Financial
Ombudsman
Service

Law Commission 13th Programme of Law Reform consultation

October 2016

The Financial Ombudsman Service welcomes the opportunity to respond to the consultation.

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about the Financial Ombudsman Service

The Financial Ombudsman Service was set up under the *Financial Services and Markets Act 2000* to resolve individual complaints between financial businesses and consumers – fairly, reasonably, quickly and informally – and we are free to consumers.

We handle complaints about all kinds of money matters – from insurance and mortgages to savings and payday loans. If a financial business isn't able to resolve a customer complaint, we can step in to settle the dispute.

We're independent and impartial. When we decide a complaint, we look carefully at both sides of the story and weigh up all the facts. If we decide the business has treated its customer fairly, we'll explain why. But if we decide the business has acted wrongly, we can order it to put matters right – and pay compensation of up to £150,000. Consumers don't have to accept any decision we make. But if they accept an ombudsman's decision, it's binding both on them and the business.

our response

Thank you for inviting us to contribute to your consultation process. Having consulted with our internal stakeholders, we have identified the following areas which the Commission may wish to consider in its future work.

- contracts of insurance
- fraud
- joint interests
- section 75 of the *Consumer Credit Act 1974*
- appointed representatives

1. contracts of insurance

summary

There is a lack of clarity in the law about what a contract of insurance actually is. A body of case law has built up over the years that creates a variety of "tests" as to what is a contract of insurance. But these can be open to interpretation and we can find ourselves disagreeing with firms about what is and isn't a contract of insurance, and therefore whether our service

has jurisdiction to consider certain complaints. The distinction is an important one because, in broad terms, we can often consider complaints under our compulsory jurisdiction made against FCA-regulated firms about contracts of insurance, but, in most cases, we cannot consider complaints about service contracts. The distinction may also be important for firms for commercial reasons, and it also has possible consumer protection implications.

There have been a number of judicial decisions on whether specific contracts were contracts of insurance but none have provided a comprehensive definition that can be applied in every case.

For example, it has been argued by one business that its plans reserve it "absolute discretion" as to whether or not any benefit is provided on the occurrence of a breakdown or other repair request – and that this means they are not contracts of insurance. This argument turns on what constitutes "absolute discretion" and at what point a business's discretion is absolute to the extent that it would make an agreement not a contract of insurance.

We also regularly encounter issues around when a motor car warranty could be considered a contract of insurance – when the agreement provides benefits that are "significantly more" than a dealer's normal statutory obligation, such that it could be considered a contract of insurance.

case study 1

A consumer had bought a three year old car, and at the same time purchased a mechanical warranty agreement. When he later experienced a problem with his car and registered a claim under the warranty, he was told the part in question was not covered and the diagnostic fee was non-refundable. Unhappy with the outcome of his complaint, he brought it to us.

The provider disputed our ability to look into the complaint, stating that motor retailer warranties and extended warranties are not generally regarded as contracts of insurance. It said warranty products simply provide consumers with certainty as to the lengths suppliers will go to in order to adhere to their commercial and legal obligations.

However, we felt that provisions in the agreement, and the fact that the customer had paid several hundred pounds for the warranty, suggested that the business was taking on more responsibilities than its existing obligations – and the substance of the agreement made it a contract of insurance.

We also see issues where there is both an "insurance element" and a "non-insurance element" within an agreement – and this can also raise questions as to how best to determine whether the agreement as a whole is a contract of insurance.

We encounter issues about whether an agreement is a contract of insurance in all sorts of cases, ranging from boiler care to rental deposits to furniture protective coating. Whilst in all cases we take into account the relevant case law and regulatory guidance, ultimately it is a matter of interpretation about whether the agreement constitutes a contract of insurance.

We estimate that we receive around 20-30 complaints a month that involve service agreements. Some businesses are willing to work with us to reach a resolution although they may dispute jurisdiction. But where we do need to consider jurisdictional issues before we can determine whether we can consider the merits of their complaint, this will add to the length of the consumer journey. It can also mean that consumers do not always receive referral rights to our service when making their complaint.

2. fraud

summary

A particularly challenging area of our work – because of the nature of what's happened and its impact on the people affected – is financial fraud.

In July 2015 the ombudsman service published an insight report, *calling time on telephone fraud: a review of complaints about "vishing" scams*, sharing our insight on the complaints consumers had brought to our service about voice phishing scams. In particular, the report focused on 'no hang-up' frauds, where fraudsters had taken advantage of a technical feature on phone lines to add to the plausibility of the scam. Often posing as the police or a bank, fraudsters had tricked consumers into believing they were protecting their money when in fact it was being stolen. Many of the consumers who had contacted us were over the age of 75 and had lost significant amounts of money.

As we explained, we consider all the complaints we receive on their own individual facts and circumstances – but our approach takes into account relevant regulations.[1] Unfortunately it means that where the consumer has been tricked into making a payment or transfer of funds *themselves,* they are unlikely to be able to get their money back.

As we noted in the report, action was already being taken by telecoms companies to remove the facility that enabled the no hang-up trick to be carried out on UK landlines. And that appears to have impacted on the complaints that reach our service: we haven't seen a no hang-up-type fraud for some time. However, we continue to see variations in the methods used by fraudsters, including fake emails (pretending to be from solicitors, for example, and giving incorrect bank details for transfers of money); calls about non-existent computer problems (where people are tricked into allowing fraudsters access to their online accounts); and number spoofing (where people respond to a text or call apparently from their bank, because their mobile phone 'recognises' the number).

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[1] There is a long-established principle that banks are generally obliged to carry out their customers' instructions. The *Payment Services Regulations 2009* say that where a payment is made in line with the payer's instructions it is deemed to have been *correctly made,* That's the case even if the payer has been tricked by a third party into giving those instructions.

case study 2

Mr J and Ms R complained that a bank wouldn't reimburse money which a fraudster tricked Mr J into transferring from their joint account.

Mr J received a telephone call from someone claiming to be from his bank's Visa verification team, warning him his account was at risk and that he should transfer money to new, secure accounts. Mr J said the caller knew his account holdings and the balances. He also said that it appeared that the call was being made from the telephone number on the back of his card. As he believed the caller was genuine, he followed the instructions he was given.

Very soon after he made the transfers, Mr J felt that he might have been the victim of a scam and contacted the bank – but it was already too late to stop the transfers. Although the bank recovered some of Mr J and Ms R's money, it was unable to cover the full amount that had been transferred.

When the couple complained to the bank, it said it hadn't done anything wrong as it had been following Mr J's instructions about where to move his money. It did acknowledge that it could have provided better service when dealing with the complaint and paid £100 to reflect this. It also acknowledged that one of the refunds hadn't been calculated correctly so it said it would refund the difference. Unhappy with this outcome, Mr J contacted us.

Our starting point was that a bank should generally comply with its customers' instructions. We found that the bank hadn't identified any inappropriate accessing of Mr J's account – and whatever information the caller did have, this alone wasn't enough to make the transfers. In these circumstances, we decided it wasn't fair to make the bank bear the loss: Mr J had authorised the transaction; and the bank acted quickly once it was aware of the scam.

3. joint interests

summary

We sometimes see problems arising for consumers who hold joint insurance policies, but whose interests become separated – for example when one policyholder under a jointly held policy causes deliberate damage.

This is an issue that may be familiar to the Law Commission from previous work. The 2011 consultation paper, LCCP201 *Insurance Contract Law: Post Contract Duties and Other Issues*, considered co-insurance – and that where two or more people take out insurance to jointly protect their property, the law usually treats them as acting together. Where parties have become estranged the paper pointed out that this could lead to "harsh results" – for example if one spouse sets fire to the marital home the innocent party could lose their entire claim.

The Commission provisionally concluded that the problem did not require a legislative solution – though it would reconsider this position if significant evidence to the contrary arose. It referred to one known case that had been considered by our service, and suspected that “many insurers already pay the innocent party’s claim without relying on their strict legal rights.” It also said that the courts could adapt the law to do justice, by (for example) construing the policy as a “composite” policy.

Whilst the case we describe below arises from a unique set of circumstances, and cases like this are rare, we thought it would be helpful to draw your attention to the continued existence of scenarios in which insurers have declined claims.

case study 3

Mrs C was unhappy her insurer wouldn’t pay her claim for loss under her home insurance policy following a fire at her property. Mr C, who had a history of domestic abuse, and had been taken into police custody after attacking his wife, was released on bail, broke into the home, and after inflicting injuries on Mrs C for a number of days, set fire to the home. The insurer relied on the exclusion clause for deliberate acts – although it paid a sum to Mrs C as a gesture of goodwill.

In this case, Mrs C wasn’t a policyholder, but she owned the property jointly at the time of the fire and as a result we deemed that she could make a claim under the policy as a person intended to benefit from it. Whilst there was no doubt Mr C had started the fire deliberately, we decided that at the time of the fire, their interests were entirely separate.

As a result it was fair for the insurer to pay Mrs C 50% of the amount it would have paid Mr and Mrs C under the terms of the policy – as well as 50% of the value of any jointly owned items under the contents policy, and 100% of any items solely owned by Mrs C (minus any money paid as a gesture of goodwill).

4. section 75 of the *Consumer Credit Act 1974*

summary

Section 75 of the *Consumer Credit Act 1974* states that consumers have an equal right to claim against the provider of credit if there’s either a breach of contract or misrepresentation on the supplier’s part. However it only applies when certain criteria are satisfied – and one of those is that there has to be a direct relationship between the debtor, creditor and supplier.

As shopping habits are changing and more people are shopping online, we are seeing cases where an additional business (for example, another payment handler) is involved in the transaction. This means the ‘debtor-creditor-supplier’ relationship is broken, and the consumer often loses their right to claim under Section 75. We frequently see cases involving a break in the debtor-creditor-supplier relationship. And in these situations, in our experience, consumers who are making a payment using their credit card may not realise that the usual protections do not apply.

case study 4

Mr B complained that he was misled about a timeshare he paid for using his credit card. He brought his complaint under section 75 of the Consumer Credit Act. Mr B said that the supplier had told him he and his wife would be entitled to free holidays, the disposal of an existing timeshare contract with another supplier, access to five-star resorts, cruises, flights and savings. However Mr B said this wasn't true.

Mr B's credit card provider said that as Mr B was making the complaint about the actions of the supplier, but the credit card payments were made to third parties, there wasn't a valid 'debtor-creditor-supplier' relationship.

We considered all the available evidence – but did not uphold the complaint. We explained that Mr B's credit card payments for the service did not appear to have been made directly to the supplier. They were made to third parties who appeared to be payment handlers – and therefore concluded there wasn't a valid debtor-creditor-supplier relationship for his claim to be valid. We also explained that it is not unusual for a business to use a third party to accept payments.

5. appointed representatives

summary

We see cases involving appointed representatives where there can be consumer detriment involved – but we cannot always consider these complaints because of the way agreements involving appointed representatives are set up.

An appointed representative (AR) is an agent of a regulated firm. The AR is not itself authorised but relies on the regulated status of the firm that has appointed it (the principal) to be its representative. The agreement between the principal and the AR will generally set out what the AR can and cannot do. This relationship has a statutory basis under section 39(3) of the Financial Services and Markets Act 2000, which states:

> *"The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility."*

Therefore if the AR acts *outside* the terms of the agreement, i.e. does something it is not authorised to do by the AR agreement, and the act done is not connected to, or done in the carrying on of, an activity that *is* authorised under the agreement, then the principal is generally not responsible. If this is the case we do not have jurisdiction to look at the complaint.

We do see cases of consumer detriment here, for example when ARs are arranging or advising on high risk investments, often abroad, and the consumer won't have been sighted on the detail of the agreement between the principal and the AR. As a result the consumer might not be aware that the AR is acting outside of its agreement with the principal, and that therefore the same protections won't apply.

case study 5

A consumer, who had a long-standing relationship with an appointed representative, and had made a number of investments on his advice, was advised to put some of her cash into an unregulated collective investment scheme (UCIS). That UCIS later failed, and the consumer lost her money.

She complained to the principal firm, saying that she'd been advised by the appointed representative that the investment was safe. The principal said it wasn't responsible, as its contract with the appointed representative limited the investments he could sell, and the UCIS was not an investment that was allowed. In this case, we reached the same conclusion, meaning that a regulated activity was carried out by an authorised individual, but we could not help the consumer.

annex – Law Commission potential project on mortgages

In addition to approaching us about the Commission's next programme of law reform, we were also approached on behalf of Professor Nick Hopkins, Commissioner at the Law Commission, who asked us if we could share our insight on a potential project on mortgages. For ease, we include our response to that approach here and would be grateful if you could share it with the appropriate team.

We very rarely see complaints about mortgages where the law – by which we refer to *The Law of Property Act 1925* and subsequent legislation – is cited. However we have shared some thoughts and insight from our general experience.

We feel that modernisation and codification of the law could be helpful, as it doesn't reflect how different people's lifestyles and living arrangements are now, and it doesn't match the complexity of the products available. For example, the law hasn't kept up to date with innovations such as shared ownership and equity release products.

We do sometimes see complaints about possession. Generally speaking, possession should be a last resort, and if a complaint comes to us before a possession order has been issued by a court, we are able to look at whether lenders have explored other options first – and we do see lenders willing to do this. However this flexibility is less available to the courts. The existing law gives a mortgagee an absolute right to possession, subject to contract – which isn't well understood or expected by borrowers. In practice, this means that a court has no discretion where arrears are proved other than to grant or suspend possession or adjourn the case. We do see cases – albeit not frequently – where lenders have initiated proceedings without having explored all the alternative options. For a consumer this can mean not only that a possession order is issued, but that they are also liable for the lenders' costs – which can amount to several thousand pounds. A wider discretion as to outcome could match the range of situations that arise and discourage unnecessary or premature proceedings.

And finally, we do sometimes see a lack of public understanding about what is and isn't covered by regulation. There has been some rationalisation and simplification recently – for example, the inclusion of second charge mortgage lending in the regulated mortgage contract regime from March this year – and that is welcome. We would support future legislation that continues to simplify and rationalise regulation, in a way that is helpful for consumer and industry understanding.