ombudsman news
essential reading for financial firms and consumer advisers

Financial Ombudsman Service

settling financial disputes, without taking sides

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Walter Merricks
chief ombudsman

the rites of spring ...

This first issue of *ombudsman news* in 2006 introduces not only a new look but also some new content, including *ombudsman focus* – featuring interviews with some of our senior staff. As always, we welcome your comments and suggestions about topics you'd like us to cover in future issues.

Springtime at the Financial Ombudsman Service is budget-setting time. For me and my senior colleagues this means visiting the main trade associations to talk about our plans for the coming year. It's always a valuable exercise, and most trade bodies use it to raise issues that interest them about our case-handling as well as about our financial and operational forecasts. This year we have widened the agenda by asking our stakeholders to consider some broader corporate themes as well as our budget.

For the time being our caseload continues to be dominated by mortgage endowments. Currently we receive around 250 mortgage endowment complaints every working day, as well as around 170 other complaints. We recognise that our role in handling mortgage endowment complaints (as part of the regulator's wider initiatives to tackle the issue) has been an uncomfortable one for many firms. They have felt a much larger impact from our decision-making than they have ever been used to in any other product area.

in this issue

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

To some extent, this has strained relations. And the large wave of endowment complaints we have been receiving has meant we have had to ask consumers to wait longer for their cases to be resolved than we would have wished.

In due course we expect endowment complaints to decline, as firms apply time bars. But for the next year or so we expect a period of relative stability and certainly not the dramatic increase in complaint numbers that we have seen in the past three years.

With a more stable caseload and staffing it's time to begin exploring some of the other issues that have been raised with us. One of these is the way we are funded – currently by a mix of an annual levy and case fees. We know there are many different views about this across the industry, generally influenced by the number of complaints an individual firm actually receives.

We are planning to review our funding arrangements this year. We'll be looking at a range of possibilities within the statutory and legal framework. And if there is a reasonable degree of support for changes, we might be able to introduce them next year.

Openness and predictability are also themes we are exploring. Our roots have been in what, originally, were private dispute-resolution schemes. So we don't publish our decisions – other than the anonymised cases we select and publish on these pages. This means that only the parties to an individual case see the full reasons why we've upheld or rejected the complaint. Any ensuing publicity comes from one or other of the parties in dispute, who may well put their own 'spin' on what we are alleged to have said. While *ombudsman news* and our website contain a considerable amount of information on our approach to decision-making, there is perhaps more we could do to satisfy a demand for greater predictability in this area.

So as the days lengthen and we can hope for warmer weather, if you're sparing a thought for the Financial Ombudsman Service, have a look at our *corporate plan* (available on our website), and let me know what you think.

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investment disputes where the firm claims to have acted on an *execution-only* basis – or to have given only '*limited*' advice

In some of the complaints we receive about the inappropriate sale of investment products, the firm claims – incorrectly – that it acted on an execution-only basis. And some firms say they are not responsible for the suitability of the product because they provided only '*limited*' advice.

Most of these cases involve sales by independent financial advisers that took place before 1 December 2001, when the current regulatory regime under the *Financial Services and Markets Act* took effect.

As with any of the complaints we deal with, we refer to the regulations in force at the time of the sale. And in our view there is no '*half-way*' house of '*partial*' or '*limited*' financial advice as far as sales to private clients are concerned. Unless the sale was clearly carried out on an execution-only basis, then the firm was under a duty to provide suitable advice.

(The provision of *basic advice* is not relevant in the context of this article as it applies only to the sale of stakeholder products after April 2005 – see edition 49 of *ombudsman news*, page 16, for more about this.)

A firm carries out transactions on an execution-only basis if the customer asks it to sell a specific, named investment product, without having been prompted or advised by the firm. In such instances, customers are responsible for their own decision about the product's suitability.

The practice of execution-only sales is long-established. It is covered by current FSA regulations. But it was also covered by the earlier regulatory regime. As long ago as July 1988, the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) set out guidance for such sales in its *Enforcement Bulletin 1*.

... we refer to the regulations in force at the time of the sale.

... in our view there is no '*half-way*' house of '*limited*' financial advice to private clients.

Guidance was also provided by the Personal Investment Authority (PIA) in May 1997 in its *Regulatory Update 33*, which refers to the need for firms carrying out execution-only transactions to provide '*clear and credible*' evidence of the nature of these sales.

In the disputes referred to us we would normally expect to see some evidence, in writing, that the firm:

- gave no advice; *and*
- made it clear at the time of the sale that it was not responsible for the product's suitability.

It would have to be entirely credible that the customer entered into the investment on an execution-only basis. And we would have to be satisfied there was no evidence that the customer was misled.

Firms' obligations when selling investment products other than on an execution-only basis are covered by both the current FSA rules and the rules of the earlier regulatory regime. These include a requirement to *'know your client'*, a duty to make suitable recommendations, and a duty to explain the risks involved – in terms that the customer is likely to understand. Despite what some firms seem to believe, these obligations apply even where the firm has shared some of the product provider's commission with the customer.

The following case studies provide examples of where a firm has – incorrectly – claimed that it operated on an execution-only basis, or that it provided only '*limited*' advice.

case studies

investment disputes where the firm claims to have acted on an *execution-only* basis – or to have given only '*limited*' advice

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firm denies responsibility for inappropriate sale, claiming it gave only '*limited*' advice

Mr J contacted an independent financial adviser, mentioning a high-income bond (sometimes known as a *'precipice'* bond) that he had seen advertised in the press. Mr J and his wife wanted to invest a capital sum of approximately £300,000. The income they got from this capital would form their main source of future income, as they had little pension provision.

The adviser offered a positive opinion of the bond and forwarded Mr J an application form to complete. The adviser subsequently sent Mr J a letter saying the transaction had been carried out on a '*limited advice*' basis.

... the firm said the transaction had been carried out on a '*limited advice*' basis.

Not long afterwards, Mr J approached the adviser again, saying he was seeking a way to invest the proceeds of a maturing investment. The adviser suggested four possibilities, including another high-income bond – which Mr J subsequently invested in. Again, the firm sent him a letter saying the transaction had been carried out on a '*limited advice*' basis.

The following year, concerned about poor returns from both of his bonds, Mr J complained to the adviser's firm. He said he had received poor advice and had never been warned of any risk attached to his investments. When the firm rejected the complaint, Mr J came to us.

complaint upheld

The firm argued that it was not responsible for the appropriateness (or otherwise) of either of these bonds, as it had made it clear that it had given only '*limited*' advice. It said that in the first transaction it had given only a general opinion of the product Mr J had selected for himself. And for the subsequent transaction, it had *'simply offered a few suggestions for Mr J to research for himself'*.

As we have noted, in our view there is no category of '*limited*' financial advice as far as sales to private clients are concerned. And it was clear to us that the firm had not carried out either of these transactions on an execution-only basis. The firm had made recommendations that had guided Mr J in his investment decisions. So it was responsible for the sale.

We were concerned not only about the suitability of the firm's recommendations, but also about its failure to provide any risk warnings. We concluded it was unlikely that Mr J would have proceeded with the investments if the firm had given him appropriate risk warnings, even if the bonds had been suitable for him. And on the facts of the case we did not think they *were* suitable. We therefore upheld the complaint.

... it was unlikely he would have proceeded if the firm had given appropriate risk warnings.

51/2

firm claims it sold investment on 'execution only' basis, despite clear evidence to the contrary

In May 2000 Mr G invested £90,000 in an offshore *structured capital-at-risk* bond (sometimes known as a '*precipice*' bond). When the bond matured in August 2003, Mr G discovered he had lost around £50,000.

He complained to the firm, saying that if the adviser had explained there was a risk he could lose so much, he would never have invested. When the firm refused to uphold the complaint, he came to us.

complaint upheld

The firm denied any responsibility for the suitability of the bond. It told us Mr G was an '*experienced and sophisticated investor*' and that it had simply given him '*factual information*'.

The firm said Mr G had been its customer for nearly 30 years and – in its view – was well able to reach his own conclusions about the product's suitability. As further 'evidence' that it had not provided advice, it said it had rebated 50% of the commission on this transaction.

We found no evidence that this was an execution-only sale. The fact that the firm had rebated half its commission did not, of itself, indicate that it had not given advice. Firms may forego commission for a number of reasons, for example, where a customer is making a number of investments at the same time, or as a gesture of goodwill to a long-established customer or personal friend.

We established that, some two weeks before it had a meeting with Mr G, the firm had sent him a brochure for the bond in question. At the subsequent meeting, the firm had discussed with him, in very general terms, the risks of structured capital-at-risk bonds, as well as talking about other investment options such as *with-profit bonds*. And after the meeting it gave Mr G a *Key Features* document and a full product brochure for the bond.

... the firm could not ignore its duty to provide suitable advice.

In our view, these actions made it clear that the firm had not carried out the transaction on an execution-only basis. Rather, Mr G decided to invest after being prompted to do so by the firm.

We were not persuaded that the investment was suitable for Mr G's needs and circumstances at the time. The fact that he had previous dealings with the firm, dating back over 30 years, and that he had received 50% of the commission on the sale, did not mean the firm could ignore its duty to provide suitable advice. We upheld the complaint.

did you know...

our website gives you free access to over 1,000 pages of up-to-date information?

This includes details about us and our process, plus practical guidance on a wide range of topics to help those involved with financial disputes.

What's more, all our publications are available online, allowing you – for example – to browse through cases studies in earlier editions of *ombudsman news*, refer to technical briefing notes on a specific subject, or check out our expected workload for the year ahead.

www.financial-ombudsman.org.uk

Jane Hingston on safer credit and debit card spending – and facing up to debt problems

Jane Hingston
lead ombudsman

ombudsman focus looks at disputed transactions involving credit/debit card spending, and asks what should happen when customers are experiencing financial hardship.

At this time of year many customers may still be feeling the pinch of the Christmas holiday season. It's not unusual for good intentions – ...'*we'll keep things simple this year*...' – to be forgotten as people get caught up in a seasonal spending frenzy. And many customers rely heavily on overdrafts and credit cards during the Christmas period and for New Year sales bargains.

Sometimes, in all the frantic activity, certain things can go unnoticed. Banking firms and credit card companies operate systems designed to detect unusual account activity. They may contact customers, or impose additional checks at the point of sale, to make sure transactions are authorised. Customers making genuine purchases with their credit or debit cards may sometimes find this unwelcome or embarrassing. But checks of this type are in everyone's interests to help prevent fraud.

However, these checks don't always happen and the systems cannot ensure credit and debit card transactions are always genuine. Fraudsters are known to be more than usually busy at Christmas and sale times. So it's especially important that customers monitor statements covering their seasonal spending. This will allow them to quickly identify and query any transaction they do not recognise.

A significant number of the banking-related complaints referred to us concern disputed plastic card transactions. The customer denies having made a transaction, while the banking or credit card firm insists it is the customer's responsibility. We decide such cases on the balance of probabilities. Which is more likely, taking into account all the details of the case – that the customer carried out the transaction but then forgot about it, or that their card was used without their authority?

If we decide that credit card transactions were made without the customer's authority, then (under the *Consumer Credit Act 1974*) the customer's liability is normally limited to £50.

But what if the problem is not unauthorised activity, but that the customer's level of debt has become unmanageable? Perhaps heavier-than-usual expenditure over the holiday period has been made worse by something unexpected like an illness or sudden job loss.

We asked our lead ombudsman for banking complaints, Jane Hingston, about this area of financial difficulty.

how is the consumer supposed to access money for living expenses if, for instance, they've reached the limit of their overdraft and can't afford to repay it?

This is always a difficult situation. A bank is not obliged to keep increasing the limit. Anyway, that could do the customer more harm than good in the long term. But the firm must deal '*sympathetically and positively*' with cases of genuine financial hardship. This is set out in section 14.10 of the *Banking Code*, which deals specifically with financial difficulty.

What counts as '*sympathetic and positive*' will depend, to a great extent, on the customer's particular circumstances – there is no 'one size fits all' solution here.

what other action would you expect the firm to take?

A lot of it is just good sense, really. The firm should take practical steps to avoid the situation getting worse – such as offering to cancel direct debits and standing orders which cannot be met, so that charges do not build up on the account.

... many customers rely heavily on overdrafts and credit cards.

... a bank is not obliged to keep increasing the limit.

There may be some scope to look at the interest rate charged on the account – particularly if it is currently being applied at the firm's '*unauthorised borrowing*' rate. A firm should give careful consideration before offering to consolidate existing borrowing. That is because – if approached in the wrong way – this can quickly make a customer's situation worse, rather than better.

Also, when an account is being operated on the margins, one small mistake by the firm can tip things over the edge for the customer and create further financial problems for them. So the firm needs to be more than usually careful not to make mistakes!

The firm should also make sure the customer is aware of the availability of free and reputable debt advice. Such advice can make a real difference where the customer is feeling overwhelmed – owing debts to many different lenders.

is the firm able to offset any of the customer's income against the debt?

A bank cannot just grab any money that comes into the account, in order to repay the debt. This is particularly important where the customer's salary or benefit payments are mandated to the account.

The *Banking Code* says the customer should be left with '*sufficient money for reasonable day-to-day expenses*'. This makes it important for the bank and customer to work together to agree on a repayment arrangement. The arrangement needs to take into account the customer's individual needs and reasonable expectations, so that everything coming into the account over and above the amount to be used for repayment is left free for the customer's use.

If more than one lender is involved, the firm that holds the primary bank account must be prepared to be reasonably flexible. This will help the customer to reach acceptable repayment arrangements for all the debts. The firm would need to take into account all the priority payments the customer has to make – and discuss this with the customer. Household bills and other debts are an obvious priority, as are essential goods and services such as child support payments.

The *Common Financial Statement* – the standard form developed by the British Banker's Association and the Money Advice Trust to chart income and expenditure – can help simplify things for the customer, and we would expect a firm to use this form (or something very like it).

can the ombudsman service help with debt problems in general, then?

No – because the service we offer is dispute resolution, rather than debt or money management. We are not in a position to offer debt advice, or to act as an intermediary between the customer and the firm in arriving at repayment arrangements.

However, we *can* look at cases where a dispute has arisen about whether the customer received sympathetic and positive treatment in respect of financial hardship. We see quite a lot of these types of cases and find most firms will work with us to reach a quick and informal resolution of the complaint, where we are satisfied there is genuine financial hardship.❖

... most firms will work with us to reach a quick and informal resolution of the complaint.

*working***together**

the Financial Ombudsman Service and private medical insurance firms

From time to time, in addition to our series of *working***together** conferences for firms and financial advisers, we organise smaller, informal events, focused on a specific topic. These give us the opportunity to meet a cross-section of those working in a particular field, listen to their views, explain our approach, and increase mutual understanding.

One of these events took place on the afternoon of 1 February 2006, when we hosted an informal seminar in our offices in London's Docklands. An invited audience from around 30 insurance companies and intermediary firms, together with trade body representatives from the *Association of Medical Insurance Intermediaries* and the *Association of British Insurers*, met some of our insurance ombudsmen. On the agenda were issues connected with private medical insurance.

The number of private medical insurance complaints we receive is relatively small. During 2004/05 we dealt with just 337 cases relating to private medical insurance, out of a total of 110,963 complaints. However, we do appear to be seeing a slow but steady increase in this important area of our work.

All the feedback we have received so far about the seminar has been very positive. We are likely to repeat events of this type in the future and welcome the opportunity they give us for detailed discussion with experts in their own particular fields.

The questions and answers on the following two pages reflect some of the private medical insurance issues discussed at the seminar on 1 February.

Q ***what are the main causes of private medical insurance complaints referred to the Financial Ombudsman Service?***

A Over three-quarters of the cases we receive relate to policy terms and conditions. Disputes arise over matters such as:

- the exclusion of claims because the insurer has deemed a condition to be *'chronic'* and therefore no longer covered
- limits on benefits because, for example, the insured person was not treated at a designated hospital
- the application of exclusions for experimental or unproven treatment
- the exclusion of cosmetic and other treatment.

Other significant areas of complaint include maladministration (including delays in authorising treatment or meeting claims) and non-disclosure by the policyholder.

Q ***how does the Financial Ombudsman Service decide whether an insurer should pay for medical treatment?***

A We never make our own medical judgement on whether a particular form of treatment – or a particular hospital or doctor – is right for a policyholder. Nor, generally, does the insurer. It's up to the policyholder's doctor to decide what is right for their patient.

Our role is to assess the evidence and reach a view on whether the insurer has acted fairly and reasonably when deciding whether to meet a claim, taking into account the terms of the contract, the law, good industry practice and the regulator's rules, as applicable at the time of the event complained about.

*working***together**

the Financial Ombudsman Service and private medical insurance firms

Q how does the ombudsman assess the medical evidence in disputes over medical claims?

A There can be no hard and fast rules about the weight we attach to conflicting pieces of medical evidence. Much will depend on the details of the individual case. However, some of the factors we generally take into account include:

- the doctor's professional qualifications and specialisation
- the degree of knowledge that the doctor providing the evidence has of the policyholder's circumstances
- the nature of the doctor's examination
- how close in time the report was to the events at issue
- the independence of the person reporting or commenting on the issues
- any special circumstances surrounding the report.

Our approach is set out in more detail in issue 24 of *ombudsman news*, available on our website (www.financial-ombudsman.org.uk).

Q what is the ombudsman's position regarding exclusions for unproven and experimental treatment?

A Most medical insurance policies provide cover for the cost of treatment but do not accept responsibility for providing medical treatment. However, many insurers seek to exclude treatment which is unproven or experimental. In very general terms, firms are entitled to exclude certain treatments from the cover they provide (as long as this is made clear to policyholders), and to limit cover to the cost of treatment that has been recommended by consultants or specialist physicians.

So what happens when, for a condition that is covered, a policyholder has been advised by their treating consultant to a have a newer treatment instead of an established procedure? Our view is that it would be a harsh and unfair outcome for the firm to reject the claim in its entirety and require the policyholder to have treatment that differs from that recommended by the consultant. It would also be unfair for the insurer to have to pay significantly more for experimental treatment, when it believes a conventional procedure would be adequate.

Our general approach is that it would be fair and reasonable for the insurer to indemnify the policyholder for costs, up to the sum the firm would have been liable for if the conventional treatment had been carried out.

*working***together**

the Financial Ombudsman Service and private medical insurance firms

your complaint and the ombudsman

ordering supplies of our consumer leaflet

your complaint and the ombudsman **is the leaflet that (under the FSA rules) firms are required to give consumers at the appropriate stage in the complaints procedure.**

Firms can obtain supplies by sending us a completed order form (available on the publications pages of our website www.financial-ombudsman.org.uk with a cheque for the correct amount. The leaflets cost £5 per pack of 25, including postage and packing.


order form for consumer leaflet: *your complaint and the ombudsman*

Financial Ombudsman Service

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your order details

Please post this completed form – with your cheque made payable to Financial Ombudsman Service Limited – to:

Leaflets are free to public libraries and consumer advice agencies, such as trading standards departments and citizens advice bureaux – who should email aniko.rostagni@financial-ombudsman.org.uk

ombudsman news

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Financial Ombudsman Service

Previous issues are available online, where you can also use the *search* facility to find information on specific topics.

ask ombudsman news

our first-ever complaint, what do we do?

an independent financial adviser writes ...

Q We are just a small firm and until earlier this month had never received a complaint from a client. However, it looks like our first complaint might end up with the ombudsman. If so, what do we need to do?

A We recognise there are many firms – like yours – that receive complaints rarely and may not be used to the official procedures they have to follow when a customer raises a complaint. Last year around 85% of the firms covered by the ombudsman service had no complaints referred to us.

We will automatically send you a special factsheet – *helping you resolve complaints* – if a consumer complains to us about your firm and:

- we know that we have not had a complaint referred to us about you before *or*
- we appear to get complaints about your firm only rarely.

Our factsheet is also available on the *frequently-asked questions – information and help for firms* pages of our website, together with a factsheet giving more details about how we handle complaints against firms.

You can get a quick overview of the ombudsman rules and procedures from our booklet, *an introduction to the Financial Ombudsman Service*, available on the publications pages of our website (www.financial-ombudsman.org.uk).

mortgage endowment complaints: redress

an investment firm writes ...

Q In cases where we agree the consumer is due redress for a mis-sold mortgage endowment, but where the consumer has already converted to a repayment mortgage, should we reimburse them for the cost of conversion?

A We often see cases where the consumer has already changed their mortgage arrangements and incurred conversion costs *before* the firm offers to pay redress for a mis-sold endowment. We would usually expect the firm to reimburse the costs of switching to a repayment mortgage, ordinarily with interest.

We would also expect the firm to pay any fees that the consumer may incur if they now use the compensation relating to a capital loss (excluding any interest added) to reduce their mortgage balance.

You'll find more about unusual redress scenarios for mortgage endowment complaints in the technical briefings section of our website (www.financial-ombudsman.org.uk)