



## **Comments by the Association of British Insurers on FSA Consultation Paper 75: Endowment Mortgage Complaints**

### **1. INTRODUCTION**

- 1.1 This paper sets out the comments of the Association of British Insurers on the FSA/PIA jointly issued Consultation Paper 75 setting out guidance which the regulators propose to issue in relation to the standards to be applied by firms resolving complaints of endowment mis-selling when the policy is sold in connection with a mortgage.
- 1.2 This paper sets out some general comments followed by more detailed issues and, finally, answers to the eleven questions specifically set out in CP75.

### **2. GENERAL COMMENTS AND SUMMARY**

- 2.1 The Association supports the objective set by the FSA of developing a fair and consistent set of standards to be used by all professional parties involved in dealing with complaints arising from mortgage endowment products.
- 2.2 The Association very much agrees with the premise that the proposed guidance should be based in accordance with appropriate legal principles, and also the FSA's recognition that decisions in each case should be according to their facts (paragraph 20 of CP75).
- 2.3 We do have particular concerns about the treatment of complaints in instances where the endowment mortgage matures after retirement date (see 3(i) below), also a number of points around the conversion of existing mortgage endowments to a repayment basis (see 3(ii) below).

### **3. SPECIFIC COMMENTS**

#### **(i) Endowment Mortgages Maturing Post Retirement**

- 3.1 This issue is discussed under section 4 of Consultation Paper 75 (policy reconstruction). It is accepted that the approach in Case 1 within section 4 of CP75 is reasonable where it can be clearly shown that the borrower would have taken a loan and an endowment to retirement age if he had been properly advised. But in many cases (alas possibly not documented) the claimant would have been well aware of the consequences (even beneficial to him) of taking a mortgage into

retirement and this should be taken into account in assessing whether a remedy is appropriate.

- 3.2 Clarification in the interpretation of paragraph 4.7 would be helpful: what will happen if the investor decides that he cannot afford the future increased premiums? Is the reconstruction dependant on the investor agreeing to pay the increased premiums or can he claim he would have paid increased premiums from outset but is now not prepared to because of change in circumstances?
  - 3.3 Where a loan extending into retirement was on any basis not affordable (Case 2 within Section 4 refers) then the provider of the loan bears significant responsibility for any mis-selling and should be involved in any consequential solution, particularly as the affordability issue surrounds the mortgage repayment arrangements as a whole, of which the endowment premium is nearly always only the minor cost.
  - 3.4 We are also concerned that the current complaints resolution for such cases via the PIA Ombudsman does not give sufficient weight to the affordability test taking into account the customer's current and prospective income as set out in paragraph 2.6 of CP 75. Additionally, the guidance, and PIAO practise, should ensure that affordability into retirement is looked into, in all cases, not just where the claimant has provided the information (this PIAO inconsistency being the current experience of our members).
- (ii) Cost of converting from endowment mortgage to repayment mortgage
- 3.5 There are issues here both for the regulator and for the industry including those representing mortgage lenders. It is only fair that conversion costs reflect the net costs to individual claimants, and these are likely to vary given the range of mortgage offers currently on the market.
  - 3.6 It is not clear why the cost of rearranging a mortgage from endowment to repayment should be taken into account in determining whether a loss has occurred, rather if a loss has occurred and the redress solution is to convert, then the cost of conversion should be covered, but not anticipated in that loss calculation. That said, inclusion of the mortgage rearrangement cost may be relevant where the policyholder has already rearranged his mortgage and lapsed his policy and subsequently realises he has a complaint against the endowment provider. Clarification is requested.
  - 3.7 Paragraph 3.2 of CP75 sets out the costs of conversion that the firm redressing an upheld complaint should follow. It would be helpful to receive further clarification that the conversion charges should only be in respect of conversion to the same type of mortgage as at the date of sale, ie. the compensating firm would not be expected to pay for any penalties where the consumer had for example, subsequent to the sale

of the mortgage endowment, moved to a fixed rate mortgage. An additionally valid solution should be to allow the firm to defer conversion until expiry of any fixed rate period.

(iii) “Savings”

3.8 As argued above (see paragraph 3.1) post retirement maturities should take into account “savings” by customers. Many in the industry would argue in particular that savings should be taken into account in low start low cost mortgage endowment cases, where the emphasis of the sale was to reduce outgoings in the early years, also where the policyholder chose a higher assured growth rate than “standard” at the time of the sale.

(iv) Other Issues

3.9 (a) It would be helpful if the FSA could state that the proposed guidance applies equally to IFAs as well as product providers regarding advice given at the point of sale. There are additional complexities for IFA cases, for example when comparing endowment and repayment mortgage costs it cannot reasonably be assumed for comparison purposes that the same provider would have been used under both endowment and repayment options.

(b) Many endowment products have allowed policyholders to select a preferred assumed growth rate: where an aggressively high growth rate has been selected, contributing to any current capital shortfall, it should be an option to take this into account within the compensation calculation. Another example is where the lender has agreed to basing the basic with-profits sum assured on assuming 100% of current annual bonus, which also reduces the monthly premium and the eventual maturity value.

(c) The guidelines should either address the treatment of demutualisation benefits from life offices to consumers and benefits distributed to policyholders from “inherited estates” (orphan assets), or allow relevant firms to agree with PIA.FSA as to how to treat such benefits.

(d) The redress calculation should also take into account tax benefits for endowment policies (where they had existed) and the benefit of MIRAS when comparing endowment and repayment methods for mortgages not exceeding £30,000 for the period to April 2000.

(e) The FSA are keen for complaints to be dealt with speedily. Whilst we support dealing with complaints as speedily as possible, in many situations the redress calculations can only be made once information has been gathered from third parties in particular mortgage lenders (for example as to the value of the balance of the loan, the cost of switching from interest only to repayment, the cost of decreasing term assurance the lender would have charged and the total mortgage payments made on the interest only loan net of MIRAS).

#### 4. **ANSWERS TO SPECIFIC QUESTIONS RAISED IN CONSULTATION PAPER 75**

4.1 It does not appear that the FSA has inadvertently failed to identify any area where the proposed guidance could lead to significant new costs, although additional administrative costs in calculating the comparison of outgoings (see paragraph 2.4 of CP75) and re-projections on reconstruction policies (paragraph 4.8) should be recognised. If product providers are required to go back and re-open resolved cases, this will significantly add to the costs.

4.2 As indicated in our general comments, the standard approach to redress is soundly based and should be of general application, but of course subject to each case being assessed on its merits. However, some product providers would wish to see the following conditions met before accepting the standard approach to redress. These conditions are:

- The mortgage (or re-mortgage) was sold at the same time and by the same person as the endowment (including endowments sold to replace any original lapsed policy);
- The outgoings of a repayment mortgage (if higher) would have been affordable at the time of the sale;
- The client's attitude to risk makes an endowment inappropriate.

4.3 Indications received from our members are that the proposal to permit firms to adopt a simplified approach to the treatment of lower outgoings is sustainable and attractive although this would not necessarily be the case for "low start" and post retirement cases. It is understood that the FOS has in the past required endowment providers to contact the original lender rather than use the original repayment quotation on file as FSA suggests: Is the FSA proposal acceptable to the FOS?

4.4 It is right to assume, for the purposes of calculating redress, that mortgage payments are made monthly.

4.5 Where a repayment quotation was not provided at the point of sale, we agree that there should be the option in carrying out the basic repayment/endowment comparison to use the interest rate comprised in the consumer's current endowment arrangement (subject to any amendment to take account of increases in rates because of arrears or previous poor experience). A valid alternative option however should be to use some industry agreed formula based on the largest or the top few lenders' rate experience over the years in question. This alternative has the advantage of reflecting more accurately actual rates rather than those based solely at today's level. It is an alternative of great attraction to at least one significant endowment mortgage provider.

4.6 We agree that the circumstances in which it is appropriate to deduct the cost of life cover calculating overall redress has been properly assessed. However, the cost in cover or other benefits, should only be applicable

where there is a demonstrable need for it. It should also be remembered that many lenders for a number of years insisted on life cover being arranged whether or not it was strictly needed by the customer (also the assignment of the policies). We do not believe that the FSA has made a case to require life offices to offer payment of additional premiums for a replacement protection policy (see paragraph 5.3 of CP75). Instead if the customer switches to a repayment mortgage then continuation of life cover with no underwriting should be offered...but only if life cover has been taken into account in the compensation calculations. If the FSA proposal prevails however, an option for product providers should be for them to provide the life cover, or other policy benefits, rather than paying additional premiums for such cover to third parties.

- 4.7 See comments in paragraphs 3.5 to 3.7 above.
- 4.8 Yes it is appropriate for firms to meet the costs of any policy reconstruction where this is an appropriate remedy. It should be recognised that with profits policies are not as straightforward as unit linked ones and the calculation necessary may be more time consuming. It may be that some with-profits offices may wish to approach the FSA to agree appropriate methods.
- 4.9 Yes it is appropriate for firms to provide the consumer with a re-projection letter at the time of a policy reconstruction although it is also important to ensure that the customer realises that, as with other re-projection letters, no guarantee attaches (unless specifically provided by the office).
- 4.10 Yes firms should be responsible for any income tax liability arising from either a policy surrender or reconstruction.
- 4.11 It should be left to each provider to decide whether they refer to the FSA endowment complaints guidance when settling cases. That said, we would expect most firms to mention the FSA guidance and that would be helpful where more than one provider is involved in any one particular complaint. It would also be helpful for complainants to be told that the proposed resolution of the complaints is in accordance with FOS guidelines.

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[CP75 Response \*DBUS\*EndowRev]