were not expressed in plain and intelligible language. In our view, if the policy does not include a clear and intelligible statement of what it does and does not provide, then:

- prospective policyholders cannot make a fair evaluation of the policy at the point of sale; *and*
- policyholders may be disadvantaged when making a claim.

For example, policyholders may go ahead and make arrangements with a solicitor of their choice, and incur costs, without knowing that the insurer is unlikely to fund the advice they get from that solicitor.

However, a poorly constructed policy will not always prejudice policyholders or give rise to unfairness. Indeed, in many 'routine' cases policyholders may well not be greatly disadvantaged or inconvenienced by any lack of clarity in the policy.

But in more complex cases, or in cases with other special features, it seems to us that the policyholder's position is likely to have been prejudiced. In such instances, the fair resolution of the matter, reflecting good industry practice, will be for the insurer to fund the advice that the policyholder gets from his or her chosen solicitor.

when is it generally advisable for insurers to agree the appointment of the policyholder's choice of solicitor?

Much depends on the circumstances of the individual case, but we consider that, in general, policyholders making claims in connection with motor accident disputes, minor personal injury claims and routine consumer disputes are unlikely to suffer any significant prejudice if the insurer simply appoints a solicitor for them from its own panel.

But we expect insurers to agree the appointment of the policyholder's preferred solicitors in cases that involve large personal injury claims, or that are necessarily complex (such as those involving allegations of medical negligence). We consider that insurers should also agree the appointment of the policyholder's preferred solicitors in cases that involve significant boundary or employment disputes (especially if there is a considerable history to investigate and assess).

More generally, there are other circumstances where it may be unreasonable, or out of line with good industry practice, if the insurer fails to agree to the appointment of the policyholder's own choice of solicitor. This could be the case, for example, where the policyholder's own solicitors have already had considerable involvement in (and knowledge of) the issue giving rise to the dispute, or related matters.

But where, for example, a particular solicitor has been involved in a matter at an earlier stage – and has then continued to act for the policyholder, simply because of the existing involvement, and regardless of any provisions in the policyholder's legal expenses policy – we will not automatically conclude that the insurer should be forced to accept the policyholder's choice of solicitor.

It may well be appropriate to use the policyholder's own solicitor in any cases where there is a suggestion of conflict of interest. Doing this would, however, be subject to:

- the claim fulfilling the other policy conditions (on matters such as prospects of success);
- the solicitor and insurer agreeing appropriate fees and arrangements for monitoring the conduct of the claim; *and*
- the chosen solicitor having the necessary experience for handling the case in question.

In the specific dispute brought to us by Mrs G, we concluded that the case was sufficiently complex for the insurer to accept the policyholder's choice of solicitor. The case involved a very serious injury to the policyholder's son, who was likely to require continuing medical care for the foreseeable future. We felt the case appeared to raise serious issues on liability, and was likely to require more sensitive handling and involve more face-to-face contact between the policyholder and solicitor than in more straightforward cases.

case study – legal expenses insurance

■ 26/12

commercial legal expenses – compensation payable under any settlement – firm entitled to approve settlement – whether firm entitled to withhold approval despite legal advice

Ms D put in a claim on behalf of her swimming club under its legal expenses insurance when the club's coach issued legal proceedings for unfair dismissal. She told the firm that as the coach was employed under contract and was not an employee, the club's legal advisers did not think he had a case for unfair dismissal.

The firm accepted Ms D's claim and instructed solicitors to represent the club. The solicitors obtained counsel's opinion that there was a better than 50% chance of defending the coach's allegations, so the firm funded the cost of defending the action. However, the employment tribunal concluded, as a preliminary issue, that the coach *was* an employee of the club.

Ms D then asked the firm if it would reimburse the club for £5,000 (the cost of settling the claim out of court). The solicitors had recommended this as the best course of action. However, the firm refused, saying the policy terms gave it the right to approve any proposed settlement. Ms D then brought the complaint to us.

complaint upheld

Under the terms of the policy, the firm did not have to meet the cost of settling any claim unless it had approved the settlement. However, we expected the firm to exercise its discretion reasonably. The settlement in this case was agreed on the advice of the solicitors and, once the tribunal had established that the coach was an employee, it was the best outcome possible for the claim. We required the firm to reimburse the club for the £5,000, together with interest for the period since the club had made the payment.

... we expected the firm to exercise its discretion reasonably.

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ask ombudsman news

your questions answered

mortgage endowment policy mis-sold in 1987 – who's responsible?

Q A client at the advice centre where I work believes she was mis-sold a mortgage endowment policy back in August 1987. But when she complained to the insurance company, they said it wasn't them who sold the policy. They told her that her mortgage lender arranged the policy, so she should contact them. But the lender told her that back in 1987 it didn't give advice on mortgages. So it said that if the policy was mis-sold, the insurance company must be responsible. I don't know what to suggest she should do now. Can you help?

A This lady took out her policy before the Financial Services Act 1986 came into effect on 29 April 1988. The rules and regulations that now govern the sale of these policies were not in force when her policy was sold. So there will be less documentary evidence available than for more recent sales to show who sold the policy, what was said and why it was sold.

When we look at complaints such as this, we check if there is any evidence of advice being given and – if so – by whom. If the customer asserts that they were given advice then, unless contrary evidence is available, we are likely to find that this is true. Most endowment policies are *sold* rather than bought, so it is likely that the customer would have been given some form of advice at the time.

The factors we consider when trying to establish who gave the advice include:

- where the meeting took place;
- whether there was more than one meeting;
- how many people were involved;
- who the customer thought was advising them;
- who is recorded as 'agent' on the policy proposal form; *and*
- who received commission for the sale (initially and on an ongoing basis).

Once we have weighed up these factors we should be able to determine, on a balance of probabilities, which party, if any, provided the advice and is therefore responsible for the sale.

can the time limit for bringing complaints to the ombudsman be extended?

Q My understanding is that a consumer has six months to bring a complaint to the ombudsman, after receiving the firm's final response letter. Can this time limit ever be extended?

A We have always been able to consider extending the six-month (and other) time limits, in exceptional circumstances. The rules suggest this could be where the customer is incapacitated, or where the firm has not told the consumer about the ombudsman and the time limit.

A recent rule change now also means that if a firm does not object to our considering a case that is referred to us outside the time limits, we can consider the complaint. However, in both cases, it remains for the ombudsman to decide whether or not to extend the time limit.

(*See the article on page 12 of this issue for more on this and other rule changes concerning time limits.*)