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mortgage endowment redress in more complicated cases - case studies

case studies

1 where the consumer has converted to a repayment mortgage and retained the policy knowing the risk of doing so

Mr A took out a mortgage endowment policy in 1990. In September 2000 Mr A received a red re-projection letter explaining that there was a high risk that the policy might not pay out the target amount on maturity.

Having considered the options, Mr A decided to convert his mortgage to a repayment basis and to keep the policy for savings purposes in the hope that things would improve.

Later, when he received a second high risk warning letter, Mr A complained to the firm that had sold him the policy. The firm accepted the complaint, but how should compensation be calculated?

normal approach

Usually in cases like this, where the consumer was aware of the risks at the point of conversion, we would expect the firm pay the consumer A + B where:

- **A** = the loss identified by carrying out a loss calculation in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - to the date of conversion, using the surrender value at that date;
- **B** = interest on the amount of A from the conversion date to the date of settlement.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

Mr A may have suffered further losses as a consequence of his decision to keep the policy as a savings vehicle. But as he took the decision to keep the policy after converting his mortgage, knowing that the policy was expected to produce less than the target amount, it would not be fair to expect the firm to compensate him for those losses.

2 where the consumer has converted to a repayment mortgage and retained the policy initially unaware of the risks of doing so

Mr B took out a policy in 1988. By 1996 his financial circumstances had improved and so he decided to convert his mortgage to a repayment basis, as he was keen to reduce his debts. He decided to continue paying money into his endowment policy, as he expected it to pay out the target amount, and more, on maturity.

In August 2002, Mr B received a red re-projection letter. Two years later, Mr B complained to the firm about the sale of the policy. The firm upheld the complaint, but how should compensation be calculated?

Mr B's loss at the point of conversion was the difference between his endowment mortgage position and the position he would have been in if he had taken out a repayment mortgage at the outset. But Mr B did not surrender the policy when he switched to a repayment mortgage and so he did not crystallise his loss at that time.

Unlike Mr A, when Mr B converted his mortgage to a repayment basis, he continued to rely on the advice he had received at the outset.

- When Mr B converted to a repayment mortgage, his mortgage balance was higher than it would have been if he had taken out a repayment mortgage at the outset.

- Consequently, he is likely to have paid more mortgage interest and made higher capital payments to his mortgage since conversion than he would have made to a hypothetical repayment mortgage over the same period. But the difference between his actual mortgage balance and hypothetical mortgage balance is likely to have reduced.
- In addition Mr B has continued to pay money into the policy. He would not have done so, if he had taken out a repayment mortgage at the outset, as he would not have had the policy.

normal approach

Typically, in cases like this, we would tell the firm to pay the consumer D – E, where:

- **A** = the loss identified by carrying out a loss calculation to the *calculation date* (see below) in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - but using a nil surrender value;
- **B** = the premiums paid to the policy from the date of conversion to the *calculation date*;
- **C** = interest on the premiums included in B, from the date of payment to the *calculation date*;
- **D** = A + B + C;
- **E** = the surrender value of the policy at the calculation date.

The firm should pay interest on the loss identified from the *calculation date* to the date of settlement.

The *calculation date* in this case is February 2003 – six months after Mr B received the red letter.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

When undertaking the calculation A, the firm should:

- compare the consumer's current capital position (the outstanding balance of his mortgage) with the position he would have been in, if he had taken out a repayment mortgage (usually with the same term as the endowment policy) at the outset; *and*
- compare the costs of the consumer's actual monthly outgoings (on endowment premiums and mortgage interest *before* conversion, and on capital, mortgage interest and, if appropriate, decreasing term assurance *since* conversion) with the payments he would have made to a hypothetical repayment mortgage.

We understand that some firms would prefer to calculate compensation to the date of settlement. It is unlikely that we would think that unfair.

If Mr B had complained after receiving the red letter in August 2002, and had retained the policy pending the outcome of his complaint (for example, because he thought surrendering the policy might jeopardise his complaint), then we would be unlikely to set the calculation date to February 2003.

Usually we would tell the firm to calculate the compensation to the date of decision or earlier settlement.

3 where the consumer has repaid his or her mortgage and retained the policy knowing the risks of doing so

Mrs C took out a mortgage endowment policy in 1993. In August 2003, she received a red re-projection letter.

Having considered the information contained in the letter, she decided to use her savings to repay her mortgage (in December 2003). She didn't surrender the policy.

In March 2005, Mrs C complained to the firm that had sold her the policy about the advice she had received to take out an endowment mortgage. The firm accepted the complaint, but how should compensation be calculated?

normal approach

Usually in cases like this, where the consumer was aware of the risks when repaying the mortgage, we would expect the firm to pay the consumer A + B where:

- **A** = the loss identified by carrying out a loss calculation in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - to the date that the consumer repaid the mortgage using the surrender value at that date;
- **B** = interest on the amount of A from the mortgage redemption date to the date of settlement.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

Like Mr A in [case study 1](#), Mrs C may have suffered further losses as a consequence of her decision to keep the policy as a savings vehicle. But as she took the decision to keep the policy, after repaying her mortgage, knowing that the policy was expected to produce less than the target amount, it would not ordinarily be fair to expect the firm to compensate her for those losses.

4 where the consumer has repaid his or her mortgage and retained the policy initially unaware of the risks of doing so

Mr D took out a policy in 1987. In 1994 he inherited some money from his mother. He decided to use the money to repay his mortgage. He decided to continue paying money into his endowment policy, as he expected it to pay out at least the target amount on maturity - and so would replace the money he had inherited.

In March 2003 Mr D received a red re-projection letter. Mr D was unhappy, but decided that it would be best to keep the policy as it only had a few years left to run.

Later, when Mr D received a further re-projection letter predicting a bigger shortfall, he complained. The firm upheld the complaint, but how should compensation be calculated?

Mr D's loss at the point when he repaid his mortgage was the difference between his endowment mortgage position and the position he would have been in at that stage with a repayment mortgage. But he did not surrender the policy and crystallise his loss at that time.

Unlike Mrs C in [case study 3](#), when Mr D repaid his mortgage he continued to rely on the advice he received at the outset.

Typically, in cases like this, we conclude that if the consumer had taken out a repayment mortgage at the outset:

- He would also have chosen to repay his mortgage. But (because he would already have repaid some of the capital) he would have used less of the money he inherited to repay his mortgage than he actually did. The extra money would have remained available to him.
- He would not have paid money into the policy after he repaid his mortgage – as he would not have had the policy – and so that money would have remained available to him.
- He would not have had the endowment policy which can be surrendered for value.

normal approach

Ordinarily in cases like this, where the consumer was not aware of the risks associated with his or her policy when repaying their mortgage, we would tell the firm to pay the consumer E – F where:

- **A** = the loss identified by carrying out a loss calculation in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) – using a *nil surrender value*, to the date the consumer repaid his mortgage;
- **B** = interest on the amount of A from the date that the consumer repaid his mortgage to the *calculation date*;
- **C** = the premiums the consumer paid to the policy from the date that he repaid his mortgage to the *calculation date*;
- **D** = interest on the premiums included in C from the date of payment to the *calculation date*;
- **E** = A+B+C+D;
- **F** = the surrender value of the endowment policy at the *calculation date*.

The firm should pay interest on any loss identified from the calculation date to the date of settlement.

The *calculation date* is the date six months after the consumer became sufficiently aware of the risk of an endowment that it was reasonable to assume he should have taken action – in this case September 2003.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

The purpose of the interest is to compensate the consumer for being deprived of money. We assume that the interest payments will be taxed, but we understand that:

- Some firms consider parts B and D of the loss calculation to be compensation for investment loss. Those firms calculate the compensation using a growth rate equivalent to the Bank of England base rate plus 1%, compounded annually, without deduction of tax. It is unlikely that we would think this unfair.
- Some firms calculate part B and D of the calculation using an interest rate of Bank of England base rate plus 1%, compounded annually, with deduction of tax. It is unlikely that we would think this unfair if it means that the consumer receives more compensation than our normal approach.

Ultimately, whether or not the award is taxable is a matter to be resolved between the individual consumer and the Inland Revenue. For further information about tax and redress, see our technical briefing note [is compensation taxable?](#)

We understand that:

- Some firms would prefer to calculate compensation to date.
- Some firms would prefer to calculate compensation in this way, in cases where the consumer was aware of the risk at the time of redemption.

It is unlikely that we would think this unfair.

5 where the policy was sold to support a future mortgage (a "forward sale")

Mr E complained that the firm had wrongly advised him to take out a mortgage endowment policy in 1990 when he was 20 and serving in the army. Mr E had no immediate plans to buy a house. The policy had a 25-year term.

When Mr E left the army in 1995, he bought a house and used the policy to support the mortgage.

The firm accepted that the policy had been mis-sold, but it was not sure how compensation should be calculated. We concluded that:

- If Mr E had not been sold this unsuitable policy, he would not have paid the pre-mortgage premiums. That money would have remained available to him and he should now be compensated for being deprived of that money.
- Mr E took out a policy with a 25-year term in 1990. This meant that he was able to take out a mortgage with a 20 year term in 1995.
- We could not say for certain what the mortgage term would have been if Mr E had not started to pay money into the policy in 1990. But it would be fairest to assume that Mr E would have taken out a repayment mortgage with a 25-year term in 1995. And so Mr E should be compensated to put him in the position he would have been in if he had done that.

normal approach

Usually we would tell the firm to pay the consumer D – E where:

- **A** = a refund of the premiums paid from the date the policy started to the date that the mortgage started;
- **B** = interest on the premiums paid before the mortgage started from the date of payment to the date of decision or earlier settlement;
- **C** = the loss identified by carrying out a loss calculation in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - using a *nil surrender value* and, for the hypothetical repayment mortgage, a mortgage term equal to the original term of the endowment;

- $D = A+B+C$;
- E = the surrender value of the policy at the date of decision or earlier settlement.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

other cases

If Mr E had not ultimately used the policy in connection with a mortgage, we would ordinarily have awarded:

$A + B - C$ where:

- A = a refund of premiums paid to endowment policy to the *calculation date*;
- B = interest on the premiums paid from the date each premium was paid to the *calculation date*;
- C = the surrender value of the endowment policy at the *calculation date*.

The firm should pay interest on any loss identified from the calculation date to the date of settlement.

The *calculation date* is likely to be the date six months after the consumer became sufficiently aware of the risk of an endowment that it was reasonable to assume he or she should have taken action.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

6 where the consumer has made a lump sum payment to the mortgage

Mrs F took out a policy in 1991. In January 2001, she received an amber projection letter, informing her that there was a risk that the policy would pay out less than the target amount on maturity.

Mrs F decided to use £5,000 of the savings she kept in a building society deposit account to repay part of the mortgage, to bring the balance of her mortgage in line with the projected maturity value of the policy.

Later, when Mrs F complained about the sale of the policy, the firm agreed to pay her compensation. But how should the compensation be calculated?

normal approach

Ordinarily in cases like this, where the consumer has made a lump sum payment, we would expect the firm to pay compensation calculated in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - to the date of decision or earlier settlement, with the lump sum included in both the endowment and repayment mortgage calculations.

Although Mrs F might argue she was prompted by the amber letter to use her savings to repay part of the mortgage, it is possible that she may also have used her savings to repay part of a repayment mortgage. It can be argued that Mrs F may simply have put her savings to the best use. We accept that the consumer would not have made the lump sum payment for the *same* reasons if she had taken out a repayment mortgage at the outset. But she may well have made the payment simply because it was a sensible thing to do.

And so usually we take the view that the starting point for the loss comparison should be to compare the consumer's actual endowment position with the repayment mortgage position, assuming that the consumer has used the lump sum in the most economical way.

We understand that some firms would prefer to calculate the compensation without taking the lump sum payment into account at all. We are likely to take the view that this is a fair (and generous) approach, except in cases where the lump sum payment would have fully repaid (or been more than sufficient to repay) the hypothetical repayment mortgage.

7 where the consumer has made a lump sum payment which would have been sufficient to repay a hypothetical repayment mortgage in full

Mrs G took out a £20,000 endowment mortgage in 1985. In June 2002, she inherited £14,000 from a relative. She decided to use the money to reduce her mortgage balance and mortgage interest payments.

Last year Mrs G complained about the advice she received to take out the policy. The firm upheld the complaint and offered to calculate Mrs G's loss.

The calculation showed that if Mrs G had taken out a repayment mortgage at the outset, the outstanding balance of her mortgage, when she made the lump sum payment, would have been £11,000. Consequently, if Mrs G had taken out a hypothetical repayment mortgage at the outset:

- She would have repaid the mortgage in full in June 2002, and she would not have made any further mortgage payments after that. Because Mrs G took out an endowment mortgage, she still has a £6,000 mortgage and has continued to make mortgage interest payments and payments to the endowment.
- £3,000 of the lump sum payment would have remained available to her.

normal approach

Usually we would tell the firm to pay the consumer F – G where:

- **A** = the loss identified by carrying out a costs comparison (between the costs of a hypothetical repayment mortgage and the costs of the consumer's actual interest-only mortgage and endowment policy) to the date that the consumer made the lump sum payment, together with interest on that amount from the date of the lump sum payment, to the date of decision or earlier settlement;
- **B** = the outstanding balance of the consumer's interest-only mortgage following the lump sum payment (without interest);
- **C** = the surplus lump sum that would have remained available to the consumer after repaying the hypothetical repayment mortgage, together with interest on that amount from the date of payment to the date of decision or earlier settlement;
- **D** = the payments that the consumer has made to the interest-only mortgage since the date that the hypothetical repayment mortgage would have been repaid, together with interest on each payment made from the date of payment to the date of decision or earlier settlement;
- **E** = the premiums that the consumer has paid to the policy since the date that the hypothetical repayment mortgage would have been repaid, together with interest on each premium from the date of payment to the date of decision or earlier settlement;
- **F** = A + B + C + D + E;
- **G** = the surrender value of the policy at the date of decision or earlier settlement.

Interest is usually calculated at 8% simple per year [from 1 April 1993 and 15% per year simple before that date].

step 1: calculating A

The firm should compare the costs of the consumer's actual monthly outgoings on premiums and mortgage interest prior to the lump sum payment with the costs of a hypothetical repayment mortgage.

- The lump sum payment should be *excluded* from both of the total costs figures.
- If the comparison shows that a repayment mortgage would have been more expensive, and the consumer made notional past savings as a result of having made lower payments, those savings should usually be ignored (subject to normal criteria).
- If the costs comparison shows that the consumer's endowment mortgage was more expensive than the hypothetical repayment mortgage would have been, then the additional expense, together with interest on that amount calculated from the date that the consumer made the lump sum payment to the date of decision or earlier settlement, is **A**.

step 2: calculating B and C

The firm should determine what the outstanding balances of the consumer's interest-only mortgage and the hypothetical repayment mortgage would have been, immediately before the consumer paid the lump sum. The firm should then apply the lump sum payment to those balances. This will show:

- What the outstanding balance of the endowment mortgage was (and, assuming that the consumer has not made further capital reductions, continues to be) after the consumer made the lump sum payment, is **B** (a debt that the consumer would not otherwise have had).
- How much of the lump sum would have remained available to the consumer after repaying the hypothetical repayment mortgage. This amount, together with interest calculated from the date that the consumer made the lump sum to the date of decision or earlier settlement, is **C**.

8 where the consumer has made a lump sum payment, but has more than one policy

Mrs H took out a £20,000 endowment policy in 1986 on the recommendation of Firm 1. She took out a second £10,000 policy in 1987 on the recommendation of Firm 2, when she moved house and increased her mortgage.

In 1998 Mrs H was made a redundant. She used her redundancy money (£6,000) to reduce her mortgage balance to £24,000.

Mrs H has now complained about the sale of both policies. The firms have upheld her complaints and have offered to pay compensation calculated in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#). But how should the £6,000 lump sum payment be taken into account?

normal approach

Occasionally there will be evidence to show - or it will be clear from the consumer's circumstances - that the lump sum payment was directed to a specific part of the consumer's mortgage supported by a particular policy.

But in the absence of such evidence, we will usually tell the firms to apportion the lump sum in accordance with the size of the policy.

So in this case, we would expect Firm 1 to take £4,000 of the lump sum payment into account when calculating Mrs H's loss and Firm 2 to take £2,000 into account.

9 where the consumer now has an offset mortgage

Mr J took out a £35,000 interest only mortgage supported by an endowment policy in 1990. In 2002 he re-mortgaged to a new lender in order to take advantage of the "offset facility" available to borrowers.

Since 2002, Mr J's interest only mortgage account has been linked to his current account and savings account and as a result of the offsetting facility, his outstanding mortgage balance has reduced to £34,300.

Mr J has now complained about the advice he received. The firm has accepted the complaint, but how should compensation be calculated?

We are likely to conclude that:

- With suitable advice, Mr J would have taken out a repayment mortgage at the outset.
- He would still have re-mortgaged in 2002 in order to take advantage of the offset facility, although the offset mortgage would have been on a repayment basis.
- Mr J would have received a similar benefit from the offsetting facility if it had operated on a repayment basis.

normal approach

We understand that in cases like this it can be very difficult to calculate accurately the consumer's loss.

Consequently, we will usually tell the firm to pay compensation calculated in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#) - to the date of decision or earlier settlement.

When calculating the consumer's loss, the firm should ignore the effect of the offsetting facility (to both the endowment and hypothetical repayment mortgage) if it is not possible to carry out an exact calculation. We envisage it will not be possible to carry out an exact loss calculation in the majority of cases.

Whilst the consumer may have benefited from the effects of offsetting, we are likely to conclude that he or she would have received similar benefits with a repayment mortgage. And so it would be fairest to ignore the effects of offsetting.

10 where the firm **churned** an existing policy and recommended an unsuitable policy

Mr K took out a £20,000 interest-only mortgage supported by an endowment policy in 1987. In 1991, when Mr K was looking to move house and to increase his mortgage to £40,000, he was advised to take out a new policy to cover the whole amount and to surrender his existing policy because it was an "inferior product".

Last year, when Mr K complained about the advice he had received to take out the second policy, the firm upheld his complaint. The firm accepted that it had advised Mr K to surrender his existing policy when it should not have done so and that the policy it recommended was unsuitable for Mr K.

But how should compensation be calculated?

normal approach

We are likely to conclude that the firm should compensate the consumer for both the unsuitable advice to surrender the first policy and the advice to take out a second unsuitable policy.

To compensate the consumer for the unsuitable advice to surrender the first policy, we would usually tell the firm to pay the consumer D + E where:

- **A** = the total premiums paid to the surrendered policy;
- **B** = interest on each premium, calculated from the date of payment to the date that the policy was surrendered;
- **C** = the surrender proceeds that the consumer received;
- **D** = $A + B - C$;
- **E** = interest on D, calculated from the date of surrender until the date of settlement.

Interest is usually calculated at 8% simple [from 1 April 1993 and 15% per year simple before that date].

To compensate the consumer for the unsuitable advice to take out the second policy, we would usually tell the firm to pay compensation calculated in accordance with the FSA's guidance, [Handling Mortgage Endowment Complaints](#).

note

"Churning" is the industry term for the situation where a salesman persuades a consumer to surrender or stop an existing policy and take out a new policy that, for all intents and purposes, provides the same cover or investment type.