ABI RESPONSE TO CP 158 – MORTGAGE ENDOWMENT COMPLAINTS: CHANGES TO TIME LIMITS FOR MAKING A COMPLAINT

Executive Summary

1. ABI is sympathetic to the intentions behind CP158 to ensure that consumers are not disadvantaged by the current rules on time limits for taking complaints to the Financial Ombudsman Service. The limitation law, currently reflected in the FOS rules, has been developed over many years for good reason and should not be discarded lightly. Interests of other stakeholders have to be borne in mind and balanced. These other stakeholders include other with-profits policyholders and consumers whose pensions and other savings are invested in shares of life companies. Both the companies themselves and the regulator need to consider all these interests.

2. We believe that all the current re-projection letters, red, amber and green, serve to convey to investors the nature of the investment and the risks that its final value is unknown and dependent upon future investment performance. All letters are clear that the policy might or might not grow sufficiently before maturity to meet the target sum. There is therefore no reason why all letters should not start the limitation clock running, giving consumers three years in which to lodge complaints, if it has not already started.

3. We accept that the wording of the red and amber letters make this point the most strongly and urge investors to take action if they are unhappy with the risks. An FSA factsheet is enclosed with the current round of letters with considerable detail of the risks and of how to complain. While we believe that all the letters would legally start the limitation clock ticking, it is pragmatic to agree that the green and amber letters from the first round of re-projections only should not be taken as starting the limitation clock ticking.

Introduction

4. FSA's key points for consultation in this paper are:

   - Time should only start to run as a result of sending a re-projection letter, if it states that there is a high risk that the target sum will not be achieved (a "red" letter);

   - the normal three-year time period will be extended, where necessary, to give consumers six months after receiving a second re-projection letter (or similar reminder) and

   - a complaint will be regarded as being made in time if it has been lodged with the firm, or the Ombudsman, within the relevant period.

5. Our response to this consultation will first consider the legal position briefly, and whether this is modified in the Ombudsman's rules. It will continue with our views of the proposed changes and conclude with comment on the draft rules proposed. An annex is attached with a more detailed assessment of the legal position.

The Legal Position (Summary)

6. The annex to this response contains a detailed assessment of the legal position regarding limitation periods. FSA have the powers to make rules that set out when cases can be referred to the Ombudsman. But it is important that these rules should not be substantially out of line with the general law, especially when it is imposing rights that have a retrospective effect. While the Ombudsman system is not meant to be overly legalistic, it must retain its roots in the legal system we have or it risks challenge, not least under Judicial Review.

7. The law allows an extension to the six year period in certain cases of a three year period from the point when a person might reasonably have been expected to have knowledge about the material facts that might give rise to a cause of action or complaint. We believe that there is good cause to say that all the re-projection letters that have been sent out serve the purpose of providing this knowledge. But we recognise the importance of creating a simple framework within which the Ombudsman can operate, and we agree it is reasonable to assume that the green and amber letters sent in the first phase of the re-projection exercise may not be seen by consumers as having the effect of a call to action that the red letters were intended to create.

8. However, it is not always one single event that causes individuals to become aware of information of which they may previously have been unaware. In the case of mortgage endowments, there is both a cumulative effect of information and the fact that the situation will be very different for different groups of consumers. For example, from 1995 there have been rules on product disclosure at the point of sale, and we believe that a court would be likely to hold that the provision of this information would be sufficient to start the limitation clock ticking. There have also been regular policy reviews of unit-linked policies (some 25% of the population), the January 2000 letter to all policyholders notifying the intention to carry out policy reviews (enclosing the first FSA factsheet), the first re-projection letter sent between April 2000 and June 2001 and now the second re-projection letter enclosing a comprehensive FSA factsheet. It is therefore hard to imagine that a court would not consider that the accumulation of all this information would not be sufficient to start any limitation clock ticking, regardless of the "colour" of the letter at any one stage. Bearing in mind the publicity this subject has received and the efforts of consumer organisations to raise its profile, we believe most policyholders who may believe that they were mis-sold their policies would now be considered by any court to have sufficient information if they wish to complain.

9. There is also the overall longstop of 15 years from the date of the sale of the policy. Such a longstop was introduced to ensure cases were not brought when memories had faded or witnesses were no longer available.

FSA Rules for the Financial Ombudsman Service (FOS)

10. It is recognised and appreciated by the financial services industry that one of the main purposes of having an Ombudsman system is to give consumers free access to a cheap, quick and effective dispute resolution service. This is not intended to be excessively legalistic and should not become bogged down with the sort of legal arguments that can cause Court cases to take extensive time to be resolved – sometimes also at great expense. There is therefore some merit in the FSA being reasonably generous in the way they interpret the legal position on limitation periods when making FOS rules.

11. However, it is important that the FOS are not permitted to stray too far beyond the law in their remit as laid down by the FSA. It is important to recognise that these rules have their roots in the legal system. To move too far away from these principles risks judicial review, which brings the complaints process back into the legal realms it is trying to avoid. There could also be human rights issues raised to protect the rights of other stakeholders such as shareholders and other with-profits policyholders. The insurance industry in particular has always been extremely supportive of the Ombudsman principle and of the desire to provide a good dispute resolution service to its customers as well as keeping costs down for policyholders. It can sometimes be a difficult judgement exactly where to draw the line.

12. Under DISP 2.3.1(1)(c) a complaint cannot be made to the Ombudsman "more than six years after the event complained of or (if later) more than three years from the date [the complainant] became aware (or ought reasonably to have become aware) that he had cause for complaint..."

13. The words are close to those in the Limitation Act dealing with 3 and 6 year limitation. They are probably meant to reflect the basic limitation rules in the Act but as they are in plainer English (no references to facts "observable or ascertainable"), give rise to debate as to whether the intention is the same or to be slightly more generous. It is notable that whereas the old PIAOB Terms of Reference explicitly apply, unchanged, the legal rules relating to limitation, the FOS rules alter the relevant words: this suggests the possibility of a conscious desire on the part of FSA to give FOS a little more freedom, but may merely reflect a desire to use plainer English.

14. Notably, the 15 year "longstop" is not mentioned. This does not necessarily mean that, on a proper reading of DISP 2.3, firms cannot claim the benefit of it. There is a good argument that neither FSA nor FOS can change the legal position without either an express provision or, at least, necessary implication. Silence is not enough. We assume therefore that this longstop applies to references to the Ombudsman, but believe FSA should clarify the position.

15. Finally, the Ombudsman can extend limitation periods in "exceptional circumstances". This seems intended to deal primarily with disability on the

part of claimants (DISP 2.3.3); or instances where the case has not been referred to the Ombudsman within the relevant period because firms have been slow in making a final decision. The point is that the circumstances have to be exceptional. This is not just an unlimited power to extend.

FSA's Proposed Modification

16. The main points in connection with the current CP are that:

- FSA believe that, currently, a green or amber re-projection letter should not start the 3 year limitation "clock" because they believe that only a red letter indicates clearly enough the possibility of loss. This does not square with the general legal position and, even as an interpretation of DISP 2.3.1(c), does not stand up to much scrutiny. This is presumably why FSA are proposing a rule change, rather than guidance, to be necessary. According to the proposed rule change, customers will not be time barred until 6 months after a second (presumably also red) re-projection letter is sent. (So that where, for example, a first red letter was sent 3 years ago, and a second a year ago, there will, in practice, be no extension.)

- There is an (important) note that "These changes only govern the possibility that time starts to run because of a formal re-projection letter...Time can also start to run in other cases where the customer becomes aware that he had a claim".

17. It has been suggested to us that legal action cannot begin until any shortfall can be quantified in terms of a monetary loss. We have not been able to trace any legal basis for this view. While it is clear that any action would need to specify the amount of damages claimed, we do not know of any authority to suggest that the limitation period cannot expire before any damage can be quantified. In the case of mortgage endowments, once people are put on notice of the situation regarding their policies (ie that performance is linked to investments in equities and that the outturn is not guaranteed) we see no reason why the limitation clock should not start. The loss (or damage) that would be the subject of the complaint would be (in most cases) the fact that the investor had not been told about the risks involved in the investment and should properly have a repayment mortgage. The damage would be the cost involved to put him into the position he would have been in if the negligent advice had not been given. Whether or not the policy is in fact projected to mature with a shortfall is irrelevant, as a complaint cannot be made for investment performance. It is therefore equally relevant whether the re-projection letter is red, amber or green, as these are matters related solely to investment performance which cannot be the subject of a complaint to the Ombudsman. We would welcome detailed clarification of this point if FSA disagree.

<u>ABI View of the Proposed Changes</u>

18. It is vital to remember that, while policyholders who may wish to complain have rights that should be protected, there are other consumers whose rights

also need protection. These include other policyholders investing in the with-profits fund, who may be making a significant contribution to the cost of redress, and shareholders of proprietary companies, who might rightly feel aggrieved at such retrospective legislation. It is important to remember that these shareholders are in the main private individuals and these shareholdings will form part of their personal investments, including their pensions, ISAs etc. These consumers should not be disadvantaged at the expense of other consumers by changes in the legal system for establishing time limits for seeking compensation, especially in view of the retrospective effect of such changes.

19. CP 158 quotes the words that were used in the first re-projection letters that was sent between April 2000 and June 2001. The wording was revised for the next round of letters, with the relevant words of the warning being:

Red Letters:

> There is a high risk that your Plan won't pay out enough to cover the target amount of £36,000. This is because the rate of growth needed to reach this target is higher than the maximum rate set by the FSA for illustrating future investment returns. If you have not already done so we strongly suggest you consider taking action to make sure you'll be able to repay the whole of your mortgage loan. Read the enclosed factsheet which explains your options.

Amber Letters:

> There is a significant risk that your Plan may not pay out enough to cover the target amount of £30,000. This is because the rate of growth needed to reach this target is higher than the middle rate [towards the top end *for companies not using the middle rate*] of the current projection rates set by the FSA for illustrating future investment returns. If you have not already done so, we suggest you consider taking action to make sure you'll be able to repay the whole of your mortgage loan. Read the enclosed factsheet, which explains your options.

20. At the time that these letters were drafted there was some debate about whether consumers would appreciate any difference between "There is a high risk that your plan won't pay out enough" and "There is a significant risk that your plan may not pay out enough". The amber cases were considered as not much less likely to produce a shortfall than red and it was felt that it would not be right to provide recipients of amber letters with too much comfort.

21. We are of the view that all the second re-projection letters (red, amber and green) are sufficient to start any limitation clock (where it has not already started), although we agree that the wording of the <u>first</u> amber and green letters could be viewed as insufficiently strong. We therefore believe that the legal position is that all current letters start the limitation clock. It is important, however, to remember that the colour of the letter indicates only investment performance and related possible final outcome, rather than any summary of

the risks inherent in the product itself. Any legal argument about limitations based solely on the colour of the letter is therefore not obviously relevant.

Which letters exactly?

22. CP 158 does not make clear that the proposed extension of six months applies only after receipt of the second ever red re-projection letter. The reason for this is that the first letter went out between April 2000 and June 2001. The second letter has to be sent within three years of the first, and subsequent letters at least every two years. This means that there is a possibility that the policyholder might be out of time by the time the second letter arrives. This is the reason for suggesting a six month extension. In future re-projections will be sent every two years so there should be no problem in all policyholders receiving two such letters before any limitation period started by these letters expires. We believe that the rule change should reflect the fact that this is a one-off extension applying to the first and second re-projections only.

23. In the event that FSA are unable to accommodate the point above, it is essential that the wording of the rule brings finality in future in the event of one (red) re-projection letter being issued. This is because it is possible that a red letter could be followed by an amber or green letter and a second red letter might not be issued for many years. It would not be equitable for shareholders and other with-profits policyholders to be exposed indefinitely to the ongoing risk of complaints for mis-selling once a red letter has been sent. This is why it is preferable for this extension to apply only to the second ever red (or amber) letter.

24. There are two different versions of the red, amber and green letters. Phase I letters were sent out between April 2000 and June 2001, with phase II letters following within three years. We accept that the green and amber phase I letters may not have contained sufficiently detailed explanation of the risks to which the investment was exposed to start the limitation clock ticking on their own. But the phase II letters of any colour were prepared to be as comprehensive as possible and we are firmly of the view that all will start the clock. It may be that FSA, in referring to only red letters starting the clock, were in fact also referring to only phase I letters. Rule changes must make this clear.

Mitigation of loss

25. This subject is not mentioned in the CP. We believe it is important to recognise – and perhaps to state publicly – that investors have already been put on notice (by re-projection letters and by the massive publicity) that there are investment risks attached to mortgage endowments and that they may need to take action if they are concerned at the uncertainty of the situation. The later any complaint is made the more there will be an expectation that the policyholder will have taken some action to mitigate any potential loss, and any loss following the receipt of such information will be for the investor to bear.

When the Complaint is received

26. We do not have any comments to make on the suggestion that an acknowledged complaint made to a firm or to the Ombudsman will be considered to be the date the complaint is made.

The details of the proposed rules

27. 2.3.1A G This rule says no letter other than a red re-projection letter will start the limitation clock running. But it is agreed that there are indeed other letters and correspondence that can start the clock, especially suitable contractual review letters that may have been sent over many years. The Ombudsman has already upheld the use of these letters as starting the clock. This sentence will need amending in any event but supports our premise that all letters should be included.

28. 2.3.6 R (2) This rule marks the end of the limitation period that starts with the issue of a red re-projection letter. It says this period ends six months after the complainant gets a second red re-projection letter. As mentioned in Paragraphs 22 and 23 above, while this will be true for the first and second ever letters, it will not be true going forward. In the future if someone were to get a red letter the intention is that they just have the normal three years in which to lodge a complaint. Under this wording, if they subsequently get a green letter, and more green letters, the limitation period would never end – or at least not until another red letter were to be issued in the future. This emphasises our point about the need to include text that limits this extension in time to this round of letters only.

Cost Benefit Analysis

29. We do not comment on the cost benefit analysis. The costs are difficult to estimate; many of FSA's assumptions will not be right when viewed with hindsight. We have approached this subject on the basis of what is right for all consumers, whether they be mis-sold endowment holders, other investors in the company's with-profits fund or investors in the company itself. We have balanced these considerations with the law in respect of limitations and our desire not to see the FSA or the FOS exposed to legal challenge.

Annex

The Legal Position

6 year limitation

a) Under the Limitation Act 1980, a claimant is generally prevented from bringing an action more than 6 years after the cause of action "accrued", whether the claim is made as a result of negligence (s.2) or breach of contract (s.5).

b) Generally speaking, complaints about mortgage endowments will be made in negligence. The complainant will say that he was negligently advised to buy an inappropriate product: he needed something guaranteed to pay off his mortgage without a premium increase, or which was not stock-market linked, or which was guaranteed to produce a surplus; but he was nevertheless advised to take an endowment.

c) In negligence, the cause of action generally "accrues" when the recipient of the advice acts on the strength of it: ie buys the policy (Forster-v-Outred [1982]; DW Moore-v-Ferrier [1988]: both cases of professional negligence). This would mean that the "6 year limitation" would expire 6 years after the policy was issued. (There might be some additional complexity in valuation cases, after Swingcastle [1991], but that does not appear to be relevant for these purposes.)

3 More Years - Latent damage

d) In negligence claims, the 6 year limitation period can be extended. It can even have expired and the claimant can still proceed. This additional time is given where the relevant damage was "latent". A further three years is permitted from the date any damage is discovered. Obviously, it is essential to know when, for these purposes, damage counts as having been "discovered" so as to start the three year period running.

e) The "Start Date" for the three year period (s.14A(5)) is the earliest date on which the claimant has the knowledge required to bring an action. The knowledge required is, essentially, knowledge of the "material facts" (14A(6)), which are "...such facts about the damage as would lead a reasonable person to believe it was sufficiently serious to justify...proceedings..." (14A(7)).

f) Most importantly, in the general law, a person's knowledge includes "knowledge he might reasonably have been expected to acquire...from facts observable or ascertainable by him..." (14A(10)).

g) This can be considered a tough test; it means that the claimant is deemed to know what he ought to know, on the basis of facts of which he could have been, rather than actually was, aware. For example, if he was sent a letter or document which indicated the position, the fact that he did not read it would not stop limitation running (Webster-v-Cooper & Burnett [1999]). In Paragon Finance-v-DB Thakerar & Co [1999] it was said that the burden was on the

claimant to show that "...they could not have discovered the [problem] without exceptional measures which they could not reasonably have been expected to take...".

h) In short, there is a perfectly respectable and strong argument that, under the general law, even post-sale disclosure material, or other material provided during the sale process might act as the "trigger" for the 3 year "latent damage" limitation period. The FSA's rules are not necessarily meant to reflect fully the general law; and they are also contemplating a rule change to make the position more generous to claimants. But it is important to note that (a) FSA think that a "red" re-projection letter should be needed to put a client on notice; and (b) the suggestion is that the rules should be changed so that, basically, two are needed. Under the current general law of limitation a single amber (or even green) letter would, in all likelihood, do the job, and an adverse policy review letter would certainly trigger the latent damage limitation period. Other materials might also do so. As a matter of fact, under the general law, any policy review letter - whether adverse or not - might do so.

15 Year Limitation - the Longstop

i) Under s.14B, there is an "overriding" limitation period of 15 years from the date of negligent advice. This applies whether or not the relevant damage was, or still is, latent.

j) It can be set aside - as can the 6 and 3 year periods - only if "any fact...relevant to the...cause of action has been deliberately concealed...by the defendant" (s.32). Until recently, an abberant Court of Appeal decision (Brocklesby-v-Armitage and Guest) appeared to disapply the longstop in professional negligence cases. This has now been overruled by the House of Lords in Cave-v-Robinson, Jarvis and Rolfe [2002].

k) It seems clear that, under the general law, firms could take the benefit of the 15 year limitation period. We believe that this is an important point to recognise, as it is inequitable for matters older to be the subject of adjudication. We can already see areas of difficulty in remembering what happened at the point of sale, and memories of actions and words over 15 years ago will clearly be more faded still. This 15 year long stop is intended to prevent the unfairness of very old matters being brought before the Courts and it is right that this safeguard against unfairness should remain.

<u>Conclusion</u>

30. It is not always one single event that causes individuals to become aware of information of which they may previously have been unaware. In the case of mortgage endowments, there is both a cumulative effect of information and the fact that the situation will be very different for different groups of consumers. For example, from 1995 there have been rules on product disclosure at the point of sale, and we believe that a court would be likely to hold that the provision of this information would be sufficient to start the limitation clock ticking. There have also been regular policy reviews of unit-linked policies (some 25% of the population), the January 2000 letter to all

policyholders notifying the intention to carry out policy reviews (enclosing the first FSA factsheet), the first re-projection letter sent between April 2000 and June 2001 and now the second re-projection letter enclosing a comprehensive FSA factsheet. It is therefore hard to imagine that a court would not consider that the accumulation of all this information would not be sufficient to start any limitation clock ticking, regardless of the "colour" of the letter at any one stage. Bearing in mind the publicity this subject has received and the efforts of consumer organisations to raise its profile, we believe most policyholders who may believe that they were mis-sold their policies would now be considered by any court to have sufficient information if they wish to complain.

3 January 2003

[CP158 response.LIKFLA.Endowments]