



The Law Society

Guidance on how to deal with complaints in respect of mortgage endowments

Professional Ethics

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Mortgage endowment complaints

At one time, the most popular way to repay a mortgage loan for a house was by using the proceeds of an endowment policy. Such policies were widely sold on the basis that not only would the loan be repaid, but that the policyholder could also expect to receive an additional lump sum that could be used for whatever purpose they chose. In many cases, this is what happened with the endowment policy producing the returns expected. However, we now live in a period when inflation and investment returns are much lower. As a result, some endowment policies may not produce the hoped for returns and the expected surplus could instead be a shortfall. Firms that arranged these policies may find themselves contacted by clients who allege that they were incorrectly advised to take out an endowment mortgage. What should a firm do in response to such a complaint?

Usually a complaint arises as a result of the client receiving a letter from the life office that provided their endowment policy. The Financial Services Authority (FSA) requires life offices to issue re-projection letters to policyholders giving information on the likelihood of their endowment policy failing to produce the target maturity value. In some cases, the client is advised that there is a high probability that the policy may produce a sum at maturity that falls thousands of pounds below the figure required to repay their mortgage. This often results in the client complaining to the firm that arranged the policy.

The usual basis of this type of complaint is that the client alleges that they were not advised at the time of the sale that the endowment policy might fail to repay their mortgage. They often consider that the endowment policy and interest only mortgage were wrongly sold to them and that the correct advice would have been to take out a capital and interest (repayment) mortgage instead.

Many of the life policies involved in these complaints were arranged in the late 1980s or early 1990s. If the policy was arranged after 29 April 1988, the regulatory regime introduced by the Financial Services Act 1986 will apply. It is likely that a firm of solicitors will have been authorised for investment business at the time by the Law Society and that the Solicitors Investment Business Rules (SIBR) would have applied. If a firm used a broker instead of arranging the policy themselves, then the broker should be responsible provided the permitted third party (PTP) route was properly put in place. If the firm arranged the policy direct on a discrete investment

business (DIB) basis then the firm will be responsible for the advice to take out an endowment mortgage. Since 1 December 2001, the Financial Services Authority authorises firms of solicitors that engage in mainstream investment activities.

Where a firm arranged an endowment policy on a DIB basis, consideration will have to be given to compliance at the time with the relevant parts of the SIBR. Although there were three versions of the SIBR (1988, 1990 and 1995) the main provisions in relation to 'suitability' and 'risk' are similar. Any investment transaction should have been suitable for the client in that it met their needs and objectives. This relied on a proper 'know your client' process that should have included some form of assessment of the client's attitude to risk. Was the client prepared to accept the risk of the endowment policy failing to produce a sufficient sum to repay their mortgage? The firm was also obliged to take reasonable steps to ensure that the client understood the risks of the transaction. What was done at the time to explain the risk of a shortfall to the client?

If the client file is still available, a firm can carry out an assessment of the information obtained from the client and the advice the client received. If the file has been destroyed, it may be necessary to establish if the client has retained any of the paperwork produced at the time or to check any central financial services records still held by the firm. If the available evidence indicates a lack of compliance with the SIBR, the next step will be to establish if the client has suffered any financial loss as a result of taking out the endowment mortgage.

The client is likely to believe that a loss has arisen because the life office re-projection letter will have indicated an estimated shortfall figure. However, that is the shortfall that could arise if the policy continues to run to maturity at the current premium level. The FSA has issued detailed guidance on calculating loss in these cases. This is available on the FSA website at www.fsa.gov.uk. There is also further information on the website of the Financial Ombudsman Service (FOS) at www.financial-ombudsman.org.uk.

What needs to be established is the present financial position in relation to the client's mortgage arrangements. This is based on a comparison of the client's current position with the position he or she would have been in, had a repayment mortgage been recommended and taken out instead of an endowment mortgage. In simple terms, this involves calculating the amount to date that would have been paid off a

repayment mortgage with the current surrender value of the endowment policy. If the endowment policy is worth less than the amount that would have been repaid on a repayment mortgage, then the client has suffered a loss. (There are issues surrounding any savings the client may have made through lower monthly payments with the endowment mortgage but these are not usually taken into account when calculating compensation). Comparing the capital and outgoings elements of an endowment mortgage with a repayment mortgage is a complex calculation requiring specialist computer software. Most firms will need to use an external consultant to undertake the calculation process and a list of consultants / actuaries who can provide this service is attached to this note.

Often, the current shortfall revealed by the calculation is far lower than the client (and possibly the firm) might have expected. If compensation is paid to the client and the mortgage converted to a repayment mortgage, future substantial loss can be avoided. Not all endowment complaints are straightforward as some may involve problems such as the term of the policy and the loan extending beyond the client's normal retirement date.

Evidence suggests that the number of endowment complaints is rising and firms that have engaged in this area of investment business in the past will need to ensure that they handle these complaints correctly. In summary, the steps that a firm should take if an endowment complaint is received are:

1. If the policy was arranged on a PTP basis, pass the complaint on to the PTP.
2. If the policy was arranged on a DIB basis, gather the information needed to assess compliance.
3. Assess compliance with the SIBR.
4. If the firm was non-compliant, advise the firm's professional indemnity insurer and arrange for a loss test to be undertaken to establish any financial loss to date. However, the client would need to show negligence to succeed with a complaint in respect of a policy arranged before 29 April 1988.
5. If loss is found (and negligence if it is a pre-1988 endowment), arrange compensation for the client in conjunction with the firm's insurer.

The client should, of course, be kept informed of the progress in dealing with their complaint as should the firm's insurer. If you wish to discuss any issues raised by this note, you can contact the Law Society's Professional Ethics Division (DX 19114 Redditch, Tel: 0870 606 2577).

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