

Financial Services Authority

Endowment Mortgage Complaints

Feedback on CP75 and 'final' text

May 2001



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This policy statement sets out the joint response of the Financial Services Authority and the Personal Investment Authority following their consideration of representations made in response to Consultation Paper (CP)75. It contains the guidance as finally made and issued by the Board of the Personal Investment Authority which has effect from the date herein. The guidance has also been approved by the Board of the Financial Services Authority and will be legally made when the FSA assumes its rule-making powers.

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1 Executive summary

- 1.1 This paper provides feedback on Consultation Paper 75 (CP75). CP75 sought views on the guidance that the Financial Services Authority (FSA) and the Personal Investment Authority (PIA) (the regulators) proposed to issue about the standards firms should apply while resolving complaints of endowment mis-selling where the policies have been sold in connection with a mortgage. This paper contains the regulators' 'final' guidance which has been amended in the light of comments made in the course of the consultative exercise.
- 1.2 We received 74 responses to CP75, mainly from firms, trade associations, consumer organisations and consultants as shown in Annex B. We are grateful to respondents for their detailed and helpful comments on the issues raised in CP75 and for the further additional comments they made.
- 1.3 Respondents generally welcomed the regulators' initiative in proposing draft guidance on the standards to be applied in dealing with endowment complaints.
- 1.4 A few significant points were raised during the consultation but with the exception of two matters, namely the role of the Traded Endowment Policy market and 'windfalls' in the redress process, we have not identified any need for major policy changes. Respondents were generally seeking clarification, reassurance and, in some cases, more comprehensive written guidelines. The Traded Endowment Policy market is dealt with at paras 2.21 – 2.23.
- 1.5 Those respondents who drew attention to demutualisation windfalls received by endowment policyholders contended that the guidance should provide for their amount to be brought fully into account in calculating whether, and if so, in what amount, the investor has suffered financial loss. We are considering this view very carefully and will in due course issue guidance.
- 1.6 Where possible and appropriate we have amended the text of the guidance to meet the points raised, but as it is general guidance it will not be practicable to address all the detailed points. The final text of the guidance is in Annex A.

- 1.7 The guidance applies to the handling by firms of endowment mortgage complaints where the advice in question was given after 29 April 1988 and to those which may be investigated under the voluntary jurisdiction of the PIA Ombudsman Bureau. It will also be relevant, post N2, to the handling by firms of endowment mortgage complaints which fall within the jurisdiction of the Financial Ombudsman Service.
- 1.8 The guidance is directed at firms currently regulated by the PIA and is effective immediately. It lasts until the PIA's regulatory functions end.
- 1.9 Once the relevant provisions of the Financial Services and Markets Act 2000 (FISMA) are implemented, the FSA will become the single regulator of all firms conducting investment business in or from the United Kingdom. At the date of such implementation the guidance will take effect for the purposes of the FISMA within the Complaints Sourcebook, which in turn is part of Block 4 of the FSA's Handbook of Rules and Guidance.

2 Feedback on responses to CP75

- 2.1 CP75 invited comment on 11 particular questions set out in the Summary of Consultation Questions. Below is a commentary on the responses we received to each of them. The commentary refers to those changes we have introduced to the guidance text in light of the submissions and representations made.
- 2.2 In addition to the 11 specific questions, respondents also made particular comments on the guidance section, 'Continuing Life Cover and other Policy Benefits'. This is also dealt with at the end of this section.

CP75 asked whether the FSA had failed to identify any areas where the proposed guidance could lead to significant costs which they would not otherwise incur in handling these complaints.

- 2.3 Of the 74 responses, 17 respondents commented.
- 2.4 Respondents were mainly concerned about:
- firms having to reopen settled complaints, leading to extra costs;
 - the potential administration costs of carrying out the 'repayment versus the endowment' comparison, as individual customer records were likely to be incomplete;
 - product providers and lenders charging excessive fees for providing information to reconstruct policies and remortgages;
 - redemption penalties that might be payable under a remortgage.
- 2.5 Of the above issues only the first identifies a potential source of cost which had not been identified in CP75.
- 2.6 The guidance sets out the standards that firms are to apply when dealing with endowment complaints going forward, and it is not intended to require firms to reopen complaints which have been settled prior to the issue of this statement and guidance. Firms will nevertheless want to satisfy themselves that they have dealt with past complaints in a thorough and adequate way.

The historic standards that firms have applied to resolving endowment mortgage complaints have been, and will continue to be, an aspect of FSA supervision.

CP75 asked whether the standard approach to redress set out in the guidance is appropriate.

- 2.7 Of the 74 responses, 62 respondents commented.
- 2.8 In CP75 we stated our view that in law, if a firm has determined on due investigation that a consumer has not been given proper advice, or that the firm has breached another duty of care, that firm must (if the consumer has been caused loss or damage) offer such redress to the consumer to put him, so far as is practicable, in the position that he would have been in had the breach not occurred. We considered that in most cases the approach to determining loss and making redress will probably be based upon the conclusion that the consumer would, if he had not been misadvised, have taken the same loan on a repayment basis, instead of an endowment basis.
- 2.9 Two respondents argued that the standard approach was wrong in law and that the correct measure of redress in each case would be a refund of endowment premiums paid with interest.
- 2.10 Having taken advice, we remain of the view that the correct approach will be to assess whether the consumer has suffered financial loss by making a comparison with the position he would have been in had the loan been taken out on a repayment basis.
- 2.11 Nearly all respondents thought, subject to points of detail, that the standard approach meets appropriate legal principles.
- 2.12 Some said that lower endowment outgoings should always be taken into account, arguing that this would always give the consumer an element of betterment. Others took entirely the opposite view, and said that lower endowment outgoings should never be brought into account, arguing that while a consumer may have had higher disposable income as a result of the lower outgoings, this was an inadvertent gain caused by poor advice in the first place.
- 2.13 The guidance we are issuing at DISP App 2.2.3G to 2.2.13G carries forward the general policy set out in CP75, namely, that lower endowment outgoings may be brought into account in the circumstances where it is not unreasonable to do so. This is subject however to firms electing to adopt the simplified approach and not bringing any lower outgoings into account. Furthermore, some respondents argued that our approach to the treatment of lower outgoings was wrong in principle and unreasonable in that it prejudiced unfairly the position of complainants. We have taken these responses into account, and revisited our underlying legal analysis. The final guidance

reflects this by setting out the additional area where it may be unreasonable to take lower outgoings into account. This is where the complainant was advised or informed at the time when they took out the endowment policy that he would have lower outgoings when compared with those under a monthly repayment mortgage and he has gone on to dissipate his savings.

- 2.14 We wish to emphasise that whether or not lower outgoings can properly be brought into account will depend on the facts of each individual case. It is evident from comments made by a number of respondents that the draft guidance did not set out sufficiently clearly our expectations in respect of the assessment. The assessment will necessarily involve consideration of the consumer's complete financial position. If a firm intends to make a deduction for all or any part of the lower endowment outgoings, it should clearly explain to the complainant in writing both how the 'sufficient means' test has been satisfied, including details of the information taken into account in reaching the decision, and how the amount of any deduction has been arrived at. Firms will be expected to demonstrate that an assessment in accordance with the guidance has been completed. If they conclude that a deduction for any part of the lower endowment outgoings is appropriate they should inform the consumer of how they reached that decision, and the steps he should take if unhappy with that decision. To reflect this, we have added a new paragraph (DISP App 2.2.11G) to the guidance text.
- 2.15 Some respondents requested further guidance on how to apply the 'sufficient means' test to determine whether or not and to what extent lower endowment outgoings should be brought into account. Given the need to assess the individual circumstances of each case, it is not considered that it would be practical to do so.
- 2.16 Others took the view that demutualisation benefits should also be brought into account in the outgoings calculation, as stated in the Executive summary. We will issue guidance on this in due course.
- 2.17 Some respondents were of the view that it was not appropriate to use the surrender value of the life policy for the purposes of the basic 'repayment versus endowment' comparison of the capital position arguing that the 'market' value of the policy should be used.
- 2.18 The basic objective of redress is to put the consumer, so far as is possible, in the position he would have been in if the inappropriate advice or other breach of duty had not occurred: for their part consumers should take such reasonable steps as they can to limit loss once they became aware of the position they are in by virtue of having received unsuitable advice at the time of sale. Usually this will mean relinquishing the endowment policy.
- 2.19 In practice, it is likely to be appropriate for a consumer whose complaint has been upheld to convert to a repayment mortgage, irrespective of whether or

not there is financial loss to date. It will normally be possible for consumers to do so without incurring unreasonable cost. Conversion will of course ensure that the consumers no longer has a policy which has been shown to have been unsuitable.

- 2.20 Firms should therefore in the case of upheld complaints inform consumers that it is likely to be appropriate and necessary for them to convert to a repayment arrangement.
- 2.21 As stated above, one aspect in the conversion process is the disposal of the endowment policy. The standard approach to assessing loss requires firms to calculate loss using the surrender value. However, once loss is established on this basis and firms move to deal with redress they may wish to consider whether there is a role for the policy's 'market value' within the traded endowment policy (TEP) market.
- 2.22 A firm may arrange the sale of the endowment policy on the traded endowment market, provided the full implications of such a course of action are explained to the consumer and his express consent is obtained. This includes informing the consumer that he will continue to be the life assured under the policy. The consumer will have to be informed that such an arrangement may reduce or eliminate the amount of redress actually borne by the firm, but not so as to affect the amount of redress he receives.
- 2.23 In the event that a consumer is willing to pursue this option, a firm must of course first have assessed the consumer's loss using the approach set out in the guidance and this, together with the costs of remortgaging and any other consequential costs, is the minimum amount the consumer must receive. In order to ensure the process does not delay the provision of redress the firm must pay this minimum sum once the consumer agrees to the remortgage and sale arrangement. To the extent that the net amount realised by the sale of the policy on the traded endowment market exceeds the total redress due to the consumer, this greater sum is to be paid to the consumer on completion of the sale. If the amount realised by the sale of the policy on the traded endowment market is less than the total redress due to the consumer, the firm will be responsible for the amount of the shortfall. DISP App 2.3 has been amended to take account of the possible role of the Traded Endowment Policy market.
- 2.24 Other issues raised by respondents were
- The use of underpinning or guarantees as an alternative to the standard approach.

The guidance acknowledges that some firms may choose to offer consumers a guarantee or underpinning arrangement as an alternative to the standard approach to redress (see DISP App 2.5.10G). It is

important that firms proposing to use underpinning or guarantees consult us beforehand.

- Whether a policy delivered the target amount would only be known at maturity, so redress ought not to be considered until then.

The guidance is mainly about complaints based on a firm's failure adequately to explain, and consequently a consumer's failure to understand and accept, the investment risk in an endowment policy. Damage to the consumer occurs at the point when an endowment policy is inappropriately sold. Legal principle requires that once the consumer has demonstrated that such damage has occurred, any pecuniary or financial loss can be assessed at that point, regardless of the remaining length of the contract.

- Whether the basic eight-week timescale permitted by current PIA rules for investigating complaints without firms having to send consumers a letter reminding them of the right of referral to the Ombudsman was insufficient and should be altered.

The issue was raised by only two respondents, so we do not regard it as a widespread concern. Firms are encouraged to bring operational difficulties to the regulators' attention at the earliest opportunity.

- Payment of redress should be conditional on the underlying endowment policy actually being surrendered.

As explained above, the guidance is mainly concerned with assessing loss and providing redress in cases of complaint where the firm finds that it failed adequately to explain the nature and degree of market risk inherent in the endowment policy. It follows from this that it can be expected that the consumer will be complaining (whether directly or indirectly) that he should never have been sold such a policy since, if the matter had been the subject of proper enquiry at the time it would have been found that the policy was not a suitable repayment vehicle for that consumer). Accordingly, it would not be unreasonable if a firm providing redress in these circumstances were to frame its offer of redress on the assumption that the consumer will agree to surrender the policy. However, firms should bear in mind that there may be circumstances where it is appropriate for the consumer to retain the policy, for example where it is being retained as a savings vehicle. This is now reflected in the guidance.

- In making the overall 'repayment versus endowment' comparison, account should be taken of a mortgage arrangement fee that would have been payable by the mortgagor if it had not been waived because he had bought an endowment policy (with the attendant commission).

Whilst we cannot comment on the legal effectiveness and enforceability of any individual agreements to waive arrangement fees, each case will have to be assessed on its own facts and documentation. There are likely to be cases where it is appropriate to take into account the previously waived arrangement fee. We have amended the guidance (DISP App 2.2.3G).

CP75 asked whether the proposal to permit firms to adopt a simplified approach to the treatment of outgoings is sustainable and attractive to firms.

- 2.25 Of the 74 responses, 31 respondents commented.
- 2.26 In CP75 we put forward the proposal that for practical reasons, firms could, as an acceptable alternative, ignore any consumer benefit from lower outgoings when they assess overall compensation.
- 2.27 Nearly all respondents found the proposal attractive, without making further material comment.
- 2.28 Some respondents intimated that as a matter of policy they may decide to adopt the simplified approach in all cases. Others particularly welcomed the discretion available to them in deciding whether to adopt the simplified approach on a case-by-case basis.
- 2.29 Several respondents, while agreeing with the proposal, said that it was not necessarily compatible with the aim of dealing with all complaints consistently. We note these comments, but do not consider that the simplified approach compromises the aim of consistency, as it relates only to an aspect of the redress calculation within the standard approach. As such it does not affect the overall integrity of the standard approach. Furthermore, irrespective of the guidance, it would always be open to firms to disregard endowment savings in individual cases if they so wished.
- 2.30 We have concluded that the simplified approach is likely to be a beneficial option for firms: it is administratively expedient, without reducing the redress entitlement of individual consumers.

CP75 asked whether it is appropriate to assume mortgage payments are made monthly and whether there are any alternative ways that the calculations could be simplified while not significantly changing the calculation of redress.

- 2.31 Of the 74 responses, 27 respondents commented.
- 2.32 Nearly all respondents thought it appropriate to assume monthly mortgage payments, without making further material comment. Accordingly, we have left unchanged this aspect of the guidance.

CP75 asked, when no repayment quotation had been given at the point of sale, whether it was appropriate to assume that for carrying out the basic 'repayment versus endowment' comparison the interest rate should be assumed equal to what was stated in the consumer's current endowment arrangements.

- 2.33 Of the 74 responses, 41 respondents commented.
- 2.34 Nearly all respondents agreed that our proposal was appropriate in principle. However a significant number sought further guidance or put forward suggestions as to what interest rate should be used in the comparison calculation, in view of the potentially high administrative cost of obtaining historic rates on a case-by-case basis.
- 2.35 We recognise that using standard average or assumed rates of interest may be attractive for the 'repayment versus endowment' comparison, as this would reduce the amount of work involved in making the necessary calculations. However in most cases, any given mortgage lender will usually have offered a repayment option as well as an interest-only loan, so it is possible to recreate and track the actual interest rates and mortgage conditions applicable throughout the lifetime of the mortgage. We regard this as desirable because of the large number of lenders, products and special deals in the market and the wide variations in loan terms and conditions such that the use of standard, average or assumed rates of interest could lead to a significant distortion in individual cases.
- 2.36 However, we note that a software package is available or being developed that incorporates historic interest rates for all major lenders with extra facilities to deal with special rate deals etc. Such a package may be attractive to firms.

CP75 asked whether the guidance had properly assessed the circumstances in which it is appropriate to deduct the cost of life cover in calculating overall redress.

- 2.37 Of the 74 responses, 42 respondents commented.
- 2.38 In CP75 we proposed that unless it was clear that a consumer with an endowment mortgage had no foreseeable need for life cover when the endowment arrangements were concluded, firms should normally make an adjustment representing the cost of life cover (and optional additional benefits) in their overall comparison between a repayment and an endowment mortgage.
- 2.39 Many respondents considered that the guidance had properly assessed the circumstances in which a deduction representing the cost of life cover should be made from any redress, without making further material comment.
- 2.40 Some respondents said that the cost of life cover should be deducted in all cases where the consumer has dependants, leaving it to the consumer to give good reason why this should not occur. We see the attraction of this proposal for firms but believe the correct approach is as set out in DISP App 2.2.26G. This states that due enquiry must be made to identify whether there was foreseeable need for life cover when the arrangements were concluded, regardless of the consumer's apparent status.

2.41 A significant number of respondents said the absence of a decreasing term assurance (DTA) quote on the consumer file should not itself lead to a conclusion or presumption that there was no need for life cover. An assessment of whether a need had been established should only be made by reference to the supporting fact find or enquiries of the consumer. We accept the force of these comments and have amended the guidance accordingly.

2.42 If a deduction for the cost of life cover is to be made where there is no quote available on their file, we continue to believe that firms should use DTA rates they would have quoted if they had got such a quote. We acknowledge the practical difficulties of this, but consider that the wide variation in DTA rates means that a standard or benchmark rate is likely to have unacceptable distorting effects in individual cases.

CP75 asked whether it is appropriate for firms to pay the costs associated with remortgaging.

2.43 Of the 74 responses, 38 respondents commented.

2.44 Many respondents agreed that it was appropriate for firms to pay the costs associated with remortgaging without making any further material comment. Some respondents said costs should only be paid where the customer takes a straight conversion from interest-only to repayment of an existing arrangement. Others thought that firms should not be responsible for paying early redemption penalties.

2.45 We consider that the costs payable will usually be limited to the costs of conversion that would be incurred where the arrangement is made with the existing lender and to the equivalent repayment mortgage. But in some circumstances additional costs, which could include redemption penalties, may be payable. To make the basic position clear, we have amended DISP App 2.3.4G of the guidance.

2.46 Some respondents asked why firms should have to pay remortgage costs if, on the current 'endowment versus repayment' comparison, there was no loss. This is dealt with at DISP App 2.3.1G. It states that when a complaint is upheld – irrespective of whether there is a financial loss to date – consumers should, once told that their position arises from failure of advice at the time of sale, take such reasonable steps as they can to limit possible future loss.

2.47 We consider that the costs payable are likely to include the reasonable cost of the consumer taking financial advice on the available options, although some respondents felt that any such costs should not be recoverable.

2.48 Although they offered no evidence, some respondents were concerned that lenders might seek to profit from individual remortgages by charging inflated fees; they suggested that the FSA should agree a scale of charges with the

Council of Mortgage Lenders. We note the concern, but do not consider that we should become involved.

CP75 asked whether it is appropriate for firms to meet the cost of any policy reconstruction.

- 2.49 Of the 74 responses, 31 respondents commented.
- 2.50 In CP75 we proposed that in dealing with upheld complaint cases where the policy is not affordable because the term of the mortgage extends beyond the consumer's normal retirement age, the redress may in some cases take the form of reconstructing the policy with a shorter term.
- 2.51 The majority of respondents accepted that firms should be responsible for the costs of reconstructing the policy without further material comment. Several IFAs commented on the practical difficulties that they might encounter in trying to reconstruct policies, as they would be relying on the co-operation of product providers. Some respondents said individual calculations would be time-consuming for with-profits policies, and asked that the regulators agree to a standard procedure.
- 2.52 We recognise the work involved in policy reconstruction and the considerable co-operation of product providers that is required to achieve this, and we expect firms to provide complete and timely co-operation. Noting the individual nature of every case, and the wide range of products and cost structures that could be involved, we have concluded that this is not an area where a standard approach could be easily applied. However, we would welcome proposals from firms setting out how a standard approach might work and their predicted effect on the amount of redress for different classes of consumers.
- 2.53 Further guidance was requested on the equivalent redress (DISP App 2.4.9G) that must be offered where it is not possible for a firm to reconstruct a policy. We have amended this paragraph to give an example.

CP75 asked whether product providers should provide the consumer with a reprojection letter at the time of a policy reconstruction.

- 2.54 Of the 74 responses, 32 respondents commented.
- 2.55 The majority of respondents said product providers should provide a reprojection letter at the time of a policy reconstruction without making further material comment.
- 2.56 The following points were raised by those respondents who did comment further:
- the reprojection letter should be a matter for individual firms and not compulsory;

- the exercise was unnecessary in view of the ABI's twice-yearly review programme.
- 2.57 We consider that where a firm has agreed that redress is due, it is appropriate for the firm to inform the individual consumer of his new position. He can then take action if necessary to satisfy himself that his policy will meet the amount due on the mortgage loan.
- 2.58 Some respondents were concerned that issuing such a letter which showed a projected shortfall at maturity could prompt further complaint from individual consumers. Although further complaints cannot be ruled out, we do not consider this to be a significant issue as the original complaint is likely to have been on the grounds of affordability only and not a failure to understand and accept investment risk. If a consumer, after receiving the new reprojected letter, then complains about investment risk, a firm would have to deal with the matter.
- 2.59 Despite the above comments, we believe that the benefits of issuing a new reprojected letter outweigh its potential disadvantages, so the guidance remains unaltered in principle. However, we recognise that the timing of such letters will be important and have made small textual amendments to the guidance at DISP App 2.4.8G.

CP75 asked whether it is appropriate for firms to be responsible for any income tax liability arising from either a policy surrender or reconstruction.

- 2.60 Of the 74 responses, 30 respondents commented.
- 2.61 The majority of respondents said that firms should be responsible for any income tax liability arising from either a policy surrender or reconstruction without making further material comment. Some respondents said firms should not have any such liability, while others stated that liability should only extend to policy reconstructions, not surrenders.
- 2.62 In line with legal principles for compensation, we have left unchanged the obligation in the guidance that firms reimburse complainants for any tax payable. It is confirmed that this proposal accords with current FOS policy.
- 2.63 Several respondents asked the FSA to begin discussions with the Inland Revenue about relaxing qualifying rules so that no potential tax liability arises. We have discussed with the Revenue the income tax issues which may affect policy surrenders or reconstructions arising during the resolution of mortgage endowment complaints, but believe that individual firms should discuss their own circumstances with the Revenue. The Revenue has said that there could be potential income tax liability where any form of 'underpinning' or 'guarantee' is given by way of redress and our amendment to the guidance at DISP App 2.5.8G reflects this.

CP75 asked whether offer of settlement letters may make reference, where appropriate, to the proposals for settlement being consistent with the guidance.

- 2.64 Of the 74 responses, 35 respondents commented.
- 2.65 Nearly all respondents said firms should have individual discretion to refer to the guidance in these letters, without making further material comment.
- 2.66 Some respondents felt that offer of settlement letters that referred to the guidance should go on to state that any Ombudsman award would be calculated on the same basis; and that if, on referral, the Ombudsman made the same, or no better, award, then the consumer would be liable for the firm's costs of the referral. We believe that nothing should deter consumers from going to the FOS, so we do not accept that the reference to the guidance should be qualified in this way.

Continuing Life Cover and other Policy Benefits

- 2.67 Several respondents wanted more clarification as to when firms might have a liability to pay part of the cost of continuing life cover. Appropriate amendments have been made by inserting in the guidance new paras DISP App 2.5.4G and DISP App 2.5.5G, with subsequent renumbering.

3 Table of changes to text

Table of changes to the guidance between CP75 and the final text:

Proposed placing of guidance in Block 4 of the Handbook at DISP 1 Annex 1 G (see DISP 1.3.14 G) has been replaced by	DISP App 2 (see DISP 1.2.22G)
Insert DISP App 2.2.2G	This paragraph makes it clear that it is to be assumed the complainant could have afforded the mortgage on a repayment basis unless the contrary is shown
Old para 2.2 now DISP App 2.2.3.G	The amendments make clear the date at which the repayment - v- endowment comparison is to be made, and acknowledge that, exceptionally, other factors may have to be included in the overall calculation, e.g., any waiver of mortgage arrangement fees
Old para 2.3 now DISP App 2.2.4G Old para 2.4 now DISP App 2.2.5G	
Old para 2.5 now deleted	
New DISP App 2.2.6G	States the general principle that where an endowment arrangement is cheaper than a repayment alternative, savings should be brought into account unless it is unreasonable to do so
New DISP App 2.2.7G	Outlines circumstances where it is unlikely to be reasonable to bring such savings into account
New DISP App 2.2.8G	States that it may be appropriate to bring savings into account where complainant is of 'sufficient means'
Old para 2.6	Replaced by DISP App 2.2.9G

New DISP App 2.2.10G	Outlines a streamlined process available to firms as an alternative to a full 'sufficient means' test
Old para 2.7 deleted	
Old para 2.8 deleted	
New DISP App 2.2.11G	This paragraph provides further details of firms' obligations with regard to the full 'sufficient means' test and assessment of any lower outgoings deduction
Old para 2.9 now new DISP App 2.2.12G	
Old para 2.10 now new DISP App 2.2.13G	
New DISP App 2.2.14G	This paragraph states when it may and may not be appropriate for a firm to require a complainant to surrender an endowment policy prior to a payment of compensation being made
Old para 2.11 now DISP App 2.2.15G	The amendment makes it clear that the complainant must act without unreasonable delay
Old para 2.12 now DISP App 2.2.16G	An amendment makes it clear that the effect of MIRAS is to be factored in to the comparison calculation
The Examples 1-7 (new DISP App 2.2.17G - DISP App 2.2.24G)	'Losses' are now depicted throughout the examples by the use of parentheses only
Old para 2.13 now DISP App 2.2.25G	The amendment makes it clear that the comparison between an interest-only mortgage and a repayment mortgage should be conducted by tracking actual interest rates and conditions
Old para 2.14 now DISP App 2.2.26G	The amendment gives further guidance on how any adjustment for the cost of life cover is to be treated
Old para 2.15 deleted	
Old para 2.16 now DISP App 2.2.27G	
New DISP App 2.3.1G	This paragraph specifies both the basic objective of redress and the obligations incumbent on the complainant to limit his loss
New DISP App 2.3.2G	This paragraph states that the likely course of action will be for a complainant to convert to a repayment mortgage

New DISP App 2.3.3G	This paragraph states the firm's obligation to inform the complainant that conversion to a repayment is likely to be appropriate
New DISP App 2.3.4G	This paragraph outlines circumstances in which the firm may be liable for costs of conversion
Old para 3.3 now DISP App 2.3.5G Old para 3.4 now DISP App 2.3.6G Old para 3.5 becomes DISP App 2.3.7G	
New DISP App 2.3.8G	This paragraph considers when it may be appropriate to use the traded endowment market
New DISP App 2.3.9G	This paragraph details firms' obligations where a firm arranges a sale on the traded endowment (TEP) market
New DISP 2.3.10G	This paragraph details the steps to be taken if a TEP sale is arranged
Old para 4.5 now DISP App 2.4.5G	The amendment specifies that costs to be borne by the firm in a policy reconstruction are subject to any lower outgoings deduction
Old para 4.8 now DISP App 2.4.8G	The amendments make it clear that the issue of a reprojected letter is considered to be good practice, and reminds firms that the timing of such letters will be important
Old para 4.9 now DISP App 2.4.9G	An example of equivalent redress is given where it is not possible to reconstruct a policy
Example 8	The figures have been corrected to show the difference in policy values as £8,800 and not as £8,700 as in the draft text. The reference in 'Additional Information' to the reprojected letter now reads 'should provide' in accordance with the guidance at DISP App 2.4.8G
DISP App 2.5.3G	The last sentence of the draft paragraph 5.3 has been deleted
DISP App 2.5.4G and 2.5.5G	These paragraphs give further guidance on firms' obligations with regard to continuing life cover
Old para 5.4 becomes DISP App 2.5.6G	

Old para 5.5 becomes DISP App 2.5.7G	Amendments to this and to DISP App 2.5.10G make it clear that any underpinning or 'guarantee' of policies could have income tax implications
Old para 5.6 becomes DISP App 2.5.8G	
Old para 5.7 becomes DISP App 2.5.9G	
Old para 6.1 becomes DISP App 2.5.10G	
Old para 7.1 becomes DISP App 2.5.11G	
New DISP App 2.5.12G	This paragraph gives further guidance on the inclusion of the 'statement' in the offer of redress letter

Guidance on handling mortgage endowment complaints

1. New DISP 1.2.22G is inserted as follows:-

Handling endowment mortgage complaints

‘1.2.22G DISP App 2 contains guidance to firms on the approach to assessing financial loss and appropriate compensation in circumstances where a firm regards a complaint in relation to the sale of an endowment policy (which is sold for the purposes of repaying a mortgage) as justified.’

2. Insert new appendix (DISP App 2) as follows:

DISP App 2 (see DISP 1.2.22G)

2. Handling Mortgage Endowment Complaints

2.1 INTRODUCTION

- 2.1.1 G This appendix sets out the approach and standards which *firms* should use when investigating complaints relating to the sale of endowment policies for the purposes of achieving capital repayment of a *mortgage*. It is not intended to be comprehensive. It is primarily concerned with the assessment of whether the complainant may have suffered financial loss, and if so, how much that loss is, and therefore what amount a *firm* should consider offering by way of fair and appropriate compensation in circumstances where the *firm's* investigation of a complaint reveals:
- (1) the complainant has received negligent *advice on investments*; and
 - (2) if this advice had not been negligent, either:
 - (a) the complainant would be unlikely to have acquired the endowment policy but instead would have taken out the same amount of loan on a repayment basis; or
 - (b) the complainant would have acquired an endowment *mortgage* for a shorter term.
- 2.1.2 G There will also be cases where a *firm* will conclude after investigation that, notwithstanding its own failure to give compliant and proper advice, the complainant would nevertheless have proceeded with the endowment policy as sold, in which case no compensation will be due.
- 2.1.3 G This appendix only addresses how *firms* should approach the assessment of loss and compensation where negligence on the part of the *firm* is established.
- 2.1.4 G It is relevant both to the obligations arising under the complaints handling *rules* contained in *DISP* 1.2G and to the *FSA's* approach to the supervision of *firms*.
- 2.1.5 G The appendix is also relevant to complaints which the *Ombudsman* may investigate under the *Compulsory Jurisdiction* or *Voluntary Jurisdiction* of the *Financial Ombudsman Service* established under Part XVI of the *Act*.
- 2.1.6 G Before proceeding to assess the extent of a complainant's financial loss, a *firm* will usually have completed the following stages beforehand:
- (1) gathering all relevant facts and information;
 - (2) making a fair and objective assessment as to whether it has failed to comply with a relevant duty owed to the complainant; and
 - (3) assessing whether any failure of duty by it was in the circumstances a material failure in the sense that if it had not occurred the complainant would have been likely to have acted differently.
- 2.1.7 G If it is concluded that the complainant would have acted differently, the *firm* should proceed to assess any direct or consequential loss.

- 2.1.8 G Nothing in this appendix relieves *firms* of the obligation to consider the particular facts and circumstances of each complaint and to consider whether the assessment of loss and compensation should, in the light of those facts and circumstances, be carried out on a different basis. If, however, the facts and circumstances make it appropriate to do so, the *FSA's* expectation is that *firms* will apply the approach and standards set out in this appendix, and where they do not, the *FSA* is likely to require them to demonstrate the adequacy and completeness of their alternative approach.

2.2 The standard approach to redress

- 2.2.1 G If there has been a failure to give compliant and proper advice, or some other breach of the duty of care, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice had not been given, or the other breach had not occurred. In many cases, although it must be a matter for inquiry and assessment in each individual case, this position is likely to have resulted in the complainant taking a repayment *mortgage* with accompanying life cover, and this is the assumption which underpins the standard approach to redress.
- 2.2.2 G Unless the contrary is demonstrated, it should be assumed that the complainant could have afforded the *mortgage* on a repayment basis.
- 2.2.3 G The measure of any financial loss suffered by the complainant will be arrived at by:
- (1) comparing the complainant's current capital position with the position he would have been in had the loan been a standard repayment *mortgage* as at the date the *firm* decides to regard the complaint as justified; and
 - (2) comparing the cost of the complainant's actual monthly outgoings and those he would have made had his loan been on a standard repayment basis as at the date the *firm* decides to regard the complaint as justified.
- G In some cases other factors may be included in the overall calculation, for example, if *mortgage* arrangement fees were waived by agreement on the occasion of the endowment *policy* being taken out.
- 2.2.4 G If, on comparing the complainant's current endowment position with the repayment alternative, the *surrender value* of the endowment *policy* exceeds the amount of the capital which the complainant would have repaid through the repayment method then, at the point of the assessment, the complainant has suffered no capital loss (but the complainant may suffer some compensatable consequential loss associated with changing the *mortgage* arrangements to the repayment basis, see *DISP* App 2.3). Conversely, if the capital which would have been repaid on the repayment basis exceeds the *surrender value*, there is a capital loss represented by the difference between the two amounts.
- 2.2.5 G If the complainant's endowment *mortgage* outgoings exceed the equivalent cost for the repayment method, the complainant should be compensated for the higher payments in addition to any loss on the *surrender value* and capital repaid comparison. This means, for example, that if the endowment arrangement has been more expensive, this may result in compensatable loss even though the capital repayment against surrender comparison may be favourable to the endowment.
- 2.2.6 G If the total cost of the outgoings for the endowment calculation is less than that for the repayment calculation, the "savings" should be brought into account in assessing any overall loss unless it is unreasonable to do so.
- 2.2.7 G It is unlikely to be reasonable to bring "savings" into account in circumstances where, at the time of the sale of the *policy*:
- (1) the complainant was advised or informed orally or in writing that he would have lower outgoings than would be the case under a repayment *mortgage*, whether or not this was quantified; and
 - (2) the complainant has dissipated those "savings" on the strength of this advice or information.

- 2.2.8 G The circumstances in which it may be appropriate to take some or all of the “savings” into account are those where, subject to *DISP* App 2.2.7G, the complainant is of “sufficient means” such that it is reasonable for a *firm* to assume that the “savings” have contributed to those means.
- 2.2.9 G Where it is otherwise reasonable for “savings” to be brought into account, determining whether or not a complainant is of sufficient means and if so, to what extent the “savings” are to be brought into account, will have to be based on the facts of each individual case. It will be appropriate to require the complainant to provide adequate information to assist the *firm* in this task. Matters to be taken into account in this assessment may include:
- (1) the length of the remaining *mortgage* term;
 - (2) the complainant’s current and prospective resources;
 - (3) the amount of the capital shortfall in proportion to the endowment outgoings balance.
- 2.2.10 G Firms may adopt streamlined processes to assist them in individual assessments of “sufficient means”, but will have to satisfy themselves that the complainant’s position is nevertheless protected. Firms will need to ensure that the complainant is given an opportunity to make an informed choice as to whether to accept the streamlined process, that the process itself is transparent, and that the firm is satisfied that the outcome would be fair to complainants.
- 2.2.11 G If a *firm* intends to make a deduction for all or any part of the lower endowment outgoings, the *firm* should explain clearly to the complainant in writing both how the “sufficient means” test has been satisfied, including details of the information taken into account in reaching the decision, and how the deduction has been arrived at. The letter should further inform the complainant that if he is unhappy with the proposal to make a deduction, either in principle or as to the amount, he should give his reasons to the *firm*.
- 2.2.12 G If a complainant puts forward a case that it would be unreasonable for a deduction to be made, the *firm* should reach a fair and objective determination on the facts of all relevant matters including those set out at *DISP* App 2.2.8G and *DISP* App 2.2.9G.
- 2.2.13 G In recognition that *firms* may not wish, for practical reasons, to make individual assessments of “sufficient means”, *firms* may decide not to seek to bring into account any benefit to the complainant in assessing overall compensation.
- 2.2.14 G It would not be unreasonable if a *firm* providing redress in these circumstances were to frame its offer of redress on the assumption that the complainant will agree to surrender the *policy*. However, *firms* should bear in mind that there may be circumstances where it is appropriate for the complainant to retain the *policy*, for example, where it is being retained as a savings vehicle.
- 2.2.15 G If a complainant becomes aware that he has taken out the endowment *policy* on the basis of unsuitable advice and inadequate information, he should if necessary, after taking appropriate advice, take reasonable steps to limit his loss, and may in any subsequent *claim* be unable to recover for losses which are avoidable. The complainant may have to show that he has not delayed unreasonably since becoming aware of his loss. The reasonable costs and expenses the complainant may have incurred in limiting his loss are to be taken into account in assessing his compensation. This is likely to include the complainant taking advice on whether he should convert from an endowment to a repayment *mortgage* and incurring expenses in doing so, see *DISP* App 2.3.

2.2.16 G The standard approach to redress can be illustrated by the following examples, which show how redress would be calculated in certain hypothetical but typical scenarios. (Because the examples are illustrative, round numbers have been used for “established facts” in each example. The payments should be taken as being made monthly: *firms* should not approximate by assuming that payments are made annually. If the complainant has benefited from MIRAS, the calculations should allow for the effect of MIRAS both on the endowment *mortgage* and the repayment comparison.)

2.2.17 G Table of examples

- Example 1 Capital shortfall and higher endowment outgoings
- Example 2 Capital shortfall partially offset by lower endowment *mortgage* outgoings
- Example 3 Capital shortfall more than offset by lower endowment *mortgage* outgoings
- Example 4 Capital surplus more than offset by higher endowment *mortgage* outgoings
- Example 5 Capital surplus partially offset by higher endowment *mortgage* outgoings
- Example 6 Capital surplus and lower endowment *mortgage* outgoings
- Example 7 Low start endowment *mortgage*

2.2.18 G Example 1

EXAMPLE 1

Capital shortfall and higher endowment *mortgage* outgoings

Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 5 years

Endowment *premium* per *month*: £75

Established facts

Endowment <i>surrender value</i> :	£3,200
Capital repaid under equivalent repayment <i>mortgage</i> :	£4,200
<i>Surrender value</i> less capital repaid:	(£1,000)
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i> :	(£200)

Total outgoings to date

EXAMPLE 1

Equivalent repayment <i>mortgage</i> (capital + interest + DTA life cover):	£21,950
Endowment <i>mortgage</i> (endowment <i>premium</i> + interest):	£22,250
Difference in outgoings (repayment – endowment):	(£300)

Basis of Compensation

In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid and also because of the higher total outgoings to date of the endowment *mortgage* relative to the repayment *mortgage*. The two losses and the conversion cost are therefore added together in order to calculate the redress.

Redress

Loss from <i>surrender value</i> less capital repaid:	(£1,000)
Loss from total extra outgoings under endowment <i>mortgage</i> :	(£300)
Cost of converting to repayment <i>mortgage</i> :	(£200)
Total loss:	(£1,500)
Therefore total redress is:	£1,500

2.2.19 G Example 2

EXAMPLE 2

Capital shortfall partially offset by lower endowment *mortgage* outgoings

Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 5 years

Endowment *premium* per *month*: £60

Established facts

Endowment <i>surrender value</i> :	£2,500
Capital repaid under equivalent repayment <i>mortgage</i>	£4,200
<i>Surrender value</i> less capital repaid under equivalent repayment <i>mortgage</i> :	(£1,700)
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i>	(£300)

Total outgoings to date:

Repayment <i>mortgage</i> (capital + interest + DTA life cover):	£21,950
Endowment <i>mortgage</i> (endowment <i>premium</i> + interest):	£21,350
Difference in outgoings (repayment – endowment):	£600

Basis of Compensation

In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid but has gained from the lower outgoings of the endowment *mortgage* to date. In calculating the redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings

Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment <i>mortgage</i> :	£600
Cost of converting to repayment <i>mortgage</i> :	(£300)
Net loss:	(£1,400)
Therefore total redress is:	£1,400

Redress if it is unreasonable to take account of gain from lower outgoings

Loss from <i>surrender value</i> less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment <i>mortgage</i> :	Ignored*
Cost of converting to repayment <i>mortgage</i> :	(£300)
Net loss taken into account:	(£2,000)
Therefore total redress is:	£2,000

* In this example, and also in Examples 3, 7, 8 and 9, the complainant's circumstances are assumed to be such as to make it unreasonable to take account of *any* of the gain from lower outgoings.

2.2.20

G Example 3

EXAMPLE 3

Capital shortfall more than offset by lower endowment *mortgage* outgoings

Background

EXAMPLE 3

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 8 years

Endowment *premium* per *month*: £65

Established facts

Endowment *surrender value*: £7,300

Capital repaid under equivalent repayment *mortgage*: £7,600

Surrender value less capital repaid: (£300)

Cost of converting from endowment *mortgage* to repayment *mortgage*: (£200)

Total outgoings to date

Repayment *mortgage* (capital + interest + DTA life cover): £34,510

Endowment *mortgage* (endowment *premium* + interest): £33,990

Difference in outgoings (repayment – endowment): £520

Basis of Compensation

In this example, the complainant has suffered loss because the surrender value of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment *mortgage*. In calculating redress the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings

Loss from *surrender value* less capital repaid: (£300)

Gain from total lower outgoings under endowment *mortgage*: £520

Cost of converting to repayment *mortgage*: (£200)

Net gain: £20

Therefore, there has been no loss and no redress is payable.

Redress if it is unreasonable to take account of gain from lower outgoings

Loss from *surrender value* less capital repaid: (£300)

Gain from total lower outgoings under endowment *mortgage*: Ignored

Cost of converting to repayment *mortgage*: (£200)

Net loss taken into account: (£500)

EXAMPLE 3

Therefore total redress is: £500

2.2.21 G Example 4

EXAMPLE 4

Capital surplus more than offset by higher endowment *mortgage* outgoings

Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 8 years

Endowment *premium* per *month*: £75

Established facts

Endowment *surrender value*: £7,800

Capital repaid under equivalent repayment *mortgage*: £7,600

Surrender value less capital repaid: £200

Cost of converting from endowment *mortgage* to repayment *mortgage*: (£250)

Total outgoings to date

Repayment *mortgage* (capital + interest + DTA life *cover*): £34,510

Endowment *mortgage* (endowment *premium* + interest): £34,950

Difference in outgoings (repayment – endowment): (£440)

Basis of compensation

In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment *mortgage* but has gained because the *surrender value* of the endowment is greater than the capital repaid. Since the sum of the loss and the conversion cost is greater than the gain, the redress is calculated as the difference between the two.

Redress

Gain from *surrender value* less capital repaid: £200

Loss from total extra outgoings under endowment *mortgage*: (£440)

Cost of converting to repayment *mortgage*: (£250)

EXAMPLE 4

Net loss:	(£490)
Therefore total redress is:	£490

2.2.22 G Example 5

EXAMPLE 5

Capital surplus partially offset by higher endowment *mortgage* outgoings

Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 10 years

Endowment *premium* per *month*: £75

Established facts

Endowment <i>surrender value</i> :	£11,800
Capital repaid under equivalent repayment <i>mortgage</i> :	£9,700
<i>Surrender value</i> less capital repaid:	£2,100
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i> :	(£300)
<u>Total outgoings to date</u>	
Repayment <i>mortgage</i> (capital + interest + DTA life cover):	£46,800
Endowment <i>mortgage</i> (endowment <i>premium</i> + interest):	£47,500
Difference in outgoings (repayment – endowment):	(£700)

Basis of compensation

In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment *mortgage* relative to the repayment *mortgage*. However the sum of this and the conversion cost is less than the complainant's gain from the difference between the *surrender value* of the endowment and the capital repaid. Thus no redress is payable.

Redress

Gain from <i>surrender value</i> less capital repaid:	£2,100
Loss from total extra outgoings under endowment <i>mortgage</i> :	(£700)

EXAMPLE 5

Cost of converting to repayment <i>mortgage</i> :	(£300)
Net gain:	£1,100

Therefore there has been no loss and no redress is payable.

2.2.23 G Example 6

EXAMPLE 6

Capital surplus and lower endowment *mortgage* outgoings

Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 10 years

Endowment *premium* per *month*: £65

Established facts

Endowment <i>surrender value</i> :	£10,100
Capital repaid under equivalent repayment <i>mortgage</i> :	£9,700
<i>Surrender value</i> less capital repaid:	£400
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i> :	(£200)

Total outgoings to date

Repayment <i>mortgage</i> (capital + interest + DTA life <i>cover</i>):	£46,800
Endowment <i>mortgage</i> (endowment <i>premium</i> + interest):	£46,300
Difference in outgoings (repayment – endowment):	£500

Basis of compensation

In this example, the complainant has gained both because the *surrender value* of the endowment is greater than the capital repaid and because of the lower total outgoings of the endowment *mortgage*. These gains are larger than the cost of converting to a repayment *mortgage*. Thus no further action is necessary.

Redress

As there has been no loss, no redress is payable.

EXAMPLE 7**Low start endowment *mortgage***Background

Capital sum of £50,000

25 year endowment *policy*

Duration to date: 10 years

Endowment *premium* per *month*: starting at £35 in first year, increasing by 20% simple on each *policy* anniversary, reaching £70 after five years and then remaining at that level.

Established facts:

Endowment <i>surrender value</i> :	£8,200
Capital repaid under equivalent repayment <i>mortgage</i> ::	£9,700
<i>Surrender value</i> less capital repaid:	(£1,500)
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i> :	(£250)
<u>Total outgoings to date</u>	
Repayment <i>mortgage</i> (capital + interest + DTA life cover):	£46,800
Endowment <i>mortgage</i> (endowment <i>premium</i> + interest):	£45,640
Difference in outgoings (repayment minus endowment):	£1,160

Of this difference in outgoings, £800 arose in the five year period when the complainant was paying a low endowment *premium*.

Basis of compensation

In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment *mortgage*. As in Example 3, in calculating redress the whole of the gain should be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to do so. However, unlike Example 3, in a low start endowment *mortgage* the complainant may have chosen to pay a lower than usual *premium* in the early years (this would need to be established on the facts of the case). Where it has been established that the complainant chose to make lower payments, even if it is unreasonable to take account of the whole of the gain from total outgoings, the gain from paying a lower *premium* during the low start period is normally taken into account. In such cases the redress is calculated as the capital loss plus the conversion cost minus the total amount by which repayment *mortgage* outgoings would have exceeded the actual low start endowment *mortgage* outgoings during the five year low start period.

Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings

EXAMPLE 7

Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings under endowment <i>mortgage</i> :	£1,160
Cost of converting to repayment <i>mortgage</i> :	(£250)
Net loss:	(£590)
Therefore total redress is:	£590

Redress if it is unreasonable to take account of gain from lower outgoings

Loss from <i>surrender value</i> less capital repaid:	(£1,500)
Gain from total lower outgoings during low start period of endowment <i>mortgage</i> :	£800
Cost of converting to repayment <i>mortgage</i> :	(£250)
Net loss taken into account:	(£950)
Therefore total redress is:	£950

INTEREST RATES

- 2.2.25 G In fixing a repayment comparator, it would be appropriate to have regard to the repayment quotation actually provided at the time of sale. If more than one repayment quotation was obtained, the comparison should be with the quotation which approximates most closely to the terms comprised in the endowment *mortgage* actually taken. If a repayment quotation was not provided, or is not now available, it should be assumed that the interest rate for the repayment comparison should be the same as that comprised within the *mortgage* endowment arrangements. *Firms* will then need to replicate interest rate changes throughout the lifetime of the comparator *mortgage*.

LIFE COVER

- 2.2.26 G Unless after due inquiry there is clear evidence that the complainant with a *mortgage* endowment had no foreseeable need for life cover at the time the endowment *arrangements* were concluded, in the overall comparison between a repayment *mortgage* and an endowment *mortgage* the monthly outgoings under the repayment will include the premium for the decreasing term assurance that would have been required. This adjustment for the cost of life cover is only to be made if the firm is undertaking a comparison of monthly outgoings. It is not appropriate to deduct the cost of life cover from the capital loss calculation, as this would constitute double counting.
- 2.2.27 G If a deduction is to be attributed to the provision of life cover, the appropriate approach is to assume that the complainant took out the insurance quoted in the alternative repayment quotation provided at the time of the sale. If the quotation is not available, the deduction should be at the rates that would have been quoted at the time.

2.3 Remortgaging

- 2.3.1 G As already noted, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice or other breach had not occurred: for their part, the complainants should take such reasonable steps as they can to limit loss once they are informed of the position they are in because of the *failure* of advice at the time of *sale*.
- 2.3.2 G In practice, it is likely to be appropriate for a complainant whose complaint has been upheld to convert to a repayment *mortgage*, irrespective of whether or not there is financial loss to date. It will normally be possible for complainants to do so without incurring unreasonable cost. Conversion will of course mean that the complainant no longer has a *policy* which has been shown to have been unsuitable for mortgage endowment purposes.
- 2.3.3 G *Firms* should therefore in the case of upheld complaints inform complainants that it is likely to be appropriate and necessary for them to convert to a repayment arrangement.
- 2.3.4 G *Firms* should make it clear that they will bear the costs of conversion if the rearrangement is made with the existing lender and to the equivalent repayment *mortgage*. If a complainant is not willing to rearrange with the existing lender, then the costs to be paid by the *firm* should normally be limited to those which would have been payable had the rearrangement been made with the existing lender and to the equivalent repayment *mortgage*. If it is not possible to rearrange with the existing lender, for example, if the lender has a closed book, the *firm* should pay all costs which are not unreasonable in completing the rearrangement with an alternative provider. Such costs might include an administration *fee* for changing the existing arrangement, redemption penalty, arrangement fee for the new *mortgage* and the reasonable cost of further advice if necessary.
- 2.3.5 G If the “new” *mortgage* is, in fact, arranged at a lower interest rate than the existing loan, the benefit to the complainant should usually be disregarded, as it is always open to complainants to change their underlying *mortgage* arrangements at any time.
- 2.3.6 G If the “new” *mortgage* is arranged at a higher interest rate than the existing loan, the increased payment should not normally be taken into account in calculating any payment to be made to the complainant.
- 2.3.7 G If the complainant takes the opportunity to increase his loan on the occasion of the remortgage, the expenses which a *firm* pays by way of compensation should be paid by reference to the capital sum due under the “old” loan.
- 2.3.8 G As stated, one aspect of the conversion process is the disposal of the endowment *policy*. The standard approach to assessing loss requires *firms* to calculate loss using the *surrender value*. However, once loss is established on this basis and *firms* move to deal with redress, they may wish to consider whether there is a role for the *policy's* “market value” within the traded endowment *policy* (TEP) market.
- 2.3.9 G A *firm* may arrange the sale of the endowment *policy* on the traded endowment market, provided the full implications of such a course of action are explained to the complainant and his express consent is obtained for the firm to arrange the sale. This includes informing the investor that he will continue to be the life assured under the *policy*. The complainant will have to be informed that such an arrangement may reduce or eliminate the amount of redress actually borne by the *firm*, but not so as to affect the amount of redress he receives.

- 2.3.10 G In the event that a complainant is willing to pursue this option, a *firm* must of course first have assessed the complainant's loss using the approach set out in the *guidance*, and the minimum amount the complainant must receive under such a sale arrangement is the sum representing the position the complainant should have been in under the *guidance* together with the reimbursement of remortgaging costs. In order to ensure the process does not delay the provision of redress, the *firm* must pay this minimum sum immediately the complainant agrees to the sale arrangement. To the extent that the net amount realised by the sale of the *policy* on the traded endowment market exceeds the total redress due to the complainant, this greater sum is to be paid to the complainant on completion of the sale. If the amount realised by the sale of the *policy* on the traded endowment market is less than the total redress due to the complainant, the *firm* will be responsible for the amount of the shortfall.

The following example illustrates the position:

<i>Surrender value</i>	£10,000	TEP value	£16,000
Loss calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	<u>£15,300</u>		

Complainant receives £16,000 all ultimately funded from the TEP sale.

<i>Surrender value</i>	£10,000	TEP value	£13,000
Redress calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	<u>£15,300</u>		

Complainant receives £15,300, £13,000 ultimately funded from the TEP sale and £2,300 ultimately funded from the *firm*.

2.4 Policy Reconstruction

- 2.4.1 G This section of the *guidance* is primarily concerned with circumstances where the term of the *mortgage* and associated endowment *policy* extend beyond the individual complainant's normal retirement age in circumstances where the *firm* regards a complaint as justified because the arrangement is not affordable in retirement; and this could have, and should have, been foreseen at the time of the advice.
- 2.4.2 G Two sets of circumstances are examined at DISP App 2.4.3G to DISP App 2.4.13G. Although these are considered in isolation, *firms* will, as part of their investigation of all of the factors involved in the complaint, have to consider whether either set of circumstances should be considered in conjunction with those factors examined at *DISP* App 2.2G.

CASE 1

- 2.4.3 G If on enquiry it is found that no proper assessment of the complainant's post-retirement means had been undertaken at the time of *sale*, but if the likelihood had been that the complainant would have borrowed the same amount over a shorter term (up to retirement) using an endowment *policy* as a repayment vehicle, then an appropriate form of redress would be for the *policy* to be reconstructed with a shorter term.
- 2.4.4 G Redress is in most cases to be provided by meeting the cost of rearranging the *policy*, by way of a lump sum payment into the *policy* in respect of the higher rate of *premium* due from its inception. It may be appropriate in individual cases to take account of the lower *premiums* that the complainant will have paid to date. The *guidance* in *DISP* App 2.2G, as to the circumstances in which this will be appropriate, will be relevant here.
- 2.4.5 G If the *policy* extends beyond retirement age and the complainant is already retired, the *policy* should be reconstructed to a maturity date as at the accepted retirement date, with the *policy* proceeds becoming immediately payable. The costs are to be borne by the *firm*, subject to any lower outgoings adjustment.
- 2.4.6 G *Firms* should consider whether the reconstruction would have tax implications for complainants (see *DISP* App 2.5.8G and *DISP* App 2.5.9G).
- 2.4.7 G The reconstruction process deals with the situation to the date the *policy* is reconstructed. The complainant will generally be responsible for paying the increased *premiums* for the remaining term.
- 2.4.8 G At the time the complainant is advised of the revised *premium*, he should as a matter of good practice be provided with a reprojection based on the prevailing *projection* rates, thereby giving him the option of how to address any projected shortfall.
- 2.4.9 G If it is not possible for a *firm* to reconstruct a *policy*, then it should *offer* the investor equivalent redress, for example, by paying a cash lump sum equivalent to the amount that would have been credited to a reconstructed *policy*.

CASE 2

- 2.4.10 G If a loan extending into retirement was on any basis not affordable, whether or not it is reconstructed to the retirement date, *firms* will need to consider whether, if properly advised, the loan would have been taken out at all and, if not, consider what arrangements might now need to be made in order to reduce the amount of the complainant's borrowings.

MISMATCHED LOANS AND POLICY TERMS

- 2.4.11 G If a complaint is regarded as justified by the *firm* on the basis that the endowment *policy* maturity date extends beyond the *mortgage* term expiry date and the *firm* is responsible for this situation, the *policy* should be reconstructed so that it matures at the expiry of the *mortgage* term.
- 2.4.12 G In these circumstances the *guidance* given elsewhere in *DISP* App 2.4G will apply as appropriate.

EXAMPLES

- 2.4.13 G The following examples illustrate the approach to redress as described in this section.

EXAMPLE 8

Term extends beyond retirement age and *policy* reconstruction

Background

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th *policy* anniversary.

It has always been the intention of the complainant to retire at State retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the *mortgage* is 5 years after retirement.

Established facts

Established <i>premium</i> paid by investor on <i>policy</i> of original term (25 years):	£81.20
<i>Premium</i> that would have been payable on <i>policy</i> with term from <i>sale</i> to retirement (20 years):	£111.20
Actual <i>policy</i> value at time complaint assessed:	£12,500
Value of an equivalent 20-year <i>policy</i> at time complaint assessed:	£21,300
Difference in <i>policy</i> values at time complaint assessed:	£8,800
Difference in outgoings (20 year <i>policy</i> – 25 year <i>policy</i>):	£4,320

Basis of compensation

The *policy* is reconstructed as if it had been set up originally on a term to mature at retirement age, in the above example, a term of 20 years. The difference in the current value of the *policy* actually *sold* to the complainant and the current value of the reconstructed *policy*, as if the *premium* on the reconstructed *policy* had been paid from outset, is calculated. The complainant has gained from lower outgoings (lower *premiums*) of the actual endowment *policy* to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

Redress generally if it is not unreasonable to take account of the whole of the gain from lower outgoings

Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	<u>£4,320</u>
Net loss:	(£4,480)

Therefore total redress is: £4,480

Redress if it is unreasonable to take account of gain from lower outgoings

Loss from current value of reconstructed <i>policy</i> less current value of actual <i>policy</i> :	(£8,800)
Gain from total lower outgoings under actual <i>policy</i> :	<i>Ignored</i>

EXAMPLE 8

Therefore total redress is: **£8,800**

Additional Information

If the *policy* is capable of reconstruction, the complainant must now fund the higher *premiums* himself for the remainder of the term of the shortened *policy* until maturity. In this example the higher *premium* could be £111.20. However the *firm* should provide the complainant with a reprojection letter based on the reconstructed *policy* such that the actual monthly payment required to achieve the target sum could be even higher, say £130. The reprojection letter should set out the range of options facing the complainant to deal with the projected shortfall, if any.

EXAMPLE 9

Term extends beyond retirement age: example of failure to explain investment risks

Background

45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th anniversary.

It has always been the intention of the complainant to retire at state retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the *mortgage* is five years after retirement.

In addition, an endowment does not meet the complainant's attitude to investment risk and a repayment *mortgage* would have been taken out if properly advised.

Established facts

<i>Surrender value</i> (on the 25 year <i>policy</i>) at time complaint assessed:	£12,500
Capital repaid under repayment <i>mortgage</i> of term to retirement date (20 years):	£21,000
<i>Surrender value</i> less capital repaid:	(£8,500)
Difference in outgoings (repayment – endowment):	£5,400
Cost of converting from endowment <i>mortgage</i> to repayment <i>mortgage</i> :	£200

Basis of compensation:

The *surrender value* of the (25 year term) endowment *policy* is compared to the capital that would have been repaid to date under a repayment *mortgage* arranged to repay the loan at retirement age, in the above example, a repayment *mortgage* of a term of 20 years. The complainant has gained from lower outgoings of the endowment *mortgage* to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain. The conversion costs are also taken into account in calculating the redress.

Redress generally

Loss from <i>surrender value</i> less capital repaid:	(£8,500)
Gain from total lower outgoings under endowment <i>mortgage</i> :	£5,400
Cost of converting to a repayment <i>mortgage</i> :	(£200)
Net loss:	(£3,300)
Therefore total redress is:	<u>£3,300</u>

Redress if it is unreasonable to take account of gain from lower outgoings

Loss from <i>surrender value</i> less capital repaid:	(£8,500)
Gain from total lower outgoings under endowment <i>mortgage</i> :	<i>Ignored</i>

EXAMPLE 9

Cost of converting to a repayment *mortgage*:
Therefore total redress is:

(£8,700)
£8,700

2.5 Additional Considerations

INTRODUCTION

- 2.5.1 G This section addresses two issues which may be relevant to the standard redress for unsuitability cases, as well as some post-retirement cases upheld on the grounds of affordability.

CONTINUING LIFE COVER AND OTHER POLICY BENEFITS

- 2.5.2 G *Firms* will need to consider the importance for many complainants of having life assurance in place to ensure a *mortgage* is paid off in the event of death.
- 2.5.3 G If a complaint is upheld and the *policy* is to be surrendered as part of the settlement, the *firm* should remind the complainant in writing that the life cover within the endowment will be terminated and that it may therefore be appropriate to take advice about the merits or otherwise of taking out a stand-alone *life policy* in substitution.
- 2.5.4 G If a need for life assurance at inception has been established so that a deduction representing its cost has been made from the redress payable under *DISP* App 2.2.4G, the *firm* should advise the complainant that the *firm* would be responsible for paying any *premium* for an appropriate replacement *policy* which exceeds that used for calculating the deduction or alternatively will, where possible, provide the cover itself at that cost. If it is not possible for the *firm* to provide the cover itself at the original cost, it may choose to discharge that obligation by the payment of an appropriate lump sum. Any such amount should enable the complainant to effect the cover at the original cost, with no additional cost in respect of increased age or deterioration in health. This option may be particularly relevant if the *firm* against which the complaint has been made is an Independent Financial Adviser (IFA) which cannot itself provide the cover, although it may be possible for such a *firm* to arrange for the *product provider* to offer cover to the complainant at the original *premium* on payment by the IFA of an appropriate lump sum to meet any increased cost.
- 2.5.5 G *Firms* will not be responsible for any increased costs resulting from the complainant choosing another *product provider* or for increased *premiums* charged by another provider chosen by the complainant in respect of the risk now presented, for example, higher *premiums* charged by the other provider due to deterioration in health, unless the original *product provider* no longer writes new business and is unable to offer revised life cover on a decreasing term assurance basis.
- 2.5.6 G There can be exceptional circumstances where, in order to retain suitable life cover, the endowment *policy* has to be retained and any additional costs will be the responsibility of the *firm* that sold the endowment *policy*.
- 2.5.7 G The same considerations will apply to the establishment of the need for other *policy* benefits including critical illness cover, disability cover and waiver of *premium*.

TAXATION

- 2.5.8 G *Firms* will need to consider the likely taxation implications for complainants if *policies* are surrendered or reconstructed, or any form of underpinning or guarantee is given.
- 2.5.9 G If there is potential tax liability for the complainant, it will be appropriate for *firms* to undertake in writing to the complainant to reimburse any tax payable, or which becomes payable, and make payment on production of appropriate evidence of the liability and payment having been made.

"UNDERPINNING"

- 2.5.10 G *Firms* proposing to offer arrangements involving some form of minimum underpinning or “guarantee” should discuss their proposals with the *FSA* and the Inland Revenue at the earliest possible opportunity (see *DISP* App 2.5.8G). The *FSA* will need to be satisfied that these proposals provide complainants with redress which is at least commensurate with the standard approaches contained in this appendix.

REFERENCE TO THE GUIDANCE IN FIRMS’ COMPLAINTS SETTLEMENT LETTERS

- 2.5.11 G One of the reasons for introducing this *guidance* is to seek a reduction in the number of complaints which are referred to the *Financial Ombudsman Service*. If a *firm* writes to the complainant proposing terms for settlement which are in accordance with this *guidance*, the letter may include a statement that the calculation of loss and redress accords with the *FSA guidance*, but should not imply that this extends to the assessment of whether or not the complaint should be upheld. Firms should point out that if the complainant remains dissatisfied, he may refer the complaint to the *Financial Ombudsman Service*.
- 2.5.12 G This statement should not give the impression that the proposed terms of settlement have been expressly endorsed by either the *FSA* or the *Financial Ombudsman Service*.

Definition title	Definition wording
Act	the Financial Services and Markets Act 2000.
advising on investments	the regulated activity, specified in article 49 of the Regulated Activities Order (Advising on investments), which is in summary: advising a person if the advice is: <p>(a) given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and</p> <p>(b) advice on the merits of his (or his principal's) buying, selling, subscribing for or underwriting a particular investment which is a security or a contractually based investment, or exercising any right conferred by such an investment to buy, sell, subscribe for or underwrite such an investment.</p>
claim	(1) (in COMP) a valid claim made in respect of a civil liability owed by a relevant person to the claimant. (2) (in LLD) a claim under a contract of insurance.
Compulsory Jurisdiction	the jurisdiction of the Financial Ombudsman Service to which firms are compulsorily subject.
DISP	Dispute resolution: the Complaints sourcebook.
Financial Ombudsman Service	the scheme provided under Part XVI of the Act (the Ombudsman Scheme) under which certain disputes may be resolved quickly and with minimum formality by an independent person.
Financial Ombudsman Service Limited	the body corporate established by the FSA under paragraph 2(1) of Schedule 17 to the Act (The Scheme Operator) to administer the Financial Ombudsman Service.
firm	an authorised person.
FSA	the Financial Services Authority.
guidance	guidance given by the FSA under the Act.
life policy	a long term insurance contract other than a pure protection contract or a reinsurance contract, but including a pension policy.
money	any form of money, including cheques and other payable orders.
month	(in accordance with the Interpretation Act 1978) a calendar month.
mortgage	an investment described in paragraph 23 of Schedule 2 to the Act as rights under any contract under which: <p>(a) one person provides another with credit; and</p> <p>(b) the obligation of the borrower to repay is secured on land.</p>
Ombudsman	a person appointed to the panel of persons maintained by the FOSL to determine complaints, including the Chief Ombudsman.
policy	[awaiting publication of Order under section 424(2) of the Act.]
premium	(1) (in relation to a general insurance contract) the consideration payable under the contract by the policyholder to the insurer. (2) (in relation to a long term insurance contract) a payment under the contract; a premium is a regular premium if it is one of a series of payments under the contract: <p>(a) (i) which are payable on dates that are certain or ascertainable at</p>

Definition title	Definition wording
	<p>the time the contract is made;</p> <p>(ii) which are payable over a period that exceeds one year in length; and</p> <p>(iii) assuming the policy evidencing the contract is not surrendered or otherwise terminated before the premiums fall due, will fall due on those dates without either party to the contract exercising any option under the contract; or</p> <p>(b) of which the first payment is an obligation under the contract, and subsequent payments, calculated according to an agreed formula, are payable over a period which exceeds one year in length under a collateral written arrangement with the insurer or friendly society.</p> <p>(3) (in relation to an option) the total amount which the purchaser of the option is, or may be, required to pay in consideration for the right to exercise the option.</p>
product provider	<p>a firm which is:</p> <p>(a) a life office;</p> <p>(b) a friendly society;</p> <p>(c) the operator of a regulated collective investment scheme or an investment trust savings scheme.</p>
projection	<p>a projection of the amount of any future benefit payable under a contract or policy, being a benefit the amount of which is not ascertainable under the terms of the contract or policy when the calculation is made.</p>
rule	<p>(in accordance with section 417(1) of the Act (Definitions)) a rule made by the FSA under the Act, including:</p> <p>(a) the Principles; and</p> <p>(b) an evidential provision.</p>
surrender value	<p>(a) where the contract is a contract of life assurance or a contract for an annuity, the amount (including a nil amount) payable by the firm or other body issuing the contract on surrender of the policy;</p> <p>(b) where the contract is a pension contract, the amount payable on the transfer of the investor's accrued rights under that contract to another pension contract;</p> <p>(c) where the contract is a Holloway sickness policy, the amount payable by the firm on surrender on or before the projection date for the policy;</p> <p>(d) where the contract is for any other policy, the amount payable by the firm on the surrender of the policy.</p>
Voluntary Jurisdiction	<p>the jurisdiction of the Financial Ombudsman Service in which persons (whether authorised or unauthorised) participate by contract.</p>

List of respondents to Consultation Paper 75

Abbey National Group

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Adepta Services Limited

Aegon UK plc

Association of Independent Financial Advisers

AMP (UK) Financial Services

Andrews, Gwynne & Associates

Association of British Insurers

Association of Friendly Societies

Association of Independent Financial Advisers

AXA Sun Life Services plc

Barclays Life Assurance Company Limited

Bowbanks & Field

Bradford & Bingley plc

Britannia Building Society

Burns Anderson Independent Network plc

Canada Life Limited

Council of Mortgage Lenders

Collegiate Management Services Ltd

Consumers' Association

Countrywide Assured

Cumberland Financial Services Limited
David Williams Training
DBS Financial Management plc
Donnellsons Partnership
Faculty and Institute of Actuaries
Fehnert plc
Financial Services Consumer Panel
Financial Services Authority Small Business Panel
Friends Provident Life Office
GMAC RFC Ltd
Guernsey Financial Services Commission
Halifax plc
Heath Lambert Group (Financial Services)
HSBC Holdings plc
Ingleby & Partners
Investment and Life Assurance Group (ILAG)
J M Hodge & Son
Justice in Financial Services
Kingswood Mortgage & Investment Services
KPMG
Legal & General Assurance Society Ltd
Liverpool Victoria Friendly Society
Lloyds TSB plc
Lynbrook Financial Management
M H Hier & Co
Marsh Financial Services Limited
MGM Assurance
Misys IFA Services plc
Moneyhill Financial Consultants

National Association of Citizens Advice Bureaux

National Federation of Consumer Groups

Nationwide Building Society

Natwest Insurance Services

Norwich Union Life and Pensions Limited

Office of Fair Trading

P J Barry Consultancy

Portman Building Society

Royal London Group

Scottish Widows Group plc

SEB Trygg Life (UK) Assurance Company Ltd

Solicitors for Independent Financial Advice Ltd

Standard Life Assurance Company

Sturdy Edwards (Financial Services) Ltd

Sun Life Financial of Canada

Swiss Life (UK) plc

Tunbridge Wells Equitable Friendly Society

Wainwright Training Management

Wesleyan Assurance Society

Whichers IFA Ltd

Windsor Life Assurance Company Ltd

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