Policy Statement

Financial Services Authority

Mortgage endowment complaints: Changes to time limits for making a complaint

Feedback on CP158 and made text

January 2003

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This policy statement reports on the main issues arising from Consultation Paper 158. It also contains the made text.

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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 In Consultation Paper 158 "*Mortgage Endowment Complaints: changes to time limits for making a complaint*" (CP158) we, set out proposed changes to our rules governing the time limits for making a complaint concerning a mortgage endowment. The rule changes mainly aimed to ensure that there was a closer link between the reprojection exercise (the sending of the letters by providers highlighting the relative risk of the policy falling short of its target amount) and the time limits for a complaint to reach the Financial Ombudsman Service (FOS). The proposals were:

- to define the point at which consumers generally become aware of a specific problem; and
- to allow the FOS to consider some complaints that might otherwise have been time barred.

1.2 We received a total of 83 responses to the consultation and are grateful to those who commented. In considering the response we have made several drafting changes to the made text, to remove any possible ambiguity.

1.3 However, in our opinion the diversity of responses, and the lack of a compelling legal, or other, argument to the contrary, has persuaded us to confirm the policy put forward for consultation. So, we have made the following changes to the time limits that apply to the FOS in cases of mortgage endowment complaints:

- time should only start to run as a result of sending a reprojection letter, if the letter warns of a high risk that the target sum will not be achieved (a 'red' letter);
- the normal three-year time period specified in the rules will be extended, where necessary, to give consumers six months after receiving a second reprojection 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 FOS, within the relevant period.

The consequences of this Policy Statement are of interest to consumers as the rule changes deliver better protection for them, and allow clearer communication between the product provider and potential complainants.

2 Introduction

Purpose of this paper

2.1 This paper provides feedback on Consultation Paper 158 (CP158), including the revised DISP rules on changes to time limits on making complaints.

Background

2.2 CP158 presented proposals for amending our rules on time limits for mortgage endowment complaints. We did not intend to change the essence of the time bars applicable under the FOS, but rather to achieve a better integration between them and the reprojection letter system.

2.3 Neither the reprojection letter arrangements nor the proposed rule changes affected the need for complainants to show that they were mis-sold. Nor did the proposed changes affect the way in which time bars operate where time had already started to run before the reprojection arrangements came into effect.

2.4 The power to make rules on time limits is contained in paragraph 13 of schedule 17 of the Financial Services and Markets Act (FSMA), which explains our procedural rules. Under paragraph (1), we must make rules that exclude a complaint from consideration by the FOS unless the complainant has referred it to the FOS 'before the applicable time limit (determined in accordance with the rules) has expired'. Under paragraph (2), these rules may provide that an Ombudsman may extend that time limit in specified circumstances.

Structure of this Policy Statement (PS)

2.5 Chapter Three contains a summary of the main issues raised by CP158 respondents. Appendix A contains a list of respondees. Appendix B provides the DISP rule amendments on time limits made following consultation, which have been legally made by our Board. They will come into force on 1 February 2003.

3 Summary of responses to CP158

3.1 We received a total of 83 responses to the consultation. Appendix A contains a full list of respondents. They included:

5 building societies	3 consultants
44 Independent Financial Advisers	3 professional firms
15 product providers/groups	3 consumer groups
5 trade associations	5 individuals

3.2 In this chapter we set out the questions we asked in CP158, and summarise the responses received. We indicate, where relevant, why we have or have not decided to amend the rules in the way that respondents suggested.

> Q1: Comments are invited on the proposals we are making to integrate the time bar rules with the reprojection letter system.

3.3 Two thirds of respondents either agreed with, or did not comment upon the general view that it is appropriate to integrate the timebar rules with the reprojection letter system. One third disagreed because they thought the current rules should not or could not be changed. Their view was that our rules either are, or purport to adopt, the same principles as the law (the Limitation Act 1980). One firm argued that the 15 year 'end stop' in the Act should be included in the rules.

Our response: The Limitation Act 1980 (as amended by the Latent Damage Act 1986) states that a consumer can bring a claim for damages within six years of the date when the transaction complained of occurred. But if it gives the consumer more time, they may claim within three years of the date when they first had the knowledge required for bringing an action for damages. The required knowledge is, in brief, material facts about the negligence and the relevant damage that resulted from it (for example the mis-selling of an investment and the consequential loss or other financial disadvantage).

Each case has to be judged on its own particular facts and circumstances. When handling complaints from consumers that (directly or indirectly) allege negligence, a firm is entitled to consider whether, on the facts of the particular case, the complaint would be time-barred under the Limitation Act 1980. And if so, the firm should consider whether it wishes to reject the complaint on that ground. We are not changing, or trying to change, the time limits that would apply under ordinary law.

We have no say in whether there should be time limits rules for the FOS (there must be rules that comply with paragraph 13(1) of schedule 17 of FSMA). So long as the rules made are rational, in public law terms, there is no requirement in the FSMA for the time limits to follow the requirements of the general law. Section 225(1) indicates that the aim is for disputes covered by the ombudsman scheme to be resolved 'with minimum formality'. This should take into account (among other things) relevant law in determining what is fair and reasonable in all the circumstances of the case. The FOS arrangements are not intended to be limited only to claims that could be made in court. So, the rules include limitations that do not apply in ordinary court proceedings, such as the requirement to refer the complaint to the FOS within six months of the firm's final response.

The proposals are to amend the rules that govern the FOS. So, there is no direct impact on regulated firms, as firms are already obliged to explain the reasons for a rejected complaint, and to provide opportunity for the consumer to refer the complaint to FOS. However, it is anticipated that the changes will also affect the way that firms approach the issue of statutory limitation when handling these complaints.

We do not consider it is in the interests of consumers to rule out the possibility of complaints being dealt with outside the 15 year period that would apply to court cases. Nor do we consider this necessary to prevent hardship to firms.

3.4 Those who argued that the timebars should not be linked with the reprojection exercise said that reprojection letters are about the performance of the policy and so had nothing to do with mis-selling.

Our response: For the purposes of the three year rule it needs to be decided when a consumer had the required knowledge both of a cause for complaint and of financial damage resulting from that cause. This is not always the same and needs to be determined case by case. The reprojection letter, in association with an FSA factsheet, provides the first reasonable point where consumers are likely to have the specific knowledge of their own situation.

It is true that the calculation of future projected value in a reprojection letter, and the calculation of loss resulting from having been mis-sold, are on different bases. But the reprojection letter acts as the most effective estimate of loss. And in conjunction with our factsheet, the letter alerts the consumer to the relative prospect of a loss through mis-selling.

3.5 Other respondents thought that the loss which would trigger a complaint would only be known at maturity and some thought that the proposals favour 'opportunistic' complainants.

Our response: Both of these views are not particular to the issue of limitation and so are not addressed by these rule changes.

3.6 The changes to the rules on limitation were opposed by some on the grounds that a special case should not be made for a particular group of complainants such as mortgage endowment policyholders.

Our response: We believe that mortgage endowment complaints are distinguished from others by:

- the importance of the issue for the complainants (i.e. the presumption that their mortgage can be repaid);
- the potential numbers of consumers who may be affected; and
- the particular measures taken or instigated by us for bringing the two key issues of potential mis-selling and resulting financial damage to the attention of consumers.

Also, we consider that the time limit provisions that bind the FOS may, in the context of complaints about mis-selling of mortgage endowment policies, unfairly disadvantage a significant number of consumers. So CP158 proposed changes to the rules to remedy this unintended effect.

3.7 A few of the respondents queried the accuracy of the projections suggesting that, in their view, they did not take terminal bonus into account.

Our response: The last guidance issued by Regulators on the subject of projections for existing policies was issued by the Personal Investment Authority (PIA) in Regulatory Update 62 (January 1999). It is quite explicit in the area of 'terminal' bonus. Projections are calculated on the principle of premiums paid to date and the current policy value at the prescribed rates of investment return, offsetting charges and expenses. So the PIA's guidance confirmed that the projection should take account of the existence of a terminal bonus. So, we reject the argument that projections, properly carried out, did not take account of the terminal bonus[1].

1 The guidance in RU62 states that:

"the policy value should be the full value of the policy taking into account the underlying assets and an allowance for any 'accrued' miscellaneous surplus. ...Note. Whilst it is recognised that for many policies, a significant part of the value of a policy is not credited until the granting of terminal bonus at maturity, the reality is that it 'builds' up over the term of the policy. The policy value should reflect this."

3.8 A few respondents commented on the short time (one month, which by necessity covered the 2002 Christmas and New Year period) given to respond to CP158 and requested an extension of the consultation period.

Our response: We were concerned that some consumers might start to be affected by time bars, resulting from the first reprojection letters, as early as February 2003. So we aimed to make rules at the FSA Board in January. We also wanted to ensure that our response to time bar issues was proportionate. As well as taking account of the phasing of the reprojection system, we also drew conclusions from:

- consumer research on the understanding of endowment problems and the ease of making a complaint; and
- quarterly data returns to us from endowment providers, which indicated the fairness of complaint handling.

We initiated pre-consultation with trade bodies (including ABI and AIFA) in July 2002 who then determined how best to engage with firms.

As a result we did not have fully relevant information on the need for changes to time limits, and their likely impact, until November 2002. To make rules at our January Board, and avoid our emergency powers under s155 (7) of FSMA, we had to adopt a one-month consultation process. We also received a high number of responses representative of all relevant sectors, trade bodies and specialist individuals covering the full range of views. So we did not consider an extension was necessary.

Q2: Comments are invited on the three proposed rule changes:

Q2(a): Time should only start to run as a result of sending a reprojection letter, if it is a red letter.

3.9 About a third of respondents disagreed with the proposal that a only red reprojection letter ("there is a high risk that your endowment policy will not pay out the target amount at the end of the term") should start the time running. They suggested that either red and amber ("a significant risk"), or all colours of letter, should start the timing.

Our response: Our view is that:

- a consumer receiving a red letter will have specific information that their policy is likely to fall short of its target sum at maturity. This, alongside the messages contained within our factsheet, alerts them to the grounds on which they might have been mis-sold, and the likelihood that they will have lost money as a result;
- consumers who received an amber or green ("the policy is on track") letter might also be alerted to the fact that they might have cause for complaint that the policy was mis-sold to them. They too may have suffered financial damage as a consequence, but in these cases the likelihood of this damage will be less clear from the reprojection

letter. We consider that the receipt of an amber or green reprojection letter would not provide such clear intimation of financial damage as would justify the start of the three-year limitation period. These consumers remain entitled not to complain until the point where they become aware that there is a potential problem relating to their own circumstances (potentially at the point where they receive a subsequent and red reprojection letter);

- a customer who receives an amber letter will have been told that there is a risk of the endowment not paying out enough to cover the target amount. Receipt of such a letter might give rise to a duty on consumers to take steps to mitigate the loss that they have suffered. This could require them to take action to reduce their exposure to the market risk to which they are subject. This might involve, for example, converting their interest-only mortgage into a repayment mortgage, or topping up the endowment policy with extra payments. A failure to take action of this type might result in the complainant receiving less compensation than would otherwise be the case. This is because the losses suffered after the duty to mitigate loss arose might not be compensatable in full or at all. Whether a duty to mitigate in fact arises will depend on the facts of each individual case.

3.10 Some respondents believed that the three-year time bar began in January 2000, with the first FSA factsheet, or earlier, when the mortgage endowment problem came to light. And so they believed that the three years had already expired, from the time the policyholder first became aware of the issue.

3.11 Some respondents believed that there might be individual circumstances by which consumers came into possession of requisite knowledge of grounds for complaint *before* the first FSA instigated mailings in January 2000.

Our response: We agree that for some consumers, the 'time clock' would have started ticking at some earlier point, and our proposed rule changes do not alter the normal time limits of such circumstances. However, any such knowledge would have to include some form of individualised calculation which indicated that a shortfall was expected, using the potential growth rates used for illustrations at the time, and providing encouragement to take action as appropriate. We believe that consumers receiving standard form annual statements, or surrender values of their policies, or other communication (e.g. from an IFA), would not in themselves be enough to alert consumers to both:

- potential mis-selling of their policies; and
- resulting financial damage so as to start the three year limitation period.

Similarly general media stories, and a mailing or FSA factsheet in the absence of any individualised statement would not be enough to start the 'clock ticking'.

Q2(b): The extension where necessary of the time limits, to allow complainants six months after the receipt of a reminder within which to complain.

3.12 A few respondents thought that there was no need to extend the time limits, though a similar number agreed to the potential six-month extension for some consumers. There also appeared to be some confusion that only a second 'red' letter triggered the extension.

Our response: The rule change allows for the potential extension of six months from the date of the next reprojection letter of any colour, or similar reminder, following the first red letter received, and is only likely to have a short-term effect. From the phase one reprojection letter to phase two, the industry provided a maximum three years between letters. For subsequent letters, the maximum interval is two years, so that no consumer will have less than six months after their reminder letter in which to make a complaint, and still be within the normal three year time limit.

3.13 A few responses queried whether the extension of the time limits for some cases affects the human rights of the firms concerned.

Our response: Our view is that it does not. There was already provision for certain cases to be brought back into consideration by the FOS, under DISP 2.3.1R(2). Equally, the Ombudsman can still reject the extension where he thinks that appropriate. Further, as previously stated, we have the power to define the applicable time limits for referring a complaint under paragraph 13 of Schedule 17 to the FSMA. As the Chancellor certified that that power was consistent with the Human Rights Act, it would also seem reasonable to conclude that any exercise of that power within its scope would also be consistent with the Human Rights Act.

So overall we conclude that for the purpose of resolving the identified concerns about the application of time limits, these amendments strike the appropriate balance between consumer protection, consumer responsibility for their own decisions and proportionate burdens on firms.

Q2(c): The more general change, such that a complaint is in time if, within the relevant period, it has been lodged with the firm or with the FOS.

3.14 There was no disagreement from respondents on the third, 'in time' proposal, and a number welcomed this.

3.15 In summary, the proposals in CP158 (as now adopted) mean that the Ombudsman needs to go through a three stage process in assessing whether a complaint about an endowment mortgage is in time. This ensures that the primacy of the normal complaint handling rules is intact, and the revised rules are only triggered for cases outside the ordinary time limits.

1. Is the complaint excluded by 2.3.1R(1)(c)?

NO	the Ombudsman can hear the complaint and does not need to consider further the provisions of DISP 2.3
YES	Move to second stage:

2. Is the complaint excluded by 2.3.6 R?

NO	the case cannot be considered
YES	Move to third stage:

3. Despite the claim being 'in time' under 2.3.6R, is there any other reason why 2.3.6R should not apply?

NO	the Ombudsman can hear the complaint
YES	the case cannot be considered

Q3: We welcome your comments on the appropriateness of the cost benefit analysis.

3.16 Most had no comments on the cost benefit analysis, but those that did felt it to be an underestimate. Some IFAs expressed the view that the likely increased costs of professional indemnity (PI) insurance resulting from the rule changes should be taken into account.

Our response: As the average redress amounts are below PI excess level, and PI insurers will have already taken account of the impact of mortgage endowment issues, this does not appear to affect the CBA.

3.17 One respondent felt that the estimate of the volume of complaints was too low as it was based on July 2002 levels, which had increased considerably since.

Our response: Our consumer research identified a latent population who was minded to complain and therefore may have brought forward those complaints. This might suggest that fewer complaints are delayed beyond the previous time limits, and therefore the effect of the rule change is lower.

3.18 In preparing final rules, we have made no substantive changes to those proposed in CP158. We have however refined the rules to ensure they reflect the policy unambiguously. In particular:

- the FOS Board will consider extending the rules to their Voluntary Jurisdiction;
- we have clarified that firms may voluntarily agree that FOS may review cases irrespective of whether such cases exhibit exceptional circumstances or would ordinarily be time barred for consideration by the ombudsman; and
- the rules explain more clearly how information, other than through the reprojection exercise, might alert the consumer to the need to complain, if they believe they were mis-sold.

3.19 Without specific evidence to the contrary, we do not propose to change the cost benefit assumptions.

3.20 As in CP158 we believe the changes are compatible with, and discharge our statutory objectives more effectively than the other options we considered. They deliver better protection for consumers, and a clearer position, which can be better communicated to potential complainants, particularly in comparison to the option of making no change, or via a voluntary agreement to waive or extend time bars. So we consider this is the most appropriate way of meeting our objectives.

Appendix A

List of Respondents

Adam Samuel

Aegon UK Plc

AGB Investment & Financial Services

Allen French & Co. Ltd.

Altorfer Financial Management Ltd

AMP

Andrew Morris & Co

Association of British Insurers

Association of Independent Financial Advisors

Baker Hudson Ltd

Bradley & Company

Brian Lentz

Britannia Building Society

Bruce & Partners Harpenden

Canada Life

CFM

Christies Financial Services & Insurance Brokers

City Asset Management Plc

City of Westminster Assurance

Consumers Association

Co-operative Insurance Society Ltd

Council of Mortgage Lenders

CPH Financial Advisory Services

David J Miller Insurance Brokers

Dawson Whyte Insurance Brokers

Delta Compliance

Director & Staff Benefit Services

Eastwood Life Assurance

Elliot Financial Services Ltd

Evan Owen

Financial Limited

Financial Ombudsman Service

Financial Services Consumer Panel

Franklins Financial Services

Friends Provident Life and Pensions Ltd

Glenbow Financial Management Ltd

Halifax Bank of Scotland Plc

HCI Financial Services

Heath Lambert Consulting

Heron House Financial Management Ltd

Householders Financial Services Ltd

IFA Compliance Limited

John Maltby Insurance Services

John P McDonald & Associates

John S Lees & Co

Joseph R Lamb IFA Ltd

JWL Academy Investment Management Ltd

Legal & General Assurance Society

M J Pearson (Financial Services) Limited

Malcolm J Pountney

Matrix Financial Planning Ltd

Medical & General Insurance Services

Mike Carpenter

Miles Northern Insurance Brokers

Moir Miller Maclean Insurance & Mortgage Consultants

Morisons Solicitors

Nationwide Building Society

Norwich Union Life

O'Halloran & Co

Oracle Financial Services Limited

P & A Associates

Parker Munroe

Perry Appleton Financial Management Ltd

Pitmans Solicitors

Portfolio Insurance Consultancy and Mortgage Brokers

Prudential Assurance

RHB Insurance Services Ltd

Scottish Widows

Solicitors for Independent Financial Advice Limited (SIFA)

Standard Life Assurance Company

Star Life Financial Services

Stroud & Swindon Building Society

Stuart Albutt Financial Services

Swiss Life (UK) Plc

The Actuarial Profession

The Graham Tanner Organisation

The Royal Bank of Scotland Group

Tudorhouse Ltd

Ty Warner

Westerby Investment Management Ltd

Wilmar Associates

Winterthur Life

Yorkshire Buidling Society

Rule amendments as a result of consultation

Complaints sourcebook (Mortgage endowment complaints) Instrument 2003

COMPLAINTS SOURCEBOOK (MORTGAGE ENDOWMENT COMPLAINTS) INSTRUMENT 2003

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions listed in Schedule 4 to the Complaints sourcebook (Powers exercised).

B. The rule-making powers listed in that Schedule are specified for the purpose of section 153(2) of the Financial Services and Markets Act 2000 (Rule-making instruments).

Commencement

C. This instrument comes into force on 1 February 2003.

Amendments to the Complaints sourcebook (DISP)

D. The Complaints sourcebook (DISP) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Complaints Sourcebook (Mortgage Endowment Complaints) Instrument 2003.

By order of the Board
16 January 2003

Annex

Amendment to the Complaints sourcebook (DISP)

In this Annex, underlining indicates new text. Where an entire new section is inserted, the place that it goes is indicated and the text is not underlined.

2.3.1 R (1) The *Ombudsman* cannot consider a complaint (except as described in (2)) if the complainant refers it to the *Financial Ombudsman Service*:

…

(c) more than six years after the event complained of or (if later) more than three years from the date on which he became aware (or ought reasonably to have become aware) that he had cause for complaint<u>, unless he has referred the complaint to the *firm* or *VJ participant* or to the *Ombudsman* within that period and has a written acknowledgement or some other record of the complaint having been received</u> (but see *DISP* 2.3.5R <u>– *DISP* 2.3.6R</u>).

(2) The *Ombudsman* can consider complaints made outside the time limits in (1)(b) or (c) when, in his view, the failure to comply with the time limits was as a result of exceptional circumstances or where he is required to do so by *the Ombudsman Transitional Order* (see *DISP* 2.3.2G) <u>or where the *firm* has not objected to the *Ombudsman* considering the complaint.</u>

After *DISP* 2.3.1R, insert the following new paragraph:

2.3.1A G If the complaint relates to the sale of an endowment *policy* for the purpose of achieving capital repayment of a mortgage, the receipt by the complainant of a letter which states that there is a risk (rather than a high risk) that the policy would not, at maturity, produce a sum large enough to repay the target amount is not, itself, sufficient to cause the three year time period in *DISP* 2.3.1R(1)(c) to start to run.

After *DISP* 2.3.5R, insert the following new paragraphs:

Exception for mortgage endowment complaints

2.3.6 R (1) If a complaint relates to the sale of an endowment *policy* for the purpose of achieving capital repayment of a mortgage and the complainant would, as a result of this *rule DISP* 2.3.6, have more time to refer the complaint than under *DISP* 2.3.1R(1)(c), the time for referring a complaint to the *Financial Ombudsman Service*:

(a) starts to run from the date the complainant receives a letter from a *firm* or *VJ participant* warning the complainant that there is a high risk that the *policy* will not, at maturity, produce a sum large enough to repay the target amount; and

(b) ends six months from the date the complainant receives a second letter from a *firm* or *VJ participant* containing the same warning or other reminder of the need to act.

(2) Paragraph (1) does not apply if:

(a) the *Ombudsman* is of the opinion that, in the circumstances of the case, it is appropriate for *DISP* 2.3.1R(1)(c) to apply without modification; or

(b) in respect of any particular complaint, the *firm* can show that the three year period specified in *DISP* 2.3.1R(1)(c) had started to run before the complainant received any such letter as mentioned in *DISP* 2.3.6R(1)(a).

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