DRN-5137728

The complaint

Mr and Mrs T have complained that the mortgage endowment policy they have with Sun Life Assurance Company of Canada (U.K.) Limited (SLOC) was not viable as a repayment vehicle for their mortgage and should not have been sold to them. They have said when the policy was sold they were told that it would either mature for more than the amount they needed to repay their mortgage, or they would be able to cash it in to repay the mortgage early – no mention was made of the potential for a shortfall.

What happened

Mr and Mrs T first spoke to SLOC in 1997 when they decided they wanted to buy their own home. They went back to SLOC in the autumn of 1998 when they had found a home and had a mortgage agreed.

The fact find completed in order for the financial adviser to determine what, if anything, should be recommended to Mr and Mrs T documented their needs and circumstances at the time of the sale. They were both working with average incomes for their jobs and location. Mr T was in his mid-30s and Mrs T in her late-20s. They didn't have any dependents and were buying their first home together. They had some deposit-based savings, but neither had any previous investments. Both were a member of their employer's pension scheme.

There was a section of the fact find that documented needs and attitude toward risk for each area of financial planning. It was stated that Mr and Mrs T didn't want to discuss retirement planning, protection on death, savings, investment, capital protection, and income protection, but against each potential need it was recorded that they had an attitude toward risk of '*5 – Managed Funds*' on a scale of 1 to 10. It is not documented how the other ratings were described. This rating was also recorded beside boxes in both Mr and Mrs T's names where the need was documented as 'other'. Mr and Mrs T's priority was recorded as house purchase and they were again both recorded as having an attitude toward risk of '5 – Managed Funds'.

The financial adviser's recommendation was recorded on the fact find as:

Return required: With Profits

We have discussed various types of mortgages currently available i.e. capital repayment, interest-only endowment, interest-only pension. I have recommended and you have agreed that an interest-only mortgage is most suitable because if in the future you move home, you consider it is more flexible than a repayment mortgage. Your regular payments to the lender during the life of your mortgage will clear the interest owed to that lender. In addition you must accumulate sufficient money to clear the capital owing to the lender in 25 years time. Also, in the event of you or your partner being diagnosed with a critical illness or dying at any time during the existence of the mortgage you must generate a sufficient sum of money to clear the mortgage. I have recommended and you have agreed on a Unit Linked Endowment plan to run alongside the mortgage loan because it guarantees a minimum payout in the event of your death, and the performance of the policy's investment fund may increase this. This plan is unit linked so it must be remembered that the value of the units will fluctuate and *therefore the maturity value cannot be guaranteed. The plan will provide a guaranteed sum assured of £65000 in the event of your death or, if earlier, should you suffer a defined critical illness, or permanent and total disability.*

There was then a summary of the details of the policy being recommended; the name of the policy, the amount of the death benefit/target value, premium and term. Where the selected fund should have been detailed, it was left blank.

The policy that was set up was a unitised low-cost endowment policy. It provided life and critical illness cover of £65,000 over a term of 25 years and was designed to build up a lump sum of the same amount by the end of the term. In addition, waiver of premium benefit was attached to the policy in the event that Mr T was unable to work due to illness or injury. The policy was invested in the managed fund.

The "key features document" given to Mr and Mrs T at the time of the sale set out some basic facts about the endowment policy. It contained a section on risk factors, which stated that the amount payable at maturity might not be sufficient to repay their mortgage and that unit prices could rise as well as fall. The charges associated with the policy were also detailed. It was confirmed that there was an initial charge to cover the setting up costs. After that, units would be cancelled to cover the cost of the monthly plan fee, benefits provided and management of the fund.

The policy matured on 28 September 2023 with a value slightly below £63,000. The amount was confirmed to Mr and Mrs T in a letter of 3 October 2023.

Mr and Mrs T complained to SLOC when the policy matured with a shortfall. They complained that:

- The policy was mis-sold, and they subsequently explained that they had not been told about the potential for a shortfall, only an excess, and that they would have taken a repayment mortgage had they known that the policy might not pay off their mortgage.
- They were told the policy would be transferred to safer funds in the last five years of the term to protect its value.
- They believe the funds the policy was invested in were badly managed.
- They believe the plan had made a loss against the premiums paid from one year to the next.
- The increase in units held by their policy had got smaller each year.

SLOC responded to the complaint in a letter of 21 November 2023. It set out why it considered the policy was suitable for Mr and Mrs T. in addition, it confirmed that while there were initial costs associated with setting the plan up, as the documentation provided to them had explained, there were ongoing costs for the administration of the policy and the cost of the benefits it provided. SLOC highlighted that the policy didn't automatically transfer its fund holding into lower risk funds toward the end of the term, and there hadn't been an option for that to happen, other than Mr and Mrs T instructing periodic fund transfers.

Mr and Mrs T were not happy with SLOC's response. They highlighted that it had not commented on some of their complaint points.

SLOC responded in a letter of 1 March 2024, responding again to the complaint point about the transfer of the unit holding to a safer fund. It also responded to the concerns Mr and Mrs T had in relation to the number of units that had been purchased at different times. SLOC confirmed that its position had not changed from the letter of 21 November 2023.

Mr and Mrs T remained dissatisfied with the answers they'd been given and referred their complaint to this Service. One of our Investigators considered the complaint, but he didn't recommend that it be upheld.

Mr and Mrs T didn't accept the Investigator's conclusions. They continued to question the number of units that had been bought each year and the fact that this dropped as the term progressed. Mr and Mrs T also raised the fact that when financial advice is given a customer will rely predominantly on the oral representation of the product being recommended, rather than the documentation provided. They also said that they thought that given the amount of discussion that takes place, it is unlikely that everything is documented. Mr and Mrs T said that they think that SLOC should have offered them different opportunities to manage the plan better.

The Investigator considered Mr and Mrs T's further comments, but they did not change his conclusions about the complaint. As Mr and Mrs T remained dissatisfied, it was decided that the complaint should be passed to an Ombudsman for review.

I issued a provisional decision on 5 November 2024, in which I set out my conclusions and reasons for reaching them. Below is an excerpt.

'*Mr and Mrs T have said they were told that the charges on the policy were front-end loaded. That descriptor was a common one used at the time Mr and Mrs T's policy was sold to highlight that the amount invested in a policy in the very early years would be minimal, in order to pay for the cost of setting up the policy. It didn't however mean that there would be no other charges throughout the term of the policy – there would always be costs for the benefits being provided, management of the funds invested in and a monthly plan fee. In the case of the benefit costs and plan fee, these costs are deducted by encashment of units each month. This is entirely normal for a unit-linked policy.*

As for Mr and Mrs T's belief that the fund holding would be transferred to lower risk funds in the later years of the term. This is something that some policies provide for, but not the one that Mr and Mrs T had. As such, the fact that it didn't move their investment into safer funds to protect its value in the latter years of the term is not something I can criticise SLOC for.

Mr and Mrs T have said that, due to the shortfall at maturity, they think the fund the policy invested in was badly managed. The economic and regulatory situation is very different now from what it was in 1998. That is nothing to do with SLOC. I don't know where SLOC's investment returns "sit" in any table of results but it will no doubt be more successful than some but less successful than others. Being able to say that, looking back, different investment decisions would have been more profitable than the ones actually taken is a statement of the obvious. To make judgments like that, however, would be to use hindsight in making a decision. I cannot do that.

A very large number of decisions over a 25-year period relating to investments, costs and charges have been made by the investment managers at SLOC. Those decisions were made in a regulated environment with layers of governance, independent scrutiny (such as by actuaries and the Regulator) and oversight. Some of the factors influencing returns were outside SLOC's control. Even if I were to try and "drill down" to individual decisions it is very unlikely that I could point to an individual decision or set of decisions which were, without using hindsight, so manifestly bad or wrong that redress should be paid. I am afraid the simple fact here is that Mr and Mrs T invested in an investment product which has not performed as well as was hoped for. I have seen no grounds for upholding this aspect of their complaint.

That said, I have concerns about the suitability of the policy for Mr and Mrs T at the time it was taken out. On the face of it, they were sold an endowment policy that matched their attitude toward investment risk for their priority of buying their home. However, I have some concerns about the documentation, the risk rating selected and the policy sold.

In relation to the documentation, as I have detailed above, the financial adviser documented all of the potential areas of financial planning that he could have discussed with Mr and Mrs T. Against most of these the financial adviser had noted that they didn't want to discuss them. However, despite no discussions having taken place, an attitude toward risk (ATR) of 5 was recorded. This would indicate that either the fact find itself had a default setting of 5 or that the financial adviser in advance of the meeting with Mr and Mrs T entered all of the potential areas of financial planning he might be discussing with them and selected that ATR in advance of the discussions. Either of these scenarios would bring into question the ATR recorded against Mr and Mrs T's actual need and priority of buying their home.

This concern is then compounded by the contents of the recommendations. The explanation of what was being recommended doesn't detail what fund the policy was to be invested in, which I find surprising given that there were seven funds available in which the policy could be invested. However, above the text explaining the recommendation, the financial adviser has documented 'Return required: With Profits'. For Mr and Mrs T's information, With Profits is a type of investment fund, which at the time they were sold their policy would have been considered to represent a low level of risk. A recommendation for a with-profits policy would not indicate that the ATR recorded for Mr and Mrs T in relation to their house purchase was correct. I would also confirm that, based on the options available on the application form, there was not a with-profits fund available for the mortgage endowment policy to be invested in.

Given the evidence indicates that the ATR recorded is likely to have been incorrect, I have looked at Mr and Mrs T's circumstances. They were both employed earning modest salaries and were purchasing their first home. They had deposit-based savings and had no investments, other than possibly their occupational pension schemes. While these circumstances would not preclude Mr and Mrs T from having a balanced ATR as was recorded, it would make it less likely. In general most investors will take a cautious approach to investment initially, either by investing modestly with money they can afford to risk, or in lower risk environments where loss is less likely. I have also noted Mr and Mrs T's comments contained in the questionnaire they completed for SLOC. This indicates that they were under the impression that they didn't think there was any real possibility of the policy falling short of its target value. In light of this, I am not persuaded that the ATR of 5 was an accurate reflection of the level of risk Mr and Mrs T were willing to take with their house purchase. I think it likely that their ATR would have been considerably lower down the scale, reflecting a more cautious approach or them not being willing to accept risk at all.

Overall, I am not persuaded that a managed fund mortgage endowment policy was appropriate for Mr and Mrs T, based on the risks it presented. As such, I intend to uphold this aspect of the complaint.

When determining redress on a complaint we aim to place a consumer in as close a position to that which they would have been in, but for the error on the part of the financial business. In this case, quite simply, the endowment policy that was sold to Mr and Mrs T would not have been and so the redress will be based on what alternative arrangement I think it likely they would have entered into. It is not clear what Mr and Mrs T would have done had the financial adviser not sold them the policy in question. As such, I consider it would be appropriate to base the redress in this case on Mr and Mrs T having been recommended a repayment mortgage.

I have noted SLOC has commented during the term of the complaint that Mr and Mrs T had arranged their mortgage before they returned to speak to the financial adviser. The implication being that their mortgage lender considered an investment backed mortgage was appropriate for them. I would firstly comment that before they met with their mortgage lender, they had already discussed their mortgage needs with the financial adviser, and so that could well have influenced their decision regarding the type of mortgage they arranged. I would also comment that it was common practice in the industry in the 1990s and earlier for the majority of mortgages to be sold on an interest-only basis with the option of changing them to repayment if the financial adviser concluded that an investment backed mortgage was not suitable for them, or if the financial adviser didn't have a suitable investment in the product range they were able to sell. As such, I don't consider that Mr and Mrs T having already arranged an interest-only mortgage when they met with the financial adviser would make an otherwise unsuitable recommendation suitable.

Putting things right

In the early 2000s the Regulator at the time (the Financial Services Authority) set out guidance for calculating redress where an unsuitable mortgage endowment policy had been sold. This was known as RU89. It required the financial business to compare the position the consumers were in with the one they would have been in if they'd had a repayment mortgage from the outset. This comparison took account of both the capital position of the mortgage and the costs of the mortgage.

As Mr and Mrs T continued to use the endowment policy as the repayment vehicle for their mortgage throughout the term, their loss should be calculated as A+B where:

A. *The shortfall between the maturity value and its target.*
B. *The cost comparison of the interest-only mortgage with the endowment policy and an equivalent repayment mortgage. As Mr and Mrs T were a couple and reliant on each other financially, it is reasonable that the cost of a decreasing term assurance be included in the overall cost comparison. I note that they chose to include critical illness cover and waiver of premium benefit on the endowment, and so it would also be reasonable for these benefits to be included in the hypothetical decreasing term assurance policy.*

In line with RU89, if the interest-only mortgage would have been cheaper than the repayment mortgage over the term, SLOC should not deduct that saving from A.

This calculation will be completed as at the maturity date of the endowment policy. I will need Mr and Mrs T to confirm what they did about the shortfall at that point. If they:

- *left the remaining balance on the mortgage and repaid it on a repayment basis over a period of time, any additional interest should be reimbursed, along with interest* at 8% simple per year on the entire amount of each monthly payment from the date of each payment to the date of settlement. This interest will compensate Mr and Mrs T for the loss of use of the money.*
- *used savings to repay the shortfall, any lost interest on that sum should be paid at the rate they would have received in the account the funds had previously been held in.*
- *arranged new borrowing to cover the shortfall, any interest charged on the borrowing should be reimbursed, along with interest* at 8% simple per year on the entire amount of the payment from the date of each payment to the date of settlement.*

**If SLOC considers it is required by HMRC to deduct income tax from any interest paid, it should provide Mr and Mrs T with evidence of the deduction, which they can use for HMRC purposes if required.*'

SLOC did not respond to my provisional decision. I am satisfied that my provisional decision and our reminder of the deadline were sent to the correct email address and SLOC had the opportunity to respond if it wanted to.

Mr and Mrs T appear to have accepted my provisional decision, but they wanted comment on the unit allocation issue they raised during their complaint. They also reiterated that they believed the policy had been badly managed in the last years as the value of the policy increased by less than the premiums they had paid in the final four years.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I would initially confirm our role. We will not always comment on all issues raised by a consumer if those issues do not affect the outcome of a complaint. That was the case here, as given I had found that the policy should not have been sold to Mr and Mrs T at all, the variations in the unit holding in different years was not a key issue that would affect the outcome of the complaint.

I have noted Mr and Mrs T's comments about the value of their policy in relation to the premiums they paid, but that is not evidence of mismanagement of the fund the policy invested in. As I explained in my provisional decision, there are a lot of factors that affect the performance of a fund and the value of the units held by policies such as Mr and Mrs T's. In addition, there are costs that are deducted from the unit allocation of a policy – the monthly plan charge and the cost of the protection benefits that are being provided.

As for the number of units held by the policy at each policy anniversary, that will as they have been told be affected by the price of the units at any given time. The higher the price the fewer units that will be bought by a monthly premium. In addition, units will be deducted for the cost of administering the policy and to pay for the protection benefits. I wouldn't expect the number of units held by a policy to increase in a linear manner as there are a lot of factors that affect the unit holding, and so the resultant value, of a policy.

As no new information or evidence has been provided, I see no reason to alter my conclusions about the outcome or the redress that SLOC should calculate and pay Mr and Mrs T.

As Mr and Mrs T have not confirmed what they did about the shortfall in the maturity value, they should provide that information to SLOC if they accept this decision. They will also need to provide supporting documentation.

My final decision

My final decision is that I uphold this complaint. I order Sun Life Assurance Company of Canada (U.K.) Limited to settle the complaint as detailed about in 'putting things right' above.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr and Mrs T to accept or reject my decision before 11 December 2024.

Derry Baxter
Ombudsman