the Financial Ombudsman Service and mortgage endowment complaints

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This report examines how – between 2002 and 2007 – the Financial Ombudsman Service came to deal with over a quarter of a million disputes about the sale of mortgage endowment policies. It looks at the causes behind this surge of complaints – and at how the ombudsman service responded strategically and operationally to the challenges created by this substantial increase in its workload.

The report has been written by David Severn at the request of the board of the Financial Ombudsman Service. David Severn is an independent regulatory consultant and former head of retail policy at the Financial Services Authority.

The report reflects David Severn's own research and views. It sets out his findings and conclusions – which may be of interest to regulators, the financial services industry, consumer groups and researchers.

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part 1: introduction

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This is a brief account of the Financial Ombudsman Service and its experience in handling complaints about allegedly mis-sold endowment policies. Although this account was commissioned by the board of the Financial Ombudsman Service, the views expressed in it are my own. The readership for this account is likely to be small in number. Yet the issue it treats affected millions of consumers, caused real hardship to some, caused further damage to the reputation of financial services, and occupied much time of regulators, the media, parliamentarians and others. The latest figures from the Financial Services Authority's website (last updated July 2007) show over 1.8 million endowment complaints to have been made and compensation in excess of £2.7 billion to have been paid.

UK consumers have long been passionate about home ownership but few consumers are lucky enough to have enough money to buy their property outright. The majority of consumers wishing to buy a home have to obtain mortgage finance from somewhere and then need to decide on some means of repaying the loan. Until the mid-1980s most consumers repaid their loan by taking out a repayment mortgage. It was sure and steady, and it guaranteed that if payments were kept up, the mortgage would eventually be repaid.

From the late 1980s the use of a low-cost endowment policy (effectively an insurance-based investment contract bundled together with some life insurance cover) rapidly became the popular method for repaying a mortgage loan. The use of an endowment policy carried a risk that investment returns might not be good enough to produce sufficient money to repay the loan at the end of the mortgage term. While investment returns were good, the probability of such a risk crystallising tended to be discounted. As economic circumstances changed it became clear that the risk of a shortfall was not a theoretical one and that some consumers were likely to face a shortfall – sometimes a very significant one – between the proceeds they would get on their endowment policy and the amount which they owed their mortgage lender.

At the very least, consumers had to be alerted to this position so that they could decide what action they needed to take to get the repayment of their loan back on track. That was not, however, the end of the story. It is possible that when a consumer was advised to buy an endowment policy as the repayment vehicle for their mortgage they were poorly advised.

In a few cases, there might have been downright misrepresentation by an adviser. More likely, however, was that little or no attempt was made by the firm advising on the endowment policy to assess whether or not the consumer was prepared to take a risk that the policy might not repay their loan. In other words, there might have been mis-selling.

Matters started to come to a head in 1999. There were calls from some quarters for the regulator of the financial services industry, the Financial Services Authority (FSA), to order the industry to carry out a proactive review of endowment sales. The FSA decided that such a review would be a disproportionate response to the situation. Instead, it set in hand a process for consumers to be informed about the progress of their policy in being able to pay off the mortgage and what action might be taken if there was the prospect of a shortfall. This would be backed up by the use of the existing complaints procedure set up by the regulator. If a consumer facing financial loss believed that the firm which sold the endowment policy had mis-sold it, the consumer could make a complaint to the firm which gave the advice. If the firm rejected that complaint, the consumer could then take the complaint to the Financial Ombudsman Service.

The programme of action set out by the FSA might have worked smoothly. But what happened, in fact, is that a deluge of complaints was generated that had to be handled by firms – with a very substantial number then referred to the ombudsman service. At the time of writing, there looks to be some light at the end of the tunnel for the ombudsman service – but the problem may linger for many years yet, given the long-term nature of mortgage endowments.

The sale of endowments to back a mortgage reached their peak of 83% of the market in 1988. As policies were typically sold for periods of 25 years, there may be many policies maturing in 2013 and beyond. And some consumers may then find – despite the collective efforts of the regulator, industry, media and others – that the money they get back, rather than giving them a nice nest egg on top of repaying their mortgage loan, actually leaves them with a shortfall and the need to find some way to pay the balance. By that time, however, consumers will find that they have no means of obtaining redress, because of the "time bar" which exists on making a complaint.

The focus of this account is on the Financial Ombudsman Service itself. How did the ombudsman service respond as events unfolded from 1999? How has the ombudsman coped with the large influx of complaints – and what has it meant for its normal run of financial cases? What has the consumer experience been in dealing with the ombudsman service? Although the focus of this report is on the ombudsman service itself, it would create a somewhat distorted picture if no attention was give to the context in which the endowment mortgage problem arose.

So this account also gives some brief attention to certain matters in the almost 30 year history leading up to the FSA decision in 1999 on how the mortgage endowment situation should be handled. There is therefore some brief coverage of how the endowment came to be such a popular product as a repayment vehicle; who was selling endowments; how sales were regulated; and how earlier complaints mechanisms operated.

There are some important limitations to this account which need to be made clear at the start. It has been researched against a limited timescale. Its focus has been principally on documents originated by the ombudsman service itself, although there is also some coverage of documents originating from the regulators, government, the Treasury Select Committee and consumer organisations. In contrast, there is little coverage of the issues from the industry perspective. While an effort has been made to look at most of the key documents involved from the ombudsman service and the other main sources mentioned, some may have been missed – so this account does not purport to be comprehensive.

The account is also mainly based on documents which are already in the public domain. So one day a fuller account of this episode might be written, when someone is given full access to all the information. The one exception to the use of published information is the ombudsman service itself. I was given access to the records of the Financial Ombudsman Service, including papers and minutes of its board. In addition, I had useful discussions with a number of staff at the ombudsman service who were able to give the essential "flavour" of how things felt to them at the time, which may not come across from simply reading the documentary evidence.

the road to 1999

It will be no surprise that for a product which was purchased for the purpose of repaying a mortgage loan (such loans generally being repaid over periods of 20-30 years) one has to go a long way back to trace the roots of the problem. Endowments had been around for many years but it was only in the 1980s that sales linked to a mortgage really took off – reaching a staggering peak of

83% of the mortgage market by 1988. The impetus to the growth of the market was given by a number of policies of the Conservative Government of the 1980s.

1988 is a key date for another reason. It is the year in which the provisions of the Financial Services Act 1986 were brought into force providing for the regulation of the marketing and selling of investment products (including endowments). Prior to 1988, regulation of the marketing and selling of insurance contracts was almost non-existent and the standards exhibited by many of those engaged in the industry were very poor. So for almost a decade, endowment policies were being sold in a market over which there was no regulation – and the sales of endowments actually reached their peak during that period.

Also in the 1980s, the government commissioned Professor Jim Gower to review the state of investor protection. In his report, published in 1984, Gower painted a bleak picture of the prevailing standards of conduct in the industry and made recommendations to address the concerns he identified. On the basis of Gower's report, the Government published a white paper setting out its plans for the introduction of a new system of financial regulation. It did not accept all of Gower's recommendations. In particular, it was no surprise that a Conservative Government would not share Gower's view that there should be intervention to control the level of commissions paid to those who sold products such as endowments. The Government subsequently introduced legislation to give effect to its proposals. This became the Financial Services Act 1986 (hereafter referred to as "the 1986 Act"), the provisions of which were brought into force in 1988.

The 1986 Act introduced a byzantine system of regulation. The Act gave the Secretary of State for Trade and Industry the power to delegate to a designated body many of his regulatory powers, including the power to make rules. The body recognised for this purpose was the Securities and Investments Board (SIB). The 1986 Act was founded on the principle of self-regulation. And so the plan was that SIB would not itself regulate firms – but would instead recognise a number of "self-regulating organisations" (SROs) which would regulate their constituent parts of the financial services industry.

For the purposes of this report, the two principal SROs were the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) and the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA). Later, in 1994, these two organisations were to be subsumed within a new regulatory body, the Personal Investment Authority (PIA).

Three other features of the 1986 Act are worth mentioning. The Office of Fair Trading (OFT) was given a statutory duty to review the rules of the regulators for their competition effects. This gave rise to years of dispute between the OFT and the regulators over certain of the regulators' rules. The second feature is that the Act contained a specific prohibition on the regulators from making rules governing the amounts of commission which could be paid to those who sold endowments or other investments. The third feature was that rules made by the regulators could govern the marketing and selling of investments such as endowments. But it was not possible for them to address such matters as the provision of ongoing information to endowment policyholders.

The arrival of a new Labour Government in 1997 meant that regulatory reform was again on the agenda. The desire of the new Government was to move from a position where self-regulation was exercised by numerous separate bodies, under the supervision of SIB, to one where there was a single regulator operating on a statutory basis. In July 1997 SIB published a report in response to the Chancellor of the Exchequer's request to Sir Andrew Large to bring forward a plan to implement the Government's policy for reform of financial regulation. The report set out the proposed aims and responsibilities of the new regulator, which was to become the Financial Services Authority (FSA). It also set out, among other things, proposals to bring together the existing complaints-handling mechanisms in financial services; and, following the PIA example, a proposed role for a consumer panel to advise the new regulator.

Action soon followed. In 1997 the PIA, along with other regulatory bodies, began to work with the FSA on the construction of the new regulatory regime – in advance of new legislation, the Financial Services and Markets Act 2000, being passed and implemented. For various reasons, that new legislation was not brought fully into effect until late 2001. This meant that for several years, the PIA and other regulators remained formally responsible for regulating their sectors – but depended for the delivery of the regulation on the FSA, under service level agreements.

In addition to creating a statutory based system of regulation, the Financial Services and Markets Act 2000 introduced many other changes. The prohibition on the regulator making rules to control commissions was removed. The tension with the OFT was largely removed, by creating an obligation on the part of the FSA itself to have regard to the competition effects of its proposed rules.

And the FSA was no longer confined, as its predecessors were, to making rules governing just the marketing and selling practices of firms. It could now address issues relating to the provision of ongoing information.

One of the functions delegated to the regulators was that of making detailed rules to govern such matters as the conduct of business by financial services firms. At this point, it is worth making a diversion, to comment on certain of the rules of the regulators (SIB, FIMBRA, LAUTRO, PIA and the FSA). This is relevant to considering some important aspects of what is said later about complaints relating to sales of mortgage endowments.

In particular, I would like to comment on the rules setting out the standards expected of advisers – because it was the failure of many advisers to follow these rules that gave rise to the endowment problem. Moreover, some in the financial services industry have the mistaken belief that the 1986 Act introduced new obligations on those who chose to offer advice on investments, when in fact there were common law obligations on those who chose to give advice *prior* to the 1986 Act.

I would also like to comment on the rules about product disclosure – because after the 1986 Act there were continual efforts made to improve the quality of information provided to consumers so that they were aware, for example, of the risks which they might be taking on with an investment such as an endowment. The rules on commissions are touched on briefly, because of the widespread view that "commission hungry" firms caused the mis-selling of endowments.

I will also discuss the rules on "projections" (or "illustrations"), because in some ways it was the 1997 review of the rates of return used in projections – alongside the specialist supervision work by the PIA on mortgage endowments – which was the catalyst for the mortgage endowment exercise.

The issues mentioned above have such a long and controversial history that they could easily merit a report of their own. What follows, therefore, is but the briefest account of how matters developed over the years.

suitability

Some in the financial services industry hold to the myth that practices frowned on today were ones which were entirely acceptable in the past – and that the regulators, and the ombudsman, are often applying today's standards retrospectively to past business. This view just does not seem to be supported by the evidence. As early as 1985, the new regulators were consulting on various aspects of the conduct of business rules which were to come into force once the 1986 Act was implemented.

In December 1985 the Securities and Investments Board and the Marketing of Investments Board Organising Committee published "*Life assurance and unit trusts: independent intermediaries, tied agents and company representatives*". This referred back to the government white paper which laid down a number of principles, "*such as the principle of fair dealing, the general duty of skill, care and diligence and the obligation to have an adequate and reasonable basis for any investment recommendation, bearing in mind the nature of the investment and the circumstances of the client*". The paper said that these principles would be embodied in the conduct of business rules of the regulator, "*and will be underpinned by a requirement to maintain detailed records, which will facilitate the investigation of complaints*".

In a document called "*Life assurance and unit trusts and the investor*" published in April 1986, it was made clear that certain general obligations would apply to all firms. Those obligations were: the principle of fair dealing (*ie* to deal honestly and fairly and aspire to best market practice); to take reasonable steps to ascertain the customer's personal circumstances before advising or making recommendations *("know your customer"*); to recommend only what the firm has reasonable grounds for believing to be suitable to the customer ("suitability"); and an obligation to act with due skill, care and diligence. The document went further and made clear that certain record-keeping requirements would be imposed, including that "*the records should be capable of establishing that in each transaction the salesman had full knowledge of the investor's circumstances and had recommended only what was suitable to the investor.*"

If any firm were in any doubt as to the obligations which it was under when giving advice, the consultations by the regulator prior to the 1986 Act coming into force should have removed those doubts. Firms had at least two years to try and put their house in order before the rules of SIB and the other regulators took effect in 1988. In essence, there were three limbs to the process.

First, to establish details of the personal and financial circumstances of the customer (so called "fact finding"). Next, to establish the customer's attitude to, and understanding of, risk. And finally, to make a recommendation to buy an investment only where it was suitable to a customer, taking account of what was known, or ought reasonably to have been known, about the customer's circumstances. These basic requirements were reflected in the rules of the other regulators, and from time to time those regulators gave reminders of the general obligations, as well as specific guidance on how the requirements applied in particular circumstances.

As an example, the FIMBRA rulebook contained principles and more detailed rules on, among other things, standards of advice. In addition, FIMBRA issued a series of guidance notes. The first of these, GN1, was issued in July 1988 and gave comprehensive guidance on FIMBRA's expectations on compliance with the "best advice" rule. It said that members of FIMBRA would be expected *"… to take steps to ascertain what is appropriate for a client"* – and then went on to say that member firms *"… will have to review actively and give due weight to all the factors and information which could reasonably have been expected to have been known at the time the advice was given."*

FIMBRA's GN1 also said that firms *"must obtain as much information as is necessary about the client's circumstances and his understanding of the risks involved."* FIMBRA warned that in its compliance visits it would look to see the *"… steps taken by members to inform themselves about their clients, the markets and their suppliers."* Later, in February 1993, GN9 – *"Giving investment advice"* – replaced GN1. But it covered much of the same ground as the earlier note and said: *"Members must also agree the client's investment objectives and evaluate the client's ability to accept risk and to understand the nature of the risks involved in any transaction."*

Although FIMBRA issued other guidance notes, none of these specifically addressed mortgage endowments. Principal areas of concern were with pensions matters (transfers and opting out, contracting out *etc*), equity home income schemes, and specialist areas such as broker funds and business enterprise schemes. LAUTRO similarly had rules and guidance on suitability, and through its various bulletins to its members it gave feedback on the general state of compliance with the rules, as well as sometimes giving specific guidance on the application of the rules in particular circumstances.

It should therefore have been apparent from 1988 onwards that a firm should obtain information about a customer's circumstances and attitude to risk, recommend an endowment only if suitable, and keep a basic record of what happened. The fact that the regulators had to repeat these requirements, and that as recently as 2007 the FSA was still finding fault with the quality of some firms' advice and record keeping, speaks volumes about the standards of compliance by some in the industry.

product disclosure

In December 1988 SIB published proposals in *"Life assurance and unit trust disclosure: the regime for 1990"* on various aspects of the information which should be disclosed by firms to consumers. The issue of product disclosure and commission disclosure is one which has been the subject of a war of attrition between various parties over the years – and remains so today. So far as product disclosure is concerned, SIB's 1988 document set out some objectives for disclosure, including the need for the disclosures to be expressed in terms which are most likely to be understood by consumers – and most useful to them for the purposes of making comparisons.

SIB also recognised the potential problem of "information overload" for consumers. In terms of delivery by the industry, the so called "product particulars", which were the vehicle for disclosure of product information, seemed generally better at obscuring information than clarifying it for consumers. SIB and LAUTRO would no doubt have got round to addressing this situation. But the pace was forced by the OFT, which in 1990 published a report on the product and commission disclosure regime and found that in a number respects it was anti-competitive.

In such circumstances, it was a matter for the government (at that time the Secretary of State for Trade and Industry was the relevant minister) to decide the fate of the regulator's rules. The Conservative government sat on the fence, by asking SIB to "think again" about its rules, taking account of the OFT's views. In March 1992 SIB published its consultative paper 60 – setting out new ideas on product disclosure, agreed with LAUTRO. And in May 1992 it published a policy statement, *"Retail regulation review: disclosure and standards of advice"*, which confirmed the new regime.

This new regime was to consist of three levels of disclosure. The first tier would be "key features" about the product, to be given to the investor by the adviser before or at the time a recommendation was made. The second tier would be product particulars sent to the investor by the product company no later than the start of the cooling-off period. (In part this was a "belt and braces" approach to disclosure – against the risk of IFAs or insurance company sales staff failing to hand over key features documents.) The third tier would be more detailed information, which would be available to the consumer on request. SIB also introduced the idea of the "reason why" letter, essentially putting an adviser in the position of explaining in writing why a particular investment, such as an endowment, was considered to be suitable to a consumer's circumstances.

SIB did not want to repeat what had happened before, with rules being brought into force and implemented by the financial services industry – only for the rules to be found wanting by the OFT and therefore needing to be revised. So on this occasion, SIB announced that these new rules would not be brought into force until such time as the OFT had completed its competition appraisal of them. In fact, OFT was to find the rules wanting again.

The rules for disclosure made by SIB in 1992 were again found by the OFT to be anti-competitive in a number of respects. On this occasion, the government did not ask SIB to "think again". Instead, the Chancellor of the Exchequer (responsibility for financial services having now moved to the Treasury) decided that the competition effects of the proposed disclosure rules were more than was necessary to secure consumer protection. And so he directed SIB to change its rules to remove their anti-competitive effect.

Shortly before the Chancellor's decision, the chairman of SIB, Sir Andrew Large, had decided to set up a taskforce of regulators, comprising representatives from SIB, FIMBRA, LAUTRO, IMRO and the DTI. This taskforce had the responsibility of giving effect to the Chancellor's direction. Some major changes emerged from the taskforce's work in relation to the information given to consumers. These changes were subsequently consulted on by SIB in its consultative paper 77, "*Life assurance: disclosure of commissions and other matters*", published in January 1994.

The taskforce reached the view that product information provided to consumers needed a major overhaul – as the content, presentation and language of the existing disclosure material was simply failing to communicate clearly to consumers. Implementation of the taskforce's recommendations was later to fall to the PIA.

In SIB's consultative paper, two examples were published of what a new disclosure document, called "key features", might look like for a low-cost with-profits mortgage endowment. In both cases, the documents included the heading "risk factors" prominently on their front page. One of the risks covered was that *"the proceeds will depend on investment performance. The amount you get back may not necessarily cover the mortgage."* Inside the two documents, slightly different approaches were suggested to dealing with questions the consumer might have. In one document there was the heading *"Is repayment of your mortgage guaranteed?"* – and the text that followed made clear that at the end of the mortgage term *"we do not guarantee to repay it at the end of its term. But it would be repaid if we were able to earn 5% or more on your contributions."* In the alternative version, there was a page headed "six key questions", one of which was *"Is the amount I might get back guaranteed?"* The answer stated *"No. It depends on investment performance."*

commission disclosure

The work of the taskforce of regulators, set up by SIB, also settled the thorny issue of commission disclosure. Earlier in this account, mention was made of the fact that the Conservative government did not share Jim Gower's view that competitive forces would not work to keep commissions down – and that direct intervention was needed. For a brief time, some semblance of order was maintained, as parts of the industry adhered to a voluntary maximum commissions agreement (MCA). It was clear, however, that this agreement was also going to fall foul of competition law – and so the MCA was abandoned. Once the MCA had gone, there was nothing to keep commissions in check, other than the hope that disclosure would do so.

It was again the Chancellor of the Exchequer who decided that commissions should be disclosed – and this then became another task remitted to the taskforce of regulators. Apart from the sheer emotion which it aroused from all parts of the industry, there were some genuine and difficult issues of a technical or practical nature in working out how best to require advisers to disclose their commissions. In brief, however, the taskforce proposed that the precise amount of commission should be disclosed in cash – before the consumer was committed to a transaction (for example, by signing an application form). Again, implementation of the new commission disclosure requirements fell to the PIA in 1994. Going forward, the requirements at least ensured that consumers were told how much commission their adviser got from recommending an endowment.

projections

Over the years, it has been common for projections, or illustrations, of the possible future value of a life policy to be used as part of the sales pitch of advisers. Projections were inherited by the regulators, not invented by them. Indeed, at times there has been debate among regulators about whether projections should be prohibited. In his "*History of LAUTRO*", Kit Jebens, a former chief executive, referred to the situation inherited by the regulators of "*wildly exaggerated bonus projections*" which had "*resulted in considerable, justifiable public criticism*" – and also to the use of "telephone number" illustrations – before the regulators introduced some constraints on the assumptions to be used.

As early as April 1986, a document called "*Life assurance and unit trusts and the investor*" published by the Securities and Investments Board and the Marketing of Investments Board Organising Committee said: "*Most life assurance contracts are long-term investments. The investor will accordingly expect, in making his*

investment decision, to have a reasonable idea of the ultimate benefits … where benefits are not guaranteed it is possible only to give estimates, which are bound to be uncertain to a considerable degree. They will depend on future economic conditions – growth rates, inflation rates, exchange rates, interest rates etc – and on future investment performance of the company."

The document went on: *"None of these can be predicted with any certainty in relation to any product of any company for 10, 15, 25 or more years in the future. Moreover, small differences in assumptions applied to long-term investments can result in widely different projections of benefits on maturity. Nor is the past necessarily a reliable guide to the future. For example, it is generally considered that investment results in recent years may well prove to have been exceptionally favourable."*

The paper concluded that, "*despite these, the Board considers that on balance future estimates or projections should not, in general, be prohibited. In relation to at least some widely used investments, an investor should have some indication of the future prospects before deciding whether or not the contract is suitable for his needs. For example, an investor an endowment assurance to cover a mortgage will want to be reasonably satisfied that the policy proceeds will actually be enough to repay his loan."* The Board then went on to promise that given the difficulties it did not think it right to produce definitive rules, *"without the fullest discussion with the industry, consumer bodies and other interested parties".*

One aspect of projections which was the subject of controversy was whether or they should be based on a company's *own charges* or on *standard charges*. Acres of print were expended on this subject in the early 1990s – and perhaps the best summing up of the position that the regulators reached by 1992 was given in a SIB policy statement, *"Retail regulation review: disclosure and standards of advice"*, published in May 1992. SIB noted that when it had consulted on the issue there had been very strong views expressed both for and against "own charges" – and that it had given much consideration to the differing viewpoints.

In setting out its reasons for staying with standard charges, SIB had three main reasons. The first reason was that "*… projections are conjectural. Investors should regard them with healthy scepticism, and the regulators, for their part, should do nothing to abate that scepticism."* SIB's view was that introducing cost differentials into illustrations would obscure their essentially conjectural nature.

SIB's second line of reasoning was that a shift to "own charges" would, because of the effect of compounding over long periods of time, *"have the effect of amplifying small transitory or chance differentials in current cost calculations."*

The third line of argument from SIB was that "*… if there were no other way for investors to be given information on the differences in charges and expenses between product providers, the own charges approach to illustrations might have to be adopted despite its serious drawbacks. But that is not the position. The key features will contain clear information showing the effect of charges and expenses and that information will be both company-specific and product-specific.*"

In conclusion SIB said: "*Given the conjectural nature of illustrations, it is clearly of importance that their limitations should be unequivocally conveyed to any investor who receives one. Illustrations have to be accompanied by a caveat, and SIB expects a stronger caveat to emerge from the current revision of the rules.*"

In his "*History of LAUTRO*", Kit Jebens, a former chief executive, also made reference to the issue of "own charges" projections and the divisions which existed within LAUTRO itself on the issue. He commented that, "*On the whole, the experience of life office practitioners, who had lived throughout the period of telephone-number illustrations, enabled them to see the technical difficulties of policing an own charges regime*" – and this would lead to the fear, which SIB shared, of spurious competition on the basis of charges alone.

However, this was again an area where the OFT won the day – and another job for the taskforce of regulators was to introduce rules requiring projections in future to be prepared on an "own charges" basis.

the experience of the Financial Services Act regulators

It may be wondered how the problems with endowments came about, given the various regulatory requirements referred to above – which, had they been observed properly, should have safeguarded consumers from buying a product which exposed them to the risk of a shortfall. The first point to repeat is that prior to 1988 there was no regulatory system in place to supervise the conduct of business by firms selling endowments – and by that date, much of the damage had already been done as sales of endowments started to decline after 1988.

Once the regulatory system of the 1986 Act was operating, the regulators then had the problem of widespread failure by the industry to abide by the rules properly – or in some cases at all. This, in effect, is the situation which FIMBRA and LAUTRO faced. In some respects, the regulators, and particularly FIMBRA, had problem enough just in dealing with those who were simply not fit and proper, or competent, to engage in investment business – let alone to have the resource to deal with the many more firms whose compliance with the rules was cavalier.

Like a super-tanker, the financial services industry was slow to come to a stop in its non-compliance – and to start moving in the right direction. There was still much progress to be made by the time the PIA took over in 1994. And the PIA faced a significant problem of its own as soon as it opened for business – in seeking to resolve the pensions mis-selling which had taken place before it was formed.

The proportion of mortgage endowment complaints turned down by the ombudsman service in relation to endowments sold *after* 1994 is significantly higher than the proportion of complaints relating to endowments sold *before* that date – which suggests that *after* 1994 firms were starting to improve standards of selling and were better able to demonstrate the suitability of sales. It might be argued, however, that after 20 years of conduct-of-business regulation, the industry would now be showing a high degree of compliance with the regulatory requirements. In fact, as recently as 2007 the FSA was still critical about the quality of advice given by some firms.

are endowments a good thing?

Another factor which needs to be borne in mind is that at no time was it the view that an endowment was necessarily a bad choice as a repayment vehicle for a mortgage – always providing that the consumer taking out the endowment understood that it carried an investment risk and was prepared to take that risk. In 1995, for example, the OFT published a report on mortgage repayment methods which concluded that an endowment might still be right for some consumers. Or again in 1999, the Institute and Faculty of Actuaries published guidance on the circumstances where it thought an endowment might still be suitable advice.

It has not been possible, given the scope of this study, to examine the decades of commentary and media coverage on the merits of endowments. But in general terms, commentators on endowments became less positive about them – both as tax advantages disappeared and then as investment conditions changed.

part 2: chronology

1999-2002 – *Houston, we have a problem*

the endowment problem crystallises

It was noted in Part 1 that projections of the future value of an investment was one area subject to regulatory control. Changing the assumptions that had to be used by firms in projections was a costly and time-consuming business, as firms had to change computer systems, their product literature, and probably also had to give training to their advisers. The assumptions were not, therefore, subject to frequent change. Moreover, it was not really necessary to make frequent changes to the assumptions to reflect short-term volatility in investment returns or changes in inflation. The projections were for periods of 20 years or more – and so what was important were the long-term prospects.

In 1997 the regulator, PIA, commissioned a report from Lombard Street Research on the economic analysis underlying the rates of return used in projections. The report concluded that, given the changes in economic conditions, there was a strong case for reducing the rates of return used in projections. It then became more apparent that endowments (even if they had been properly sold to consumers and were held for their full term) were less attractive as a means of repaying a mortgage loan – and that some policies already sold might no longer be on target to meet the loan.

At this point, a considerable amount of effort was being spent on working through the arrangements for the transition to the new system of regulation under the FSA. In consequence, there was some delay in implementing the new projection rates. However, following consultation, effect was given to new rates of return from 1 January 1999, although firms were given a period of grace until 1 July 1999 in which to make the system changes.

The new rates to be used were 4%, 6% and 8% – in place of 5%, 7.5% and 10%. But by this time it was clear that economic circumstances had changed quickly. A further report was commissioned from Lombard Street Research in June 1999.
In 1999 the "PIA supervision" arm of the FSA was also carrying out themed work on mortgage endowments. This work, combined with the reducing investment returns, started to show clearly the problems with endowments.

In September 1999 the Association of British Insurers (ABI) took the initiative and introduced a code of practice, requiring its members to carry out regular "re-projection" exercises. These "re-projections" would occur at the tenth anniversary of the endowment policy – and every five years thereafter. They were intended to provide the consumer with an estimated value at maturity for their endowment – based on the investment growth rates permitted by the regulator.

In its code of practice, the ABI introduced the idea of a "traffic-light system" for "re-projection" letters. A "red" letter meant that there was a high risk of a shortfall on the endowment. An "amber" letter meant that there was a significant risk of a shortfall. And a "green" letter meant that the policy was still on target to reach the sum assured, and therefore pay off the mortgage loan.

The initial ABI code of practice was withdrawn later in 1999, when it became clear that a general mailing would have to be sent to all endowment policy-holders. A revised code of practice was issued in November 2000, coming into force in July 2001. The code was updated again with effect from 31 May 2004. Although the efforts of the ABI in 1999 were rapidly overtaken by the response of the regulators to the emerging endowment problem, it is still to the ABI's credit that it attempted to address the issues of its own volition.

In December 1999 PIA published its regulatory update 72, which set out its findings from visits to firms over the year – and the actions which PIA and the FSA would jointly be taking going forward. PIA reminded firms that compared with a repayment mortgage, "*endowment-related mortgages are complex … they have features with which many borrowers will be unfamiliar – especially the nature and extent of their exposure to market risk.*"

PIA said that particular care had, therefore, to be taken to ensure that "*… the customer understands the risk he or she is taking; the product is suitable having regard to all the customer's requirements and expectations; the customer is given all relevant information; a complete and accurate record is kept of the advice.*" PIA's visits had shown that both product provider and IFA sales were in general falling short of these standards. The shortcomings revealed included:

- Failure to demonstrate that an endowment was a suitable repayment method for the customer, having regards to his or her circumstances. There were also cases where new policies were sold without recording why any existing endowment policies had not been used as the means to repay part of the mortgage loan.

- Lack of evidence that the customer had, and would continue to have, the ability to make premium payments into the policy (recognising the possible need to increase premiums further, if that became necessary to provide the original projected capital sum on maturity). There were also cases of policies sold that stretched into retirement, with no explanation of how premiums would continue to be affordable once the customer had stopped earning.

- There was a lack of evidence that the risks of an endowment had been clearly and fully explained, or that the firms had a sufficient understanding of customers' attitudes to taking market-linked risk in the financing arrangements for their homes.

- There was a failure in some cases to demonstrate that the customer needed life assurance, or even that the customer understood that it was included in an endowment.

the FSA's 1999 announcement

On 21 December 1999 the FSA announced its conclusions on endowments and the further action which it proposed. The essence of the FSA's announcement was that it did not believe a case existed for the financial services industry to pro-actively review all the endowment policies which it had sold, in order to ascertain whether they had been mis-sold.

Instead, the FSA set out a programme of action that involved policyholders being told about the progress of their endowment towards paying off the mortgage loan – and the actions which consumers might take, if there was a potential shortfall. In addition, the normal complaints procedure for dealing with complaints by consumers would continue to operate. That is, a consumer who had some complaint about an investment should complain in the first instance to the firm which sold the investment. The firm concerned would have a certain time in which to answer the complaint. If the firm failed to provide the consumer with an answer within a certain time, or if it provided an answer with which the consumer was dissatisfied, the consumer could then take the complaint to the relevant ombudsman or complaints scheme.

By January 2000 product providers committed themselves at the FSA's behest to write to all endowment policyholders, telling them that the "re-projection" exercise was taking place and that they would be receiving individual "re-projection" letters in due course. The FSA required firms to enclose with this initial letter a copy of its own factsheet, "*Your endowment mortgage: what you need to know*".

The first phase of the individual "re-projection" letters then followed from April 2000 to June 2001. The individual "re-projection" letters – at least the "red" and "amber" ones – were accompanied by a company booklet, typically called *"mortgage endowments – delivering your needs"*, the model text for which had been supplied by the ABI.

The mortgage endowment exercise was now under way – and a key part of the FSA's strategy was that where consumers felt they had been badly advised, and in consequence were facing a financial loss, they should make use of the complaints route to obtain redress. It is time, therefore, to consider how the complaints mechanisms in the financial services area developed over time – leading up to the establishment of the Financial Ombudsman Service.

the establishment of the Financial Ombudsman Service

Prior to the establishment of the Financial Ombudsman Service, a diverse set of arrangements existed for the handling of financial services complaints. The Financial Services and Markets Act made provision for the establishment of the Financial Ombudsman Service as the new complaints-handling organisation – which would provide consumers with a free, informal and independent service for resolving disputes with firms providing financial products and services. The Financial Ombudsman Service would in due course take over from the then eight existing complaints-handling and ombudsman schemes – and so would provide a one-stop shop for complaints by consumers, something for which consumer organisations had lobbied for many years. The pre-existing eight schemes that the new Financial Ombudsman Service replaced were:

- the Banking Ombudsman
- the Building Societies Ombudsman
- the Insurance Ombudsman
- the Investment Ombudsman
- the Personal Insurance Arbitration Service
- the Personal Investment Authority Ombudsman
- the Securities and Futures Authority Complaints Bureau and Arbitration Scheme
- the Financial Services Authority Direct Regulation Complaints Unit.

In 1997 the FSA consulted on the establishment of the Financial Ombudsman Service, on the assumption that what was then the Financial Services and Markets Bill would get Royal Assent.

In its consultation paper, the FSA drew attention to the material differences among the then existing complaints-handling schemes: *"Some are compulsory, others voluntary. Some are set up under statute, others are based in contract. Some have been set up by the industry, others by regulators. And some use ombudsmen and others arbitrators. There are also significant differences … in terms of eligibility criteria, limits on awards, the availability of compensation for distress and inconvenience, time limits, terms of reference, bases for awards, procedures, funding and governance arrangements."* (FSA's consultation paper CP04)

These differences created what the FSA described as a *"patchwork quilt … that consumers find … confusing"* – and it was the aim of the government and the FSA to create a single ombudsman scheme which would rationalise the disparities among the then existing schemes. Following its consultation, the FSA published a policy statement in August 1998 – setting out the broad conclusions from its consultation.

A particular aspect of the FSA's consultation on the establishment of the Financial Ombudsman Service that merits attention is that of the time limits for making a complaint. The time-limit rules under which the new ombudsman service was to operate would be set out in the FSA's Handbook. The FSA said that the rules would broadly mirror the position under the law of limitation of actions in England and Wales. That is, there would be a six year limit – or three years from the date when the consumer knew, or could reasonably have been expected to have known, of the cause for complaint. An important difference, however, was that whereas in limitation law there is a so called "long stop" of 15 years – after which any opportunity to take a case to the courts is lost – the rules made by the FSA for the operation of the ombudsman service contained no such long stop. This was a deliberate approach by the FSA, taken after careful consideration and following public consultation.

The FSA consulted on its rules in outline in its consultation paper CP33 – and in detail in consultation paper CP49. On limitation periods, the FSA inherited different positions from the previous complaints-handling schemes. The Insurance Ombudsman scheme had no limitation periods at all; the Banking and Building Societies Ombudsman schemes had no "long stop" cut-off date; and the PIA Ombudsman scheme's rules mirrored exactly the position under the limitation law. The FSA therefore decided to harmonise these different rules in the new ombudsman service rules – introducing three and six year rules, but not including a 15 year cut-off. These points passed relatively unnoticed at the time – but were to assume greater importance later, when the mortgage endowment issue came to the forefront.

laying the foundations

Andreas Whittam Smith was appointed the first chairman of the Financial Ombudsman Service – and Walter Merricks (previously the insurance ombudsman) was appointed the chief ombudsman. The first annual report of the Financial Ombudsman Service, *"Laying the foundations"*, covered the period from 26 February 1999 to 31 March 2000. As the title suggests, it described the considerable task of planning to integrate the existing complaints-handling arrangements and to bring the staff and the work of the separate predecessor organisations under one roof.

At this stage the Financial Ombudsman Service had no powers or responsibility for handling complaints in its own right. Nonetheless, it acted corporately as if the Financial Services and Markets Act were already in force. In March 2000 the new ombudsman service signed "service level agreements" with each of the boards of the existing complaints-handling and ombudsman schemes. Under these agreements, the Financial Ombudsman Service undertook to provide the appropriate complaints-handling service in accordance with the very diverse arrangements of the separate schemes. In parallel with ensuring "business as usual", the new ombudsman service also faced the major task of putting in place the arrangements and infrastructure for the single ombudsman scheme, once the Financial Services and Markets Act was brought into force.

It is worth noting here the scale and difficulty of the task faced by the Financial Ombudsman Service. In the commercial world, a merger or takeover usually involves the integration of just two organisations – and such a merger is normally not attended by continuing media and political scrutiny. The Financial Ombudsman Service, however, had to integrate eight separate organisations, maintain their existing business until the new legislation came into effect, and prepare for the new framework set by the legislation.

Among other things, this involved putting a new management team in place, mostly recruited from the predecessor complaints-handling schemes. However, as none of the predecessor schemes was of sufficient size to warrant certain specialist functions, the new Financial Ombudsman Service had to bring in new people to head support areas such as IT, human resources, communications and service quality.

Negotiations on terms and conditions for staff at the Financial Ombudsman Service started in November 1999. By 1 April 2000 the majority of the staff of the existing complaints-handling schemes had become employees of the new ombudsman service. Of 340 job offers made, only 25 people did not accept employment with the new service.

The merger also involved finding a new single office, to which the staff of the existing complaints-handling schemes could be re-located. After finding office space in London's Docklands, the ombudsman service had five months to fit out the new accommodation. Staff from various locations across London then had to be moved to the new office in the space of two months during 2000 – while at the same time continuing their previous scheme's "business as normal".

A major project was the installation of new IT – to ensure that the new ombudsman service had a single resilient platform, capable of supporting a higher volume of enquiries and cases. While staff shared this common IT infrastructure, they also had to continue to use the complaints-handling software inherited from the predecessor schemes – until such time as the Financial Ombudsman Service was legally able to handle complaints in its own right.

The initial structure of the Financial Ombudsman Service reflected the fact that it would, under the "service level agreements", have to support and provide the complaints-handling functions of its predecessor schemes – until the Financial Services and Markets Act came into force. The organisation therefore started with a common management and support-services division – but the remainder of its business operated around four divisions:

- an insurance division responsible for the work previously carried out by the Insurance Ombudsman Bureau;

- an investment division – the largest area – whose work was handling complaints previously dealt with by the Personal Investment Authority Ombudsman;

- a banking and loans division, dealing with the complaints previously handled by the Banking Ombudsman and the Building Societies Ombudsman; *and*

- an enquiries division. This provided general advice and guidance to consumers on what to do if they were not happy with a financial product or service. It also provided the initial stages of the ombudsman process, acting as the gateway to the complaints-handling and dispute-resolution services of the existing schemes. This meant that initially its resources were structured to support the requirements of those schemes.

However, the process of integrating and aligning resources began immediately, in order to deliver the "single point of entry" for consumers which the Financial Ombudsman Service was designed to provide to consumers.

The chief ombudsman set out in the first annual report the longer term objectives for the Financial Ombudsman Service. These were to:

- provide consumers with a free one-stop service for dealing with disputes about financial services;
- resolve disputes quickly and with minimum formality;
- offer user-friendly information as well as adjudication – and promote avoidance of disputes as well as their resolution;
- take consistent, fair and reasonable decisions;
- be cost effective and efficient and be seen as good value;
- be accessible to disadvantaged and vulnerable people;
- be forward looking, adaptable and flexible, making effective use of new technology; *and*
- be trusted and respected by consumers, the industry and other interested parties.

The chief ombudsman elaborated on these aims – and some of the issues which they raised. He noted that while seamless and comprehensive coverage should clearly be the aim of the Financial Ombudsman Service, caution had to be exercised in how quickly that aim might be achieved. Initially, the coverage of the new ombudsman service under its compulsory jurisdiction would largely resemble that of the existing complaints mechanisms – brought together under one roof.

While this would provide a large measure of unification, there would still be noticeable anomalies. For example, complaints about investment advice given by independent financial advisers (IFAs) would fall within the remit of the Financial Ombudsman Service – but generally complaints about mortgage or general insurance broking would not.

Similarly, caution was expressed over the quick resolution of disputes, at least initially. The chief ombudsman pointed out that the Financial Ombudsman Service had inherited a situation in which some of the existing complaints-handling schemes had accumulated delays in processing and resolving complaints.

Add to this, the disruption caused by a new location, new systems, the transfer of existing staff and the recruitment of new staff, and it was clear that the Financial Ombudsman Service would initially have to struggle hard to meet service standards.

Commenting on the ombudsman service's aim to be user-friendly, the chief ombudsman stressed that the aim would be to maximise the opportunities for resolving disputes at the earliest possible stage, rather than leaving problems to escalate. In dealing with consumers, the Financial Ombudsman Service would, as far as possible, use their preferred method of communication – and only formalise matters when it was necessary to do so, or to record a final decision. To achieve this end, the ombudsman service undertook to review all its enquiry procedures, complaint forms, information material and standard communications.

The chief ombudsman reflected that consistency in the ombudsman service's approach was of less interest to consumers than to firms. The aim would be to set out for the industry the general policies as to how the ombudsman service would approach commonly encountered situations – and this was done through regular issues of *ombudsman news* – so that firms with complaints from their customers would have an understanding of what might happen, if the complaints were eventually referred by the customer to the ombudsman service.

It was also noted that the ombudsman service could achieve some "quick wins" on consistency – through, for example, harmonising the slightly different approaches to handling complaints about banks and building societies under the predecessor schemes.

The chief ombudsman also set out the steps to ensure that the Financial Ombudsman Service was accessible to those consumers whose first language was not English, or who had some impairment or other difficulty in using the service.

It was noted that, longer term, the establishment of the ombudsman service would lead to cost-efficiencies. But in the short term, there would be extra costs from the need to invest, for example, in new technology and additional management. This made it vital, in the view of the chief ombudsman, that the organisation should drive for productivity improvements – so that the industry would begin to see lower unit costs for the service.

Importantly, however, cost considerations should not jeopardise standards. All stakeholders would expect that the standards which the Financial Ombudsman Service provided were at least at the same level as those expected of firms. An important aspect of delivering an efficient and productive service was the investment

in IT – to reduce dependence on paper files and to allow flexibility in case handling across the organisation.

Finally, the chief ombudsman noted that the reputation of the new ombudsman service would be its most vital asset – and to assess its standing, the service would undertake stakeholder-opinion research and combine this with survey work measuring consumer and firm's satisfaction. Allied with this, the Financial Ombudsman Service would aim to gain trust and respect by operating in an open and transparent fashion.

In the Financial Ombudsman Service's first annual report, the coverage of the work of its investment division indicated that the character of complaints had shown no change from those complaints reaching the predecessor organisations: *"Most of the complaints dealt with … relate to advice given to consumers to buy investments. These cases generally involve having to decide whether the details of the investment were properly explained and whether the investment was suitable, given the consumer's personal and financial circumstances."*

The report also noted that *"personal pension plans are the investment products complained about most frequently, followed by low-cost endowments linked to mortgages, a rapidly growing area of complaint."*

At its inception, therefore, the Financial Ombudsman Service had recognised that there might be problems on the horizon with regard to endowments – but it did not anticipate quite what was to follow in the years ahead.

For any organisation, the first contact by a customer is of crucial importance. The comments of the chief ombudsman in his first annual report indicate that the approach of the new ombudsman service was to seek the earliest resolution of any issue between a firm and its customers – so as to avoid to avoid such issues becoming a formal "complaint". Consumers facing a potential shortfall in their mortgage may be aggrieved, or confused, or even desperate – and will be looking to the ombudsman for help and guidance.

This puts the ombudsman in a difficult position. The service is not – and does not behave as – a consumer "champion", despite the organisation sometimes being presented in such a light by media coverage. Those dealing with the first contact from a consumer have to be patient, helpful, courteous, but above all neutral, in dealing with an initial enquiry.

This difficult task fell initially to the consumer consultants in the ombudsman service's front-line customer contact division. Later, in 2004, when the number of endowment complaints reached record volumes, a dedicated consumer contact team was

set up just for endowment complaints – within the division which provided further support to consumers and firms for cases that were working their way through the ombudsman service's process.

the new ombudsman service gets to grips with the mortgage endowment issue

It is clear from the minutes of the board of the Financial Ombudsman Service that endowment complaints were an early topic of discussion – and one about which concerns existed. It was noted at the June 2000 meeting that the complaints crossed the boundaries of the existing complaints-handling schemes, which the new ombudsman service had to administer under the "service level agreements" – raising jurisdictional problems.

However, the board recognised that the key issues in these complaints were the same: *"At their heart there is a very simple issue … were they [consumers] warned of, and did they accept, the risk that this [failure of the endowment to produce enough to repay the mortgage loan] might happen?"*

The board also recognised fears that some parts of the industry were perhaps complacent about the situation: *"It is suspected that the position is far worse than, perhaps, was realised within the industry."*

By the following month's board meeting, it was reported that the number of new endowment complaints arriving at the ombudsman service was exceeding 500 a month – and these were throwing up new issues on which consistent policy lines needed to be agreed, discussed with the FSA, and then communicated to the industry. It was also reported to the board that the ombudsman service was in the process of producing guidance jointly with the FSA, for publication later that year, on the handling of endowment complaints.

The board continued to express concern about the extent to which the industry had the situation under control: *"The most worrying aspect … is the difference in perception of the problem in the industry. Is this going to be a problem on the scale of pensions mis-selling in terms of the cost to the industry? Hitherto the industry assumption seems to have been that this is simply a communications issue – a matter of telling people about the extent of their mortgage under-funding and what options they may have. The notion that the industry (rather than the policyholders) may in many cases have to remedy the under-funding is not widespread."*

In the light of the increased number of complaints, the growing media interest in the issue, and the risk to the reputation of the Financial Ombudsman Service so soon after its formation, it was thought it desirable to hold a special meeting of the board of the ombudsman service in September 2000 – to consider the draft

guidance which it was proposed to issue to firms. The aim of this guidance was to enable firms to resolve as many complaints as possible – so as to reduce the volume of mortgage endowment disputes reaching the ombudsman service.

the FSA's progress report of 2000

On 3 October 2000 the FSA published its "*Progress report on mortgage endowments*". In this report, the FSA set out its actions and progress since December 1999. The FSA repeated that its strategy was, first, "*to ensure that consumers are well -informed, encouraged to come forward where they are unhappy with the advice they were given, and treated consistently and fairly when they do so*"– and second, "*to follow through on identified problems in a focused way to deliver redress effectively to consumers that have lost as a result of poor advice.*"

In its progress report the FSA examined the question of whether or not there should be an industry-wide review of all past sales of endowment mortgages – to supplement, or to substitute for, the actions it had already put in hand. The FSA pointed out that going forward, any industry-wide review would, under section 404 of the Financial Services and Markets Act, need Treasury approval. The FSA's view was that it would only be likely to be appropriate to mandate an industry-wide review if:

- "there was evidence of widespread or material compliance failures, which had led to significant consumer detriment"; *and*
- "a route other than the normal complaints process would be more effective in providing redress to those who had been affected"; *and*
- "such a review was proportionate, in that the overall costs involved would be acceptable when set against the expected benefits."

The FSA went on to point out that from January 2000 consumers had been sent an initial letter by their endowment provider, enclosing the FSA factsheet, "*Your endowment mortgage – what you need to know*", which explained the general position on endowments. The FSA also pointed out that from April 2000 consumers would start receiving an individual "re-projection", showing whether or not their policy was on target to repay the loan. By the end of August 2000, the FSA said that over 4.8 million "re-projection" letters had been sent, out of an estimated 11 million letters which would need to be sent to some 6 million households.

The FSA's advice to consumers was that they should consider their letter and the options carefully. Moving on to consider the position of those consumers who felt they might have a complaint about

the firm which advised on their endowment, the FSA said that some consumers *"… may consider making a complaint about the advice they were given … The fact that a shortfall is now predicted does not mean that the consumer was badly advised; nor that they have lost out by having an endowment –indeed on average they have fared at least as well to date as they would have done with a repayment mortgage. However, amongst the millions of consumers involved, there will be a significant number who were badly advised and have lost out as a result."*

The FSA decided to help consumers who thought they might have a complaint, by producing a new factsheet specifically to assist people to understand better whether they had good grounds for a complaint – and when compensation might be payable. This factsheet was not, however, to be provided automatically to every endowment policyholder. Any consumer wanting the factsheet would have to ask their endowment company.

The FSA said it was also *"… preparing new regulatory guidance which will ensure that firms, which are under an obligation to handle complaints properly, provide a consistent, timely and fair service for consumers."* As subsequent events showed, the guidance ensured no such outcome for consumers.

The FSA noted the decline in the endowment market over recent years – particularly since its 1999 announcement. However, it pointed out that *"a mortgage endowment can still be suitable for some consumers."* Although true, this depended on advisers observing the rules on suitability.

However, in reporting, two paragraphs later, on the results of its mystery shopping and consumer research, the FSA's progress report noted that *"… disappointingly, and despite the regulators' clear warnings and guidance, the results of these sample studies have not given us comfort that the necessary improvement in selling standards has yet been achieved. In particular, some firms are still failing properly to match the risks of an endowment to the needs and personal circumstances of the consumer."*

views of the Financial Services Consumer Panel

Financial services is an area where there is a long history of lobbying by consumer organisations for the fairer treatment for consumers. The most notable bodies are the Consumers' Association – now just called Which? – and the National Consumer Council(NCC), although many other organisations have also played a key role from time to time. It was not, however, until the formation of the PIA that consumer representatives were given a more formal role at the heart of regulation – when the PIA established a consumer panel to advise the board of the PIA on issues of concern.

The success of the PIA's consumer panel was widely recognised. When the new legislation was introduced to establish the FSA, it also provided for a consumer panel, this time to be put on a statutory footing. Barbara Saunders provided continuity with the PIA consumer panel by becoming the first chair of the new Financial Services Consumer Panel.

Like its PIA predecessor, the Financial Services Consumer Panel continued, among other things, to be concerned about resolution of another mis-selling episode, the Pensions Review. By the time of its annual report for the year 2000, however, the panel had a new concern, that of endowments.

Commenting on the position, the panel said: "*The regulators, including the FSA, were slow to identify the problem and to deal with firms which broke the rules. The FSA rejected a full-scale review and instead it has produced a guide for consumers to decide whether they may have been mis-sold a policy and whether, as a result, they suffered loss. The guide is clear and will undoubtedly help many consumers who are aware of the issue, but we think it will fail to reach many others who are less aware. We had expected the FSA to do much more to identify where the problems are. We note that visits by the FSA led to referral of a number of firms for further investigation and disciplinary action, and that where concentrations of consumer loss are identified, the regulator has indicated that it will make firms conduct proactive reviews.*"

In order to monitor the position on endowments, the Financial Services Consumer Panel commissioned, in July 2000, consumer research among mortgage endowment policyholders who had received "re-projection" letters from their insurance company – to find out what action, if any, they were taking and why. The report on this research, published in November 2000, said that "*… the re-projection letters successfully got their message through to most policyholders. A high proportion of policyholders, 84%, had kept the letter containing the re-projection of their policy.*"

The panel then went on to comment on the research: "*Generally, the policyholders who may need to take action but are slower to do so are those who received a re-projection of their policy at maturity showing a shortfall at 4% and 6% growth rates. It is unsurprising that these policyholders are less likely to be clear about their situation but our research underlines the importance of future mailings to these and all policyholders updating them on the projected value of their policy at maturity.*"

A key finding from the research commissioned by the Financial Services Consumer Panel was the recollection of consumers about what they were told when the endowment was taken out: "*Our survey showed that 54% of respondents recall being told at the point of sale that their endowment policy 'would definitely' or 'was guaranteed to' pay off their mortgage.*" In only 10% of cases did the

consumer say that they recalled being told there was a risk the endowment might not pay off the mortgage.

While welcoming the factsheet issued by the FSA to help those consumers who thought they had been mis-sold, the panel said: *"However, it will not get to everyone who needs it and will not be routinely sent out by companies unless a complaint is made. We consider that where there is evidence that firms broke the rules and mis-sold unsuitable endowments they should be required to act promptly, identify consumers affected and pro-actively review those sales. It should not be left to consumers to go through the time consuming process of making a complaint where the fault lies with the company."*

The company that carried out the research for the Financial Services Consumer Panel also commented: *"Most of those policyholders who received red or amber letters who were not intending to take action had a valid reason for not doing so, for example the shortfall was small and/or they could cover it from others savings."* In other words, there would have been some consumers among this group who probably had been mis-sold – but firms were escaping the consequences, because the consumers had decided to suffer the financial loss themselves, rather than complain to the firm. These consumers might have been entitled to compensation had there been a pro-active review of their cases.

consistency in compensating consumers

On 30 November 2000 the FSA published its consultation paper CP75, containing draft guidance aimed at ensuring that consumers who were eligible for compensation had that compensation calculated by firms on a fair and consistent basis.

Introducing the paper, the FSA said that information available to it suggested that *"… the number of consumers making complaints about the mis-selling of endowment policies has significantly increased. This is reflected in the number of such complaints which are being referred to the (ombudsman)."* The FSA went on to say that it was aware *"… that firms have adopted different approaches to the investigation of complaints – particularly in the assessment of whether a consumer has suffered financial loss and, if so, in what amount. Complaints of mis-selling are of particular significance where the policies were sold as repayment vehicles for mortgages. Against this background the regulators consider it desirable for guidance to be issued with a view to brining about greater consistency."*

In general terms, the draft guidance published by the FSA explained how firms should put the consumer (whose complaint had been upheld) back in the position that he or she would have been in, had the mis-selling not occurred. In the majority of cases, the compensation would be calculated to reflect the difference in overall cost between the endowment and repayment mortgage.

This would take into account the capital repaid on a repayment mortgage, compared with the surrender value on the endowment, and any difference in monthly outgoings.

the first big fine

As this study will go on to show, financial services firms both large and small were found to have mis-sold endowments – and many firms then compounded matters by failing to deal properly with complaints from their customers. It is in the nature of things that the largest firms transact large volumes of business – and so when they get things wrong, and are fined by the regulator, it attracts significant media coverage.

The first of the big endowment-related fines was levied in November 2000 – when Royal Scottish Assurance was fined £2million, then a record amount, for its failings. The Royal Scottish case was, however, somewhat different from the fines that were to be later levied on some other well known names. The FSA said that Royal Scottish had failed to act with due skill, care and diligence in calculating the premiums for its flexible mortgage plan – and as a result of those serious deficiencies, it had set premiums at such a level that policies would not pay the mortgage debt when it matured.

the rising workload of the ombudsman service

At the December 2000 meeting of the board of the Financial Ombudsman Service, the chief ombudsman reported that *"… it has become increasingly apparent that the scale of the problems we face in the investment division calls for a different approach to that which we have adopted so far."* This was against a background where the number of staff in the division had doubled from what it was six months previously, to cope with the influx of new endowment cases.

The board agreed to terms of reference for a project, to devise and implement a new way of working on endowment complaints. By the time of the board meeting in February 2001, the executive team was able to report substantial progress on the project – with implementation of the new approach planned for 1 March of that year and new specialist mortgage endowment team-structures and responsibilities in place by 2 April 2001.

A methodology had been devised for the simplified calculation of redress, which could potentially be applied in a large number of cases – and so significantly speed up the processing of cases. A comparison was in hand to establish the case features which might determine whether or not it would be reasonable to apply the simplified approach to particular tranches of cases.

A computer model had been adapted, capable of carrying out both the simplified calculation of redress, and the precise, case-specific calculations. Management information needs had also been reviewed and enhanced.

At the board meeting in March 2001, further progress was reported. In particular, a template had been prepared on which staff could capture all the information about an endowment case in one place, in a structured format – including an extensive list of questions so that adjudicators could consider all the issues which might be relevant to a case. The process was designed to avoid duplication of work and to collate data not currently available to the management team. A trial of the new system, in parallel with the existing process, was imminent, prior to going live in April – to coincide with the expected guidance from the FSA (which was, in fact, delayed until June).

When the ombudsman service published its annual review for the year ending 31 March 2001, its concern and frustration at the air of complacency that seemed to exist in relation to endowment complaints became evident. It is worth quoting the comments of the chief ombudsman in full, because had they been acted on earlier some of the subsequent problems might have been nipped in the bud.

The chief ombudsman said in the report:

"During the course of last year, complaints to the ombudsman about the mis-sale of mortgage endowments – which in the previous year numbered only 3,135 – reached over 9,000. We had to react rapidly to this influx of work. Once the FSA decided, for understandable reasons, not to order a wholesale industry review along the lines of that required for personal pensions mis-sales, the burden was inevitable going to fall on the ombudsman.

Yet four or more years ago, many observers of the financial services industry had been warning that the advent of low inflation and low investment returns would surely spell trouble for holders of endowment mortgages. Many endowment holders were unaware of the situation, having been assured that their endowment would not only pay the mortgage debt but also provide a substantial nest-egg on top. Under the conditions of endowment policies, a policyholder is not legally entitled to know whether the investment is on track to repay the debt, and only on final maturity might this become apparent. After some pressure by the FSA, providers agreed to inform customers where they stood, by way of a phased programme involving the despatch of over ten million "re-projection"' letters. Not surprisingly, when, on receiving their letter, some people discover that their endowment may not repay their mortgage debts, they complain.

A complaint can be upheld only if people were misled about the nature of the product and its risks. As we and the regulators have already discovered, mis-selling – in the sense of selling unsuitably risky products – turns out to have been remarkably common. Even more common was exaggerated sales talk which did not correspond with the very limited commitment contained in the written product terms. The background is all too familiar. Sales staff were incentivised with generous bonuses to sell endowments: there was no bonus for compliance with the "know your customer" and "suitability" requirements. Once again, even in a period of "conduct of business" regulation, the reward structure within the industry was totally at odds with the objectives of the regulators, and has led to a debacle involving millions of pounds in compensation and an immeasurable toll of anxiety, distress and loss of confidence among the purchasers of financial services.

Most of the complaints we have upheld involved policies sold in the late 1980s and early 1990s, well within the memory of those currently in senior positions in the organisations responsible for mis-selling. Was there collective amnesia, or did the industry hope it would all somehow go away? Did they think inflation would return to cover up the problem? Given their knowledge of the sales practices at the time, and the downturn in inflation, it is difficult to believe that no one could have predicted that an explosion of complaints was inevitable."

These forthright comments by the chief ombudsman were also accompanied by some initial reflections about the varying standards of complaints handling across the industry. These comments, again, were a signal of likely problems to come – and might have put the industry on notice that it needed to smarten up its complaints handling a lot sooner than it actually did: *"Across the range of firms covered by the Financial Ombudsman Service, the standards of complaints-handling by firms varies greatly. Even within large groups offering banking, insurance and investment services, there are often differences between sectors."*

The chief ombudsman went on to say that *"… the experience of a consumer with a complaint will vary according to whether the firm involved has a centralised system – where problems are rapidly escalated to an authoritative unit empowered to resolve complaints – or operates through local, regional and central offices, where authority levels are less clear."*

It was not all, however, bad news. In relation to investment firms, the ombudsman said that *"… our impression is that the complaints-handling arrangements of most are adequate and, in some cases have improved over the past couple of years. This is a considerable achievement, considering the disruption caused by mergers, demutualisations and staff changes. Against this background, firms have had to cope – as we have at the ombudsman service – with a rapid increase in workload relating in particular to endowment mortgages."*

Later in the annual review for 2000/01, the chief ombudsman set out some of the practical constraints in resolving complaints and the targets which the ombudsman service had set itself: "*The extent to which complaints can be logged, checked and investigated to a fair conclusion is dependent on a number of factors. The extent to which this work can be supported by efficient IT systems is a key consideration. We also have to ensure that our staffing matches the workload, and that the policies under which we resolve complaints are clear.*"

The chief ombudsman went on to say: "*During the year we have had to operate with a number of different systems, inherited from the separate schemes, while preparing to install a single process and system. Our workload rose by 25% and we had to recruit and train extra staff, our complement rising from 340 at the start of the year to 450 at its end. Some of the key areas of policy for dealing with our largest single area of work – mortgage endowments – remained subject to consultation by the FSA for much of the year.*"

Although the chief ombudsman had cause to express concern and exasperation in 2001 about the endowment situation, things were to get far worse. It was, in fact, not until December 2002 that the volume of complaints to the ombudsman service really took off. After this there was an unrelenting influx of new complaints until 2006. From December 2002 mortgage endowment complaints formed an increasingly significant proportion of the total number of disputes dealt with by the service. From mid-2004 the proportion of consumers who chose to have their complaint made on their behalf by a claims-management company also increased significantly.

two recurring issues

The February 2001 edition of *ombudsman news* contained reference to a topic which was later to become a major issue in the endowments context. At this stage, for most complaints, it was generally the rules of the PIA Ombudsman Bureau that governed the time limits within which a consumer had to bring a complaint of mis-selling. These rules followed the provisions of the Limitation Act 1980 (except in the cases of Pensions Review complaints). A consequence of this was that, as cases governed by the Limitation Act were the subject of judgments in the courts, this could change the way in which time bars were applied to cases before the ombudsman.

Such a change was reported to firms in February 2001, as the result of a judgment by the Court of Appeal. However, in the May 2001 edition of *ombudsman news*, the ombudsman service had to report that in the previous month the House of Lords had overturned the Court of Appeal judgment, so restoring the earlier position on time limits under the PIA Ombudsman arrangements. By now, however, the ombudsman service had a number of investment

cases which it had started to consider, as a result of the Court of Appeal change, but where now the firms concerned could claim the complaints were time barred as a result of the House of Lords' decision. Once the ombudsman service could start dealing with cases in its own right, under the new legislation, there would no longer be the problem of time bars changing following court decisions – as the rules under which the Financial Ombudsman Service would operate did not parallel exactly the provisions of the Limitation Act.

The March 2001 edition of *ombudsman news* set out the ombudsman's approach on another key issue, that of so-called pre-"A-Day" complaints – that is, complaints relating to sales of endowments made before the Financial Services Act 1986 came into force in 1988. (Only pre-"A-Day" sales by product providers who had joined the PIA Ombudsman's voluntary jurisdiction could be considered by the Financial Ombudsman Service.) The *ombudsman news* article explained that the key issues which the ombudsman service would consider were: did the firm promise that a specified sum would be produced; was any advice given; if advice was given, was it negligent; if the advice was not negligent was there any misrepresentation; and was there full and fair disclosure?

The article went on to explain, among other things, that "*… where advice was given it will be material to consider whether or not the customer was told that there was a risk that the policy might not produce sufficient to pay off the mortgage. And in the absence of such a warning, a further consideration will be what the customer would have done if the extent of the risk had been clear.*"

the industry gets guidance

At the June 2001 meeting of the board of the Financial Ombudsman Service, it was noted that the FSA had, after a delay, published the guidance on which it had consulted in consultation paper CP75 – together with associated consumer materials. The publication of the FSA guidance cleared the way for the ombudsman service to publish – on 4 June 2001 – its mortgage endowment assessment manual, with its templates, decision trees and commentary, explaining how the ombudsman service would be applying the principles set out in the FSA guidance.

The board of the ombudsman service noted that the need to hold back its manual meant that there was delay in implementing the new approach to case handling – and in consequence, the hoped for productivity gains would be delayed. It was also anticipated that it would take firms some months to get used to the new approach.

By the time the board met in July 2001, the executive team was able to report that the new guidance on handling endowment complaints was successfully embedded in the case-handling units.

The main problem was perceived as being firms that had not been able to absorb and implement the new FSA guidance – and in particular, to put new software solutions in place, which many firms estimated could take up to another three months.

the Financial Services and Markets Act implemented

After much delay, the provisions of the Financial Services and Markets Act were fully implemented on 30 November 2001. This meant that both the FSA and the Financial Ombudsman Service were able to operate in their own right, rather than operating under "service level agreements" to deliver the regulation and dispute resolution provided for under the various predecessor schemes and legislation.

In the annual review for the year ended 31 March 2002, the chairman of the ombudsman service commented: "*Almost at the same time that we became fully fledged, we became an immediate object of attention as ombudsman decisions about complaints relating to endowment mortgages became high profile.*" The tone of this annual review was generally positive. The chief ombudsman was able to report that the ombudsman service had met its target of coping with a predicted increase of up to 40% in the number of complaints (the actual figure was 38%, almost wholly endowment cases) with only a 20% increase in its budget.

In addition to reducing the unit cost of dealing with complaints by 9%, the ombudsman service had also managed to exceed the targets it had set itself for the timeliness of resolving complaints. It had managed to close 73% of cases within six months (compared with a target of 70%) and 96% within twelve months (compared with a target of 95%). The ombudsman service decided to set itself new and more ambitious targets – to close 45% of cases within three months and 75% within six months. Those cases not closed within twelve months were considered important enough to be reported to the board.

Achievement of these more ambitious targets reflected a changed approach compared with many, but not all, of the predecessor complaints schemes. The aim now was to resolve complaints at the earliest stages through informal, mutual settlements – and so reduce the need for lengthy and time-consuming investigations and formal ombudsman decisions.

follow-up by the Financial Services Consumer Panel

The Financial Services Consumer Panel was continuing to monitor progress on the endowments issue. It commissioned a follow-up research study, published in December 2001, to "*provide an update*

on what proportion of policyholders had taken action." The study also looked at the complaints experience of some policyholders.

Commenting on the study, IFF Research said: *"At the time of the first survey … a third of policyholders had already taken action. A further 21% said they were likely to take action in future, whilst the remaining 45% intended to take no action. Just under a year later, the position has become much clearer and polarised. The proportion of policyholders who have taken action has risen significantly to 46%."*

The researchers listed the main actions taken. These were: 34% had started some additional savings; 29% had made extra capital payments; 25% had changed to repayment mortgages; and 17% had increased contributions to their existing policies. It is surprising that the panel made no comment on these figures, to reflect the point made by Which? – that some consumers, had they complained, might have been entitled to compensation, rather than having to shore up their finances in this way from their own pockets.

A worrying finding from the study on which the researchers commented was that: *"A small proportion (4% overall) had not taken action because they were worried about the financial consequences. This included those who could not afford to make up the shortfall in any way and a small number of people who felt they might be disadvantaged by taking further action. It seems that these investors might have been confused by the message that surrendering their policy could be disadvantageous."*

Turning to the topic of complaints, IFF Research said the study showed that: *"Overall about two fifths (38%)of investors who might have a case for complaining had complained or said they might do so in future. However, if those who received green letters are excluded this proportion increases to 51%. The experiences of most policyholders who had made a complaint has not been positive. They felt that providers had been slow and unhelpful in dealing with their complaints. Most of those whose complaint had been resolved were dissatisfied with the outcome because they had not obtained redress."*

The researchers also commented that: *"Amongst those who had considered complaining but decided not to, the main reason for not complaining was because they did not feel it would achieve anything."* As to ways in which the process of making a complaint might be made easier for consumers, the researchers were told that *"simplifying and speeding up the complaints procedure"* and *"more publicity in the media, including demonstrating that complaining achieves results"* were offered as ideas.

the "Tiner letter"

It was clear by April 2002 that the FSA recognised some serious shortcomings in the delivery by firms of its strategy to solve the endowment problem by a combination of information to consumers and the use of the complaints regime. On 4 April 2002 the then chief executive of the FSA, John Tiner, wrote to firms in the mortgage endowment market (the so-called "Tiner letter") with "urgent" guidance. The letter drew to their attention causes of concern about the way in which mortgage endowment complaints were being dealt with. Firms were asked to let the FSA have their views, by the end of that month, and to review their own procedures. The FSA warned that it would be considering *"whether there are further measures we should take."*

The FSA letter reminded firms that its decision in 2000 not to mandate an industry-wide review was predicated on consumers having clear information about their position and their options for the future; on there being help and encouragement for consumer who were unhappy with the advice they received to bring forward their complaints; and on firms dealing with complaints fairly, effectively and promptly. The FSA went on to say that *"… fair handling of complaints was of the essence. For the FSA's approach to succeed there must be assurance that the industry is handling complaints in a way which provides full and fair opportunity to have things put right for those people who have been mis-sold."*

The results of the FSA's monitoring work had indicated that some firms were not assessing some or all of their complaints fairly, a particular failing being their assessment of the customer's understanding and acceptance of risk.

Some firms were failing to interpret and apply properly the decision trees which the ombudsman service had produced in 2000 to help firms handle their complaints. Finally, rather than considering each separate complaint on its own facts, some firms were taking what the ombudsman had said in a decision letter on an individual case and were applying it indiscriminately to other complaints, as if it were a generic ruling.

2002-2004 – *Which? stands up for consumers*

Which? launches its campaign

If the PIA consumer panel and the Financial Services Consumer Panel represented the "official" voice of consumer interests, there was certainly no shortage of other consumer bodies making their voices heard. In particular, Which? launched its endowment

campaign in 2002 – aimed at making sure those who were mis-sold an endowment received compensation.

The campaign started in response to Which?'s belief that five million people could have been mis-sold a mortgage endowment but that, at the time, only a small proportion had complained or claimed compensation.

As part of its campaign, Which? set up a website that gave tips and information on the complaints process – and also included a "letter generator" to help people write their own letters of complaint. Later, in response to concerns about firms wrongly calculating offers of compensation, Which? also included on its website an "endowment compensation calculator" provided by the same company which supplied the redress calculation package to the ombudsman service and most of the industry. There was a fee of £52.50 for consumers to use this calculator.

Another limb of the campaign by Which? was to lobby the FSA. In May 2002 Which? wrote to the chairman of the FSA, expressing its concern that consumers were not receiving the appropriate information and assistance to pursue claims, should they be entitled to redress, and calling on the FSA to take immediate action to resolve the problem. The letter went on to say that, while recognising "*… a balance needs to be struck between raising endowment mortgage policyholders' expectations and swamping the ombudsman with dubious claims for compensation*", Which? felt that the FSA was allowing the situation to lean too far in favour of the industry.

Which? said that "*… the industry seems happy to talk up the low interest rate economic conditions as the reason for the current endowment problem.*"

But in the view of Which?, "*… the commission hungry sales practices of the 80s and 90s could also be a significant factor.*" Which? pointed to the fact that the proportion of red "re-projection" letters had "*… shot up from 15 per cent in 2000 to 35 per cent now …. More needs to be done, therefore, to ensure that those possibly large numbers of consumers who could be entitled to claim redress know all the relevant factors … how to access redress and from whom.*" Specifically, Which? suggested that the "re-projection" letters should refer to the FSA's factsheet "Endowment mortgage complaints" and that the factsheet might be included with the letters. The FSA was asked to look at this possibility immediately.

More radically, Which? argued in its letter that the FSA "*… should reconsider its approach to mortgage endowment mis-selling, including its decision not to conduct a full-scale review. Some form of wider review is necessary. In terms of numbers affected the scale of the mortgage endowment problem is greater than the pensions mis-selling problem.*"

Which? was prepared to accept, however, that a pro-active review of every single mis-selling case might not be proportionate to the individual loss suffered. It therefore suggested that the FSA might consider a stratified approach, which would have the advantage of controlling resources and drawing out all the high-risk companies.

Which? set out in its letter a number of specific steps which it wanted to see the FSA take. The first was that the FSA should identify the companies who were the worst performers, by publishing: the shortfall figures for individual companies; how many "re-projection" letters of different colours each company had issued; how many complaints had been lodged against each company; and how many of a company's complaints had subsequently been referred to the ombudsman service.

Which? also wanted the FSA to identify: how many consumers might be entitled to redress, both at an individual company level and in aggregate; how many had actually been compensated and by how much; and how many were still in the system awaiting their claim for compensation to be decided.

Which? expressed concern about cases involving mis-selling that took place *before* 1988 – where consumers could lose out altogether, if the firm concerned had not been in any complaints scheme at the time. Which? wanted the FSA to make such firms join the voluntary jurisdiction of the Financial Ombudsman Service for complaints relating to the period before 1988 – and to publish a list of those firms which refused to do so.

In its reply to Which?, the full text of which the FSA issued as a press release on 5 June 2002, the chairman of the FSA set out again the strategy which the FSA had announced in 2000 for dealing with the endowment issue.

He referred to the fact that, at that time, the second round of "re-projection" letters to consumers was already underway. With this letter, consumers would get the FSA factsheet, "*Your endowment mortgage – time to decide*" – which would set out the options open to consumers. It would also set out the circumstances in which consumers might have a valid complaint. Consumers were then advised: "*If you have a valid complaint, take action now. If you delay, you could lose the right to some or all compensation that may be due to you. Wait for the outcome of your complaint before taking further action.*"

In its reply to Which?, the FSA went on to say that consumers were told in its factsheet that those "*… who want to make a complaint can get the FSA factsheet 'Endowment mortgage complaints' free from our helpline or by downloading it from the website.*" The FSA said that it had also "*… included a new section in the factsheet: what to do next if you want to make a complaint but are not sure if you have a reasonable case*".

This had been included, the FSA explained, because "*… feedback from our research had shown that this was an area of concern, as was the decision on the further steps they should take. This section of the factsheet refers people to our complaints factsheet and to the Financial Ombudsman Service case studies, which enable consumers to compare their own case with those that the ombudsman has already assessed as reasonable complaints. We have also explained how people can track down the firm or adviser who sold them the policy if they did not buy it directly from their endowment provider.*"

In conclusion, the FSA told Which? that: "*We do not believe it would be appropriate or proportionate to also include the more detailed fact sheet 'Endowment mortgage complaints' with the re-projection letters. This factsheet is relevant only to those who wish to make a complaint, not to those who wish to know how to make up a potential shortfall but are not considering making a complaint.*"

Addressing the concern of Which? about the position of consumers who were sold their endowment pre-"A Day" and might not have access to redress, the FSA commented that: "The vast majority of the pre-"A Day" mortgage endowment complaints already fall within the jurisdiction (of the ombudsman service)", but the FSA did not provide any estimate of the number of consumers who might not have access to redress.

The FSA also referred in its response to Which? to its "firm-facing" work. It said: "*Our latest figures show that just over 100,000 … complaints have been received by firms since the re-projection exercise started in April 2000 (representing about 1% of all policies). Over one third of these complaints have been upheld by the firm, leading to average redress of £3,000.*"

The FSA said it continued to monitor the effectiveness of complaints-handling processes by firms – and it referred to the letter which it sent to firms in April 2002 about their shortcomings in this area.

The FSA told Which?: "*It is important to emphasise the economic background to these cases. Just because consumers now face a potential shortfall does not mean they were mis-sold the policy at the outset. A number of those who received a red or amber letter may well continue to consider that the product is suitable to their needs, because they can afford to increase the premiums, or because they are no longer using it to repay their mortgage. We do not accept that identifying companies who are the worst performers, in respect of investment performance, the extent of shortfalls and the number of complaints in relation to their mortgage endowments, would help consumers decide whether they were mis-sold their policy. Such information could provide an exaggerated incentive to complain, with no greater prospect of that complaint being upheld. At the same time, disclosure of individual firms' records by the regulator raises difficult confidentiality and human rights issues.*"

ombudsman re-organisation

During 2002 the Financial Ombudsman Service underwent a major re-organisation. As noted earlier, the initial divisional structure of the ombudsman service was based around industry sectors, reflecting the position which the new ombudsman service had inherited from the predecessor complaints schemes. Once the new ombudsman service gained its own statutory powers – and in the light of the increasing number of complaints it was receiving – it was thought desirable to bring about greater flexibility, to manage the unpredictable demands.

In order to achieve this flexibility, the ombudsman service moved in October 2002 to a structure of "multi-disciplinary" units – each of which could handle a wide range of complaints. The chief ombudsman commented in the annual report for the financial year 2002/03 that this new structure had played a major part in helping the service to deal with the significant increase in complaints during the year – an increase which he claimed would have overwhelmed the more narrowly focused schemes from which the Financial Ombudsman Service took over.

A new structure on its own, however, was only part of the story. The annual report for 2002/03 went on to say that "*… underpinning this move towards greater flexibility in the way in which we handle complaints is our commitment to the development of 'knowledge management' within the organisation.*" The ombudsman service had dedicated significant resource to this area during the year – so that it would be better able to capture, store and share its technical expertise and ensure a consistent and efficient approach to resolving complaints.

As the chief ombudsman pointed out, this was essential in an organisation where, at that time, over 250 adjudicators and 20 ombudsmen were making decisions on hundreds of complaints each day. An important element in improving the service's knowledge management was, of course, improvements in IT. But it also included a significant commitment to the training and development of staff.

another big fine

In September 2002 the next big FSA fine to hit the headlines was the one it imposed on Winterthur Life. The company was fined £500,000. In addition, it set aside some £10 million for redress which it might have to pay to around 10,000 customers. The company's failings related to the suitability of advice which its advisers gave to customers.

time bars again – and Which?

By October 2002, the issue of "time barring" was becoming one of concern to the board of the Financial Ombudsman Service. Under the time-barring rules, from April 2003 consumers could lose the right to complain about having been mis-sold an endowment. The ombudsman service was concerned that rejecting on procedural grounds complaints that would otherwise be justified on their merits would leave some consumers aggrieved – and risked undermining confidence in financial services, as it would leave such consumers without any avenue of remedy.

The issue of time bars was a matter for the FSA. It needed to consider whether there was a case to relax the time bar rules – or whether the rules should be maintained, but with prominent publicity that time was running out for consumers to make a complaint.

Separately, Which? (then known as the Consumers' Association) had gone public with its concerns over time bars. In a press release dated 30 October 2002, the association said: "*Millions of consumers who may have been mis-sold an endowment mortgage could have only a few weeks left to complain, according to the rules governing the submission of complaints.*"

Which? went on to say that it had "*… written to the FSA demanding that it extend the time limit for the ombudsman to deal with complaints by a year … With such insufficient warning given to consumers of the potential deadline for complaints … and inadequate information about the issue of mis-selling, millions of consumers could miss out on the opportunity to complain.*"

The late Sheila McKechnie, then director of the association, was quoted as follows: "*The clock has already started. If you are unsure about whether you were one of those mis-sold an endowment you must act now because this could be your last chance to complain. If you do one thing this week make sure it is to get that letter of complaint written. If you are unsure or confused you cannot afford to stall. Our campaign website … will give you more information on mis-selling and help you write a letter of complaint. Not only has the FSA failed to publicise adequate information on mis-selling, it has also kept this deadline hidden from consumers. It is unacceptable that as a result of inadequate communication, millions of consumers may lose out on compensation. The FSA must throw consumers a lifeline and agree to take action to change the rules to give consumers an extra year to make a complaint.*"

At the December 2002 meeting of the board of the Financial Ombudsman Service, it was reported that the FSA had, on 22 November, issued a press release proposing an extension of the time bar. In that press release the FSA said: "*We have acted*

here on behalf of policyholders, without causing unjustified alarm or panicking consumers … These proposals will clarify the position for those that might have been affected and ensure that policyholders with complaints have enough time to pursue them."

Meanwhile, the ombudsman service itself was anticipating a further dramatic increase in the number of complaints reaching it, in consequence of Which?'s campaign – widely known as the "complain now " campaign. The effect of the FSA's proposed changes to the time limits for endowment complaints would pose practical problems. For example, under some of the old complaints-handling arrangements there had been no formal requirements for recording complaints – which in some cases now meant it would be difficult to determine under the proposed new rules when exactly "the clock started to tick" on a complaint.

Intelligence available to the ombudsman service – for example, feedback on firms' own experience, and the number of visits to the ombudsman's website – suggested that there would be a dramatic increase in the number of new complaints, reaching the ombudsman shortly after eight weeks from Which?'s press release. In other words, a consumer reading in the press about Which?'s campaign would first have to write a letter of complaint to the firm which advised on the endowment, and that firm would have eight weeks in which to deal with the complaint. It would be only after having a complaint rejected by the firm that a consumer could then refer the dispute to the ombudsman service.

The December 2002 meeting of the board of the Financial Ombudsman Service also heard about another issue which would remain unresolved for some time, as more and more complaints reached the ombudsman service. This was the issue of so-called pre-"A Day" complaints – complaints about sales that pre-dated 28 April 1988 when the Financial Services Act 1986 came into force. The board was told that these complaints had to be judged against the common law obligations in force at the time – obligations not to mislead customers and not to give negligent advice. Some within the financial services industry were expressing concern that they were losing pre-"A Day" cases referred to the ombudsman service – apparently not realising that they still owed their customers certain duties even before 1988.

the Treasury decides not to act

In November 2002, Which? wrote to the Chancellor of the Exchequer, asking that the Treasury exercise its powers under section 12 of the Financial Services and Markets Act 2000 to appoint an independent person – to conduct a review of the efficiency and effectiveness with which the FSA had used its resources to discharge its supervisory and regulatory functions in relation to endowment mortgages.

The Treasury Minister responsible for financial services, Ruth Kelly MP, responded to Which? She pointed to the FSA's strategy of identifying and tackling "pockets" of mis-selling – giving all mortgage endowment holders the information necessary to deal with any problems posed by a shortfall and to identify whether there were grounds for making a complaint. She also pointed to developments in the FSA's supervisory approach and to the instigation of enforcement action against some firms since Which? made its complaint. In the light of these developments, Ruth Kelly said she did not "believe that an independent investigation is justified".

another fine

In December 2002 the FSA announced that it had fined Abbey Life £1 million – for mortgage endowment mis-selling and other deficiencies in its compliance procedures and controls between 1995 and 1999. The FSA estimated that between 42,000 and 46,000 of Abbey Life's mortgage endowment customers might be due compensation.

extension of time limits

In December 2002 the FSA also published its consultation paper CP 158, "*Mortgage endowment complaints: changes to time limits for making a complaint.*" In the consultation paper, the FSA explained that, generally, there are time limits – set by the Limitation Act – within which a claim can be brought to court. However, in the case of complaints to the Financial Ombudsman Service, the FSA had made rules which set separate time limits in place of those used in the courts. The relevant FSA rules provided that the ombudsman service could not consider a complaint if referred to it "*… more than six years after the event complained of, or (if later) more than three years from the date on which the complainant became aware (or ought reasonably to have become aware) that he had cause for complaint.*"

The FSA had re-considered the time limits because of the results of the consumer research which it had undertaken earlier in the year and published as consumer research report No.16, "*Mortgage endowments: the consumers' view*".

This research showed, in the FSA's view, that most consumers who had not so far complained recognised the problems associated with mortgage endowments, recalled getting a "re-projection" letter, and said they were aware how to contact their endowment provider and how to complain. The research findings also showed, according to the FSA, that "*… a majority of consumers who perceive from the re-projection letters that they are likely to have a shortfall … identify the shortfall as either a small problem or no problem. It also appears that most consumers who have not so far*

complained, and do not intend to complain or take any other action with regard to their endowment policies, have rational reasons for their decisions."

Worryingly, however, the research also indicated that among those for whom a shortfall was likely to be a problem there was a significant minority who had yet to take action. The FSA said that *"… the research also shows that 21% of consumers who have not yet complained and who report that they have a major financial problem with the projected shortfall between the projected maturity value of their policy and their mortgage loan, still intend to contact their provider."* Once any of these consumers got round to contacting their provider they might then, of course, decide to make a complaint.

At the time of the FSA's consumer research, there would also have been some consumers who had not, at that time, yet received their second "re-projection" letter, with the revised FSA factsheet – and those consumers might have changed their mind about contacting the provider and making a complaint. The clock was ticking for all these consumers – running the risk that once they decided to make a complaint about their situation, they could find the complaint "out of time". The FSA therefore said that it wanted to improve the interaction between the time limits and the "re-projection" letters.

The FSA said it considered that only a red "re-projection" letter – indicating a high risk that the endowment would not pay enough – should be regarded as putting consumers in possession of knowledge that they had potential for financial damage, and so start the time running for the time bar. While those consumers who had got amber or green "re-projection" letters might have taken the view, from media coverage of the issues, that they too had been mis-sold their endowment, this did not in the FSA's view constitute sufficient warning to trigger the start of the three-year limitation period.

In the case of the consumers who received a green letter, they were, of course, still being told that their endowment was probably on target to repay the loan – and so with no projected financial loss at that stage, these consumers would not have had cause for complaint. In the case of consumers who got amber letters, they were being told only that it was "possible" their endowment might not pay enough – which was unlikely to have been a sufficient trigger for many consumers to take action.

The second point the FSA made was that, in its view, it would be unfair for consumers to lose their right to have their case investigated – without at least a reminder of the need to consider their position. The second round of "re-projection" letters would be providing such a reminder. But there was still no proposal for the letters to warn consumers of the specific and final date by which they had to lodge any complaint.

The FSA's third concern was about those consumers who might be affected by the fact that the time bar counted up to the point the complaint reached the ombudsman service. So there could be cases where a complaint had been made to a firm within three years – but once the consumer had received the firm's response and had time to consider it, the three year time bar might already have been reached, preventing the ombudsman service from considering the complaint.

In order to address these concerns, the FSA proposed that time should only start to run as a result of sending a "re-projection" letter – if it was a *red* letter. Amber and green letters would not start the clock ticking. The FSA also proposed that the normal three-year period should be extended, to allow consumers six months from the receipt of a further "re-projection" letter (or other reminder letter) within which to complain. Finally, the FSA proposed that a complaint should be regarded as made in time, if it had been lodged with the firm (or with the ombudsman service) within the required period. As firms were required by the FSA rules to acknowledge within five business days any complaint received, this would provide evidence of when a complaint was lodged with a firm.

In January 2003 the FSA published its policy statement, giving feedback on its consultation in CP158 about the complaints time-limits. The outcome was reported at the February 2003 meeting of the board of the Financial Ombudsman Service. It was reported that the FSA proposed revising the time limits for making a complaint about endowment mis-selling, to take effect from 1 February 2003. Broadly, the effect of the new limits were that consumers had to make a complaint within three years from receiving their first red "re-projection" letter – or within six months from receiving their second "re-projection" letter (of whatever colour) if that was later.

The FSA's action was followed up by the ombudsman service, which in March 2003 published an article in issue 26 of *ombudsman news* – reporting that the time limits for making a complaint to the ombudsman service had changed as a result of the FSA's consultation. The *ombudsman news* article gave firms a detailed description of the practical effect of the rules.

more fines

The next big fines to hit the headlines were those which the FSA imposed in March 2003. The first was on Scottish Amicable which was fined £750,000. In this case, the company was found by the FSA to have deficiencies in its procedures, resulting in unsuitable advice to its customers. The FSA also found that its advisers had

failed to exercise due skill, care and diligence during the sales process. The second fine was on Royal & Sun Alliance, which was fined £950,000 because it had inadequate measures in place to allow its advisers to recommend appropriate products to customers.

the concerns of the Financial Services Consumer Panel

The 2002/03 annual report of the Financial Services Consumer Panel expressed continuing concerns about endowments. It said that it *"… agreed with the FSA's assessment … that a full-scale review of all endowment mortgages would be the wrong level of response."* But it noted that following its research into the way some firms were handling complaints, it had to encourage the FSA to collect more information. The panel said that this had led to the FSA having to issue its so-called "dear CEO" letter to firms on complaints handling – and the panel noted that as a result of that letter, a greater proportion of complaints appeared to be accepted by firms.

The panel was now, however, increasingly concerned about time-bars: "*We said that firms should be required to make the effect of the time bar absolutely clear to policyholders. The Panel also pushed for, and obtained, the concession that consumers would not be time-barred until at least six months after receiving a second re-projection letter following a red re-projection letter (indicating that their endowment was unlikely to be enough to pay off their mortgage).*"

the floodgates open

The Financial Ombudsman Service had been concerned for some time about the growth in the number of new mortgage endowment complaints reaching it. But in fact the figures appear to show that it was not until the end of 2002 that the volume of new cases took off in an uncontrollable way. This was largely in consequence of Which?'s so-called "complain now" campaign. Increasingly, the ombudsman service started receiving complaints from consumers that drew from the material provided by Which? or from coverage in the personal finance media.

After December 2002 new cases to the ombudsman service rose rapidly, reaching peaks in October 2004 and again in February 2006 – and only then beginning to tail off slowly. By the time of its annual review for the year ended March 2003, the ombudsman service recorded a 44% increase in the number of complaints – which meant that since its inception, the workload of the ombudsman service had doubled.

Despite this increase in the ombudsman service's workload, its unit cost in dealing with cases had fallen from £730 to £518 – as a result of improved productivity from flexible working and

economies of scale. The rising workload meant, however, that the ombudsman service inevitably had to recruit more staff to deal with the caseload. From the first half of 2003, there was a step change in the number of new staff recruited – and the level of recruitment was sustained right through to 2006. The rising staff numbers led inevitably to an increased proportion of staff with less than 12 months experience.

After speculating about the wider socio-economic factors which may have given rise to the increase in complaints, the chief ombudsman observed in his annual review for the year ended March 2003 that "*… these factors alone do not account for the rise in our workload – and sadly I see few signs of a downturn in complaints. Despite regulatory requirements, the way in which firms handle retail customer complaints is still very variable. While some firms have coped well, others have seriously under-estimated the numbers of customers complaining about mortgage endowments – leading to major backlogs and delays.*"

The unpredictability and volatility in the number of complaints reaching the door of the ombudsman service was also putting further strains on the organisation. When its budget for the year had been set, it had assumed – and nobody in the public consultation had challenged the assumption – that new complaints would remain at the same level as the previous year. Yet, as already noted, complaint volumes had risen by 44%.

The ombudsman service rose well to this challenge – and managed to resolve a record 56,459 cases, rather than the 40,000 which had been assumed in setting the budget. During this period, however, the staffing of the investment division of the ombudsman service had doubled, to keep pace with the rise in workload.

It was during 2003 that another key decision was taken at the ombudsman service – to give priority to "business as usual" complaints (such as banking and insurance disputes) over endowment complaints. This reflected the fact that where consumers complained about their mortgage endowment, generally no loss had actually yet materialised in real terms – unlike complaints in other areas, where the loss was likely to have materialised already.

It would only be if an endowment case needed to be determined for some urgent reason – such as the consumer having to imminently make good a shortfall, or because of serious ill health – that the ombudsman service would aim to settle the dispute within the normal service-level time-limits. A consequence of this decision was that endowment cases started to accumulate – creating a need for the ombudsman service to manage consumers' expectations about the speed with which endowment complaints could be tackled and resolved.

mitigation of loss

Yet another problem came to the fore at the time of the October 2003 meeting of the board of the Financial Ombudsman Service. This concerned the consumer's duty to mitigate their loss. The board was told that there was a legal duty on those who suffered a loss to act to mitigate their loss – once they became reasonably aware of the loss. As a second round of "re-projection" letters had been sent out, accompanied by the FSA's factsheet, "*Your time to decide*", consumers would, after a suitable time to reflect and perhaps take advice, have little scope to argue that they were unaware of their loss. Firms could, and now were, seeking to restrict compensation payable – to take account of action which they felt consumers should have taken to mitigate their loss.

Over the preceding couple of years, as both markets and bonus rates on policies had fallen, so had the surrender values on endowments. This raised concerns that some consumers could lose out, if they surrendered their endowment and switched to a repayment mortgage – and the firm then used the "mitigation of loss" argument. It was considered that consumers should be alerted to the need to take action, and that the industry needed guidance on the circumstances in which it was, or was not, reasonable to reduce compensation because of a consumer's failure to mitigate their loss – rather than leaving this to a case by case approach by the ombudsman.

organisational improvements

Mid-way through 2003 the ombudsman service again looked seriously at its organisation and processes – to see if there were any further improvements that might be made, to tackle the inexorable rise in the number of endowment complaints. Recognising the number of cases with similar characteristics, one of the teams of adjudicators had begun to experiment with using spreadsheets to capture standardised information about complaints from some of the larger firms. This led to the formation of a formal pilot process to consider the wider application of the "spreadsheet approach".

The approach involved providing each larger firm with a weekly spreadsheet, containing standardised brief details of relevant complaints – and a provisional view on whether or not the ombudsman service was minded to uphold or reject the complaints. There was extensive one-to-one dialogue about this streamlined process with the firms involved. The firms appeared to find the process effective in speeding up the procedures for them – which benefited them, the ombudsman service, and of course consumers.

another fine

On 17 December 2003 the FSA announced that it had fined Friends Provident Life and Pensions £675,000 for failures in its procedures which led to the mis-handling of mortgage endowment complaints. Friends Provident received 21,788 mortgage endowment complaints between March 2000, when its dedicated complaints-handling team was established, and February 2003, when its defective procedures were replaced.

Approximately 5,500 customers whose complaints were rejected were exposed to the risk that their complaints were, in fact, genuine and deserving of redress. The FSA commented that: "*Friends Provident and its senior management failed to respond in an effective and timely manner to FSA guidance and to correct problems found in its systems when it had reasonable opportunity to do so.*"

Personal Finance Research Centre appointed

In December 2003 the board of the Financial Ombudsman Service commissioned Bristol University's Personal Finance Research Centre to carry out an independent assessment of the work of the organisation. The overall aim was to evaluate the work of the ombudsman service, principally looking at outputs in terms of customer and firm interactions.

Four themes underpinned the assessment: quality, consistency, process and value. The report involved interviews with over a hundred staff at the ombudsman service; observation of the case-handling process; and detailed audit of some 72 closed cases. The findings from this assessment are reported in more detail later in this account – but broadly it gave a very favourable view of the ombudsman service in most areas of activity.

a forum to air issues

Issue 34 of *ombudsman news*, which appeared in January 2004, reported to firms on a "mortgage endowment forum" which the FSA and the Financial Ombudsman Service had hosted on 1 December 2003 – to discuss with representatives of the industry and consumer groups a number of current issues and concerns on endowment complaints.

One of these issues was time limits – and in particular the fact that some firms were still seeking to invoke the 15 year time limit on complaints, even though the ombudsman service had explained in earlier issues of *ombudsman news* that this limit did not apply under the rules for the scheme made by the FSA.

Among other issues discussed at the forum were the poor quality of some firms' communications with their customers; failures in calculating the correct amount of compensation due; deciding cases where little contemporaneous documentary evidence existed; and the confidentiality of settlements which firms reached with customers.

the ombudsman's annual review

Sue Slipman, the new chair of the Financial Ombudsman Service, reported in the annual review for the year ending March 2004 the growing demand for the services of the ombudsman. With a 57% rise in the number of complaints during the year, following a 44% rise the previous year, she commented that: "*This increase was driven largely by waves of publicity about mortgage endowment mis-selling, split capital investment trusts, and so-called precipice bonds.*"

She went on to explain that, in order to cope with this major increase in demand, the ombudsman service had carried out *"… a major exercise to recruit and train over 200 new staff during the course of the year – as well as identifying new, more effective ways of managing the increasing workload."* Although she was able to report that the ombudsman service continued to meet the majority of satisfaction rating with customers, the board was not complacent about the future against the background of such a rapid rise in the number of staff.

The annual review reported that the internal processes to keep the quality of work under review had identified an isolated batch of cases that were considered unacceptable according to the service-level standards – and provision had been made to deal with that batch. More generally, a formal review had been commissioned, to look at the organisation's infrastructure to ensure that the values of the ombudsman service – to be independent, balanced and competent and to act with integrity – were supported and reinforced by its systems and embedded in its staff.

As if the ombudsman service did not have problems enough from the rising tide of endowments and other complaints, the chairman also reported that the Financial Ombudsman Service would be preparing to take on, over the next year, mortgage and insurance brokers – when these sectors were brought within the regulatory ambit of the FSA.

In the same annual review, the chief ombudsman reported that an already high volume of endowment complaints had now become a veritable flood – over 50,000 new complaints in the year, compared with 15,000 the previous year.

2004 – *Excel to the rescue!*

After evaluating the results of its pilot project into the use of spreadsheets – to capture standardised information about mortgage endowment complaints from larger firms – the ombudsman service implemented a significant internal re-organisation in April 2004. A new and dedicated division called "Excel" was set up – to deal just with endowment complaints.

Excel consisted initially of four teams, supported by a front-line consumer-contact team. Starting with 130 adjudicators across the four teams, the number rose rapidly in line with the volume of new endowment complaints – so that by the end of the calendar year 2004 there were 180 adjudicators, and by the spring of 2005, some 250. Such a rapid rise in staff numbers, dedicated to a single specialist area of work, necessitated careful attention to training – to ensure that across the teams there was a consistent approach to dealing with cases, as well as a consistent set of messages for consumers and firms.

This led to the establishment of a training team – consisting of five sub-teams – where all staff new to Excel started off. Each sub-team consisted of a team leader, two experienced staff who acted as mentors, and a mix of newly recruited staff and staff transferred from elsewhere in the organisation (for example, adjudicators from the banking and general-insurance casework teams).

Training for newly recruited staff was delivered on a "classroom basis" for the first four weeks, while staff transferred internally had training geared to their particular needs. Following the initial training, there was one-off training on particular topics. In addition to the training, a detailed online manual was prepared, available on the staff intranet, covering all aspects of the handling of endowment complaints – to help support the adjudicators and to reinforce consistency of approach.

Within Excel itself there was focused specialisation of work. Two teams dealt with the small number of larger firms whose volume of endowment complaints was substantial. Following dialogue with these firms, their cases were largely handled using the "spreadsheet approach" described above. Complaints which were assessed as straightforward were summarised on spreadsheets and reviewed by a senior adjudicator, before being referred to the firm involved for it to consider. The emphasis was on achieving a rapid throughput of assessments, so as to keep up with the constant arrival of new complaints. Cases which seemed to exhibit special features were put aside for more detailed consideration.

Speeding up the handling of straightforward cases did not, however, mean any compromise on quality. At all times, it

was possible for an adjudicator to have access to one of the ombudsmen – to discuss any case where the merits or facts were not clear cut.

A separate team specialised in cases relating to banks and building societies (or at least those banks and building societies whose levels of complaints were not high enough to be dealt with by the teams that specialised in complaints relating to the larger firms).

Meanwhile, two other teams within Excel specialised in complaints involving independent financial advisers (IFAs). These teams initially each consisted of ten experienced adjudicators – but the teams grew to 22 adjudicators in each, as the number of IFA complaints increased. As the IFA firms involved were generally smaller-sized businesses, the number of endowment complaints each firm had were generally small as well.

This brought its own challenges. These smaller businesses were generally unfamiliar with the ombudsman process. They were also less aware of the issues which had already been raised and settled in the ombudsman service's regular interactions with the larger firms. Smaller businesses also tended to show a greater propensity to argue their case. The ombudsman service tried to tackle the challenge of communicating with the very large number of smaller businesses through its "working together" conferences – held in London and Manchester in 2004 – as well as through a series of national and regional IFA events across the UK, where senior staff from the ombudsman service spoke and made themselves available for questions.

Another development in Excel in October 2004 was the decision to centralise and specialise the decision-writing functions. Those cases which were not appropriate for resolution using the standardised spreadsheet approach each needed an individual provisional decision by an adjudicator. These written decisions needed to be clear, concise, consistent – and capable of being understood by both the consumer and the firm. Inevitably there could be individual variations in the quality of decisions prepared by adjudicators – and so it was decided to set up a specialist team just for this purpose.

A key feature of Excel was the decision to have a centralised front-line team for consumers. From its inception, the ombudsman service had a specialist customer contact division which dealt with all initial inquiries. Part of the work of this division involved helping firms to deal themselves – in the first instance – with their unhappy customers, rather than immediately escalating a problem as a formal complaint to the ombudsman service (which would have cost the firm a case fee).

Following this model, a bespoke customer contact team was set up in Excel in April 2004. Initially this team had five members to handle consumers' phone enquiries – supported by 20 administrative staff dealing with written correspondence. The number of staff handling phone enquiries eventually reached a peak of 30. This team supported all the other teams of adjudicators in Excel – and dealt with all cases before they were allocated to an adjudicator. Consumers would deal with a named member of the contact team, unless and until their case was allocated to an adjudicator.

A key task of the contact team members was to manage consumer expectations about the time it would take to handle their case – both in the light of the heavy volume of new endowment cases and the decision by the ombudsman service to prioritise complaints which involved some risk of hardship to the consumer if not dealt with speedily, or where there was some other pressing reason for the early resolution of a complaint.

Meanwhile, the front-line customer contact division continued to look to resolve cases wherever possible, prior to the enquiry becoming a complaint. At the height of incoming volumes of mortgage endowment complaints, the customer contact division was able to settle around 250 enquiries a week at this early stage – where effectively consumers were simply querying whether any compensation being offered to them by the firm was fair.

The ombudsman service had a choice here. It could have decided that these queries should be treated as new complaints – which would have meant the firms involved would have had to pay the normal case fee for each case. In fact, where appropriate, the customer contact team would reassure consumers that a firm's offer of compensation had been assessed in line with the regulator's guidance.

By dealing with these queries in this way, the ombudsman service was able to save the industry from paying a substantial amount in case fees. The front-line customer contact division also dealt with some jurisdiction issues – mainly involving time bars. This necessitated absorbing a number of adjudicators from Excel into the customer contact division.

2004-2006 – *politicians opine*

Treasury Select Committee report

In 2003 The House of Commons Treasury Select Committee began an investigation into how to restore confidence in long-term savings. It soon became clear that the situation on endowments

was such that the committee needed a spin-off from its main inquiry – to focus just on endowment mortgages. The FSA, the Financial Ombudsman Service, the Financial Services Consumer Panel, Which?, the ABI and many others gave written evidence to the committee on their work in this area. Some parties were also called by the committee to give oral evidence.

On the basis of the evidence it had been given, the Treasury Select Committee published its report, *"Restoring confidence in long-term savings: endowment mortgages"*, in March 2004. The committee described the growth of low-cost endowment mortgages through the 1980s and early 1990s. It noted that, as inflation and interest rates fell sharply in the 1990s, it became clear that the investment returns on endowments would be much less than had been assumed when the policies were sold.

The committee criticised the industry for its failure to respond more quickly to the warnings about the need to improve the marketing of low-cost endowments – which had been given by the PIA in 1999 in its regulatory update 72. The committee noted that the problems had persisted – leading to the FSA needing to take further action.

The committee's view was that the evidence pointed to between 50% and 60% of all endowment policyholders believing that their policy had been mis-sold. It also concluded, on the basis of the evidence presented to it, that around 80% of endowment policies at that time were unlikely to meet their target of repaying the mortgage loan – and that the average shortfall on policies was around £5,500.

The committee observed that these shortfalls were likely to grow over time. But even on the current figures, it calculated that a collective shortfall existed for consumers of around £40 billion.

In this context, the committee commented that: *"The industry initially failed to give policyholders adequate information about the shortfalls emerging across the endowment mortgages market, a failure that has added considerably to the difficulties many people now face. The FSA has now instigated a system of warning letters to policyholders, although these letters could be made clearer in many cases."*

The committee observed that consumers needed advice on what to do about their shortfall – but that many consumers were in an "advice vacuum" because the industry was not trusted as a source of advice, given its track record. Turning specifically to the subject of complaints and compensation, the committee noted that fewer than 6% of policyholders had so far claimed compensation, *"… suggesting that urgent action is needed to ensure that the complaints process is better understood and more accessible to policyholders. The FSA should ensure that clear information on how to make a complaint is*

enclosed with the letters warning policyholders about shortfalls. There are also currently strict time limits on policyholders' rights to claim for compensation, but these limits have not been clearly explained to many policyholders. The time limits should be extended while the rules are spelt out explicitly to all policyholders."

The next topic to attract the criticism of the committee was the quality of complaints handling by firms. The committee noted that: "*Many companies have not handled complaints fairly and the FSA has intervened repeatedly on this issue. Even so, for some companies, the Financial Ombudsman Service … is finding in favour of the consumer in over 50% of cases. This suggests that much of the industry is still locked into an unacceptable culture that focuses upon short term sales rather than long term customer care."*

As for the ombudsman service itself, the committee had heard from various industry witnesses about various concerns – but the committee concluded that the ombudsman was "*… working acceptably as an appeals body for endowment mortgage complaints."*

The committee also drew attention to its significant concerns about the position of endowment policies sold by IFAs prior to 1988, for which there was no existing mechanism for consumers to pursue redress.

Referring to evidence that had been presented by the Financial Services Consumer Panel's, the Treasury Select Committee said in its report that that "*… the panel told us that they originally concurred with the FSA's judgement that a formal industry-wide review of endowment mortgage mis-selling would be disproportionately expensive, but they were concerned that 'there was, and is still, an absence of information to help consider the costs and benefits of different redress mechanisms in various situations'. The Consumers' Association expressed similar views, telling us that 'the fundamental problem is that if you do not estimate the size of the problem then how do you measure the effectiveness of the strategy you put in place to tackle it?' Many of the consumer bodies told us that that they, like the Committee, had pressed the FSA for clearer figures, so far without success."*

The committee reported that the Financial Services Consumer Panel had told it that "*… it is a very confusing picture, and one of the things the panel has called for is for the FSA to do their level best to get much more accurate calculation of the number of policies that were sold to the number of households, and what proportion of these are likely to have been mis-sold … Until we get the best effort at a clear factual calculation it is impossible even to judge whether the mis-selling compensation exercise has been anywhere near successful or not."*

If the committee hoped that the FSA would clear up these uncertainties, it was to be disappointed. The committee had asked the FSA if it thought the estimate of 50% to 60% of

endowment policies having been mis-sold was a reasonable one – and if the FSA had any plans to commission more research to clarify the extent of the problem. The FSA's response was that it did "*… not believe it is safe to conclude that, in the Committee's words, 'between 50% and 60% of all mortgage endowment policies were very probably mis-sold'.*" The FSA was not, however, prepared to clear up uncertainty on this point, saying that "*we do not intend to commission research focused particularly on mis-selling.*"

When the Treasury Select Committee turned its attention to communications with endowment policyholders it had a number of criticisms to make. The committee took the view that the "re-projection" letters, which the FSA required firms to send to policyholders who were expected to have a shortfall, were not sufficiently stark in the message they gave.

The committee recommended that: "*To help the process of alerting as many policyholders as possible to the shortfall problem, the committee recommends that 'red' re-projection letters, warning policyholders of a high probability that their policy will fall short of its target, should always have the key section printed in red, analogous to the format used in overdue bills from utilities and others.*" The committee also expressed its concern at the industry's track record of keeping its customers informed about the deepening problems – until forced to do so by the regulator.

The committee said: "*Given the sketchy nature of the initial information from the FSA on endowment mortgage shortfalls, the committee decided to approach five major insurance companies … to give us detailed data on the shortfalls issue.*" On the basis of this and other available evidence, the committee concluded that "*… endowment policies are currently showing a collective shortfall of around £40 billion. Looking just at policies still being relied upon to repay a mortgage, the collective shortfall is at least £30 billion. Around 80% of policies are currently unlikely to generate enough funds to pay off the mortgage they were originally sold to meet, and the average shortfall is currently around £5,500. The balance of probabilities is that both the percentage of policies showing a shortfall and the average size of the shortfall per policy will worsen over the coming years. Without remedial action, endowment policies maturing but failing to meet their targets are likely to be an increasingly common problem until 2013, 25 years after the peak in endowment policy sales in 1988*".

The Treasury Select Committee expressed little sympathy for some of the arguments which had been put to it as evidence from the industry. It commented: "*Members of the insurance industry have at times seemed to suggest that the shortfall picture was being portrayed in an overly dramatic fashion. The Association of British Insurers (ABI), for example, suggested that one mitigating factor is that many policyholders 'will have accumulated substantial housing equity as a result of rising house prices.'*"

As the committee pointed out, any equity could be released only by the policyholder selling up their existing property and moving to a smaller and cheaper property. The committee tartly observed on this point that this was "*… not always a palatable or realistic option.*" The ABI had also pointed to the fact that those with endowments had benefited more from falling interest rates than those with repayment mortgages, and so had made "savings". The committee pointed out that "*… this observation would carry more weight if policyholders had been informed at an earlier stage and advised of the need to use the benefit of lower interest rates to bolster their mortgage repayments.*"

The committee observed that while for some, there were various offsets to the shortfall problem, "*it is equally clear that there are some households for which it could prove a major difficulty. Citizens' Advice, for example, told us that 'because many of our clients are poor they do not have the resources to repay projected endowments shortfalls. This is a particularly acute problem for people who are approaching retirement or who have already retired.'*"

another fine

On 18 March 2004 the FSA fined Allied Dunbar £725,000 for failings in its endowment complaints handling between May 2001 and April 2003. The FSA considered that Allied Dunbar's procedures were seriously flawed in that "*… complaints handlers were not directed to consider all the evidence about whether the original sales were suitable*" – and so a full and fair assessment of complaints had not been made in every case.

the ombudsman service considers its strategy

By the time the board of the Financial Ombudsman Service met in April 2004, there were again concerns about the imminent problem involving time bars. The first official "re-projection" letters had been issued in the second quarter of 2000 – and so time bars would soon take effect. The new rules made by the FSA, which came into force on 1 February 2003, left the ombudsman service with no scope for flexibility – and so if a firm claimed that a complaint was time barred, as some firms were now doing, the ombudsman service would have to reject the complaint, unless the consumer could show there were exceptional circumstances.

It was estimated that there were as many as 20,000 cases where time barring might be invoked – and where the ombudsman service would therefore have to decide whether or not there were any exceptional circumstances which could enable it to consider the individual case. By this time – April 2004 – the ombudsman service was receiving over 1,000 mortgage endowment complaints every week.

The ombudsman service's intelligence about what was happening in major firms suggested that they too were facing a large volume of potential complaints. Yet only a tiny fraction of mortgage endowment policyholders had yet complained to the firm which sold them the policy – and only about 1 in 20 of these complaints were subsequently referred to the ombudsman service. There was concern that if very large numbers of consumers became time-barred – and then started to complain that the ombudsman service could not look at their case – this could undermine public confidence in the complaints-handling mechanism.

At its meeting in April 2004, the board also heard that, because of the decision to prioritise "business as usual" complaints (such as banking and general insurance disputes), delays in dealing with endowment cases had increased. These delays were adversely affecting the overall performance targets for the ombudsman service. However, it was proving possible to manage these delays to some extent – through the establishment of the customer contact team in the new division, Excel, for example – and high levels of customer satisfaction continued to be recorded in regular consumer surveys, even where there were substantial delays in handling mortgage endowment cases.

the Personal Finance Research Centre's report

During 2004 the already high volume of endowment complaints started to become a flood. In September 2004 the board and executive team of the ombudsman service held a joint meeting, to discuss the way ahead. By this time the ombudsman service had the report of the Personal Finance Research Centre as an input to its discussions.

In general terms, this report gave a very favourable view of the ombudsman service in most of its areas of activity. It made recommendations in three areas.

The first concerned timeliness in handling complaints. The report said: "*Inadequate staff resources mean that there are delays in allocating cases to adjudicators and ombudsmen. We recommend that additional ombudsmen and adjudicators should be recruited to a rate that is commensurate with the organisation's capacity to train and support new members of staff and so ensure the maintenance of high standards of quality.*" Those qualifications are important. As will be seen below, at times the ombudsman service seemed to be reaching the limit of what any organisation could do, to take on and absorb new staff. It had also to be mindful of the fact that staff, once taken on, would eventually have to be laid off – and that the industry was always watchful of the costs of the service, ready to criticise if the ombudsman service recruited to a level that subsequently proved to be beyond the requirements of the workload. The report said

that more could be done to manage consumers' expectations more effectively, by providing estimates of anticipated delays.

The Personal Finance Research Centre's second recommendation related to quality control. It suggested that "*… specific responsibility for the management of quality should be assigned to a member of the executive team. A system for collating and reporting information about the levels of quality attained by all case-handling staff should be developed. The information should then be incorporated into the management information system. Procedures for checking the quality of casework should be strengthened.*" These recommendations were acted on by the ombudsman service. In particular, it recruited a director with specific responsibility for quality in the organisation.

The Personal Finance Research Centre's third recommendation looked at how improvements in training and support for staff could be implemented.

By this time, endowment complaints formed by far the greatest proportion of the workload – and the ombudsman service was approaching the limits at which it was able to close cases. The ability to settle complaints depended on the availability of trained and experienced adjudicators. The ombudsman service had reached the stage where it could not train and integrate new staff any faster than it was already doing – without an unacceptable loss of quality and consistency in case work.

The ombudsman service was already in the position where 40% of its adjudicators had been with the service for less than 12 months. It was possible to measure easily the timeliness of complaints handling by new staff – but taking a view on whether the "right" decision had been reached, or whether the reasons for the decision had been expressed in terms which both the consumer and the firm could understand, required experience.

Even if the ombudsman service had been able to recruit staff faster than it was doing, it would simply be storing up trouble for itself further downstream. It had to bear in mind the costs which might fall on the industry, if and when the organisation down-sized, once the volume of mortgage endowment complaints eventually subsided.

Meanwhile, its more experienced staff had to be depended on to provide training and coaching to the new recruits, to help in quality control of casework, and to support relationships with external stakeholders –all of which meant that the experienced staff had less time to help settle cases. There were other strains on the more experienced staff. There was said to be an "insatiable" demand from the various stakeholders for dialogue with the ombudsman service on one issue or another. The scope of the responsibilities of the ombudsman service was expanding,

which meant helping firms new to the idea of working with an ombudsman.

There was also the need for the ombudsman service to provide input into the so-called "N2+2" review – a review of certain aspects of the operation of the new Financial Services and Markets Act, two years after this legislation came into force.

quality of firms' complaints handling

The most worrying issue reported to the board of the Financial Ombudsman Service at its meeting in September 2004 was the quality of complaints handling by firms. The uphold rate by the ombudsman service for endowment complaints was now averaging around 50%, much higher than for other areas of complaint. In the case of some firms, the ombudsman service was upholding up to 75% of complaints in favour of consumers.

Although some firms were handling their complaints well, there were too many firms where the ombudsman service saw evidence of complaints being routinely rejected at first instance – with little or no account being taken of the individual consumer's circumstances, or the guidance which the ombudsman service had published about its approach to different types of case.

This apparent shoddy handling of their complaint led some consumers to pursue the matter further with the ombudsman service, only adding to its workload. But the concern was that other consumers were simply letting the matter drop, if they received an initial rejection from the firm. So far as cases that reached the ombudsman service were concerned, some firms continued to deploy generic arguments to try and dismiss whole groups of complaints, or to get the amount of compensation reduced – or raised new issues or points that had not been raised with the consumer when the complaint was first made.

Even when cases had been decided, the ombudsman service was facing further unnecessary work – caused by extensive delays by firms in calculating redress, or by firms getting the calculations wrong. There were concerns at the ombudsman service that some firms calculated that it was cheaper for them to routinely reject complaints in the first instance – knowing that only a fraction would be referred to the ombudsman service, when they would have to pay a case fee and possibly redress – than to investigate the customer's complaint properly themselves.

At its meeting in September 2004, the board of the Financial Ombudsman Service carried out a comprehensive assessment of internal operations, to review whether what was being done to cope with the situation was appropriate – and whether there

were other measures which the ombudsman service might be able to take.

The board considered a variety of factors, both internal and external, that were affecting productivity. It reviewed the current position in terms of work in progress (and the split between the "business as usual" caseload and mortgage endowment work), and possible scenarios on staffing for the organisation. Looking to the future, the gloomy forecast was that unless the flow of new cases to the ombudsman service could be slowed, the situation could only get worse.

A factor which might have exacerbated the problems for the ombudsman service during early 2004 was the withdrawal by the FSA of specific rule-waivers which it had granted to some of the largest firms. These waivers had "suspended" the rule requiring these firms to deal with complaints within eight weeks – at which point the ombudsman could step in. The waivers – granted during 2003 – had allowed the firms in question extended periods of up to 16 to 20 weeks to deal with mortgage endowment complaints, before the ombudsman could become involved.

The waivers had been intended to help firms that experienced sudden large inflows of new complaints better cope with the situation. These waivers came to an end in December 2003 and January 2004. This might have been the catalyst for some firms with large volumes of complaints to refer substantial numbers of cases to the ombudsman service – just so that they could be seen to have dealt with the complaints themselves within eight weeks.

It has not been possible to obtain figures for the rate at which firms were upholding complaints prior to 2005 – but these figures became available from the FSA after 2005. On the basis of these figures – relating to the proportion of complaints reaching the ombudsman service which the service subsequently upheld – it would appear that some firms were rejecting a unreasonable proportion of their complaints, so that they could be "dumped" on the ombudsman service to be dealt with. Support for that view also comes from the high-profile fines which at various times the FSA imposed on some of the largest firms.

responses to the Treasury Select Committee report

In June 2004, the Treasury Select Committee published "*Responses to the Committee's fifth report – restoring confidence in long-term savings: endowment mortgages*". The government said: "*There have clearly been problems in a significant number of cases with the sale of endowment mortgages.*" It then went on to support the strategy of the FSA for dealing with the problem, which the government considered "*proportionate and consistent.*" The Government said: "*As the Committee recognises, any product linked to equities carries an*

element of risk, and this applies in respect of endowment policies. The expectation of a shortfall is not an indication the consumer was mis-sold ... It is an important principle that consumers should expect to be informed at regular intervals of the performance of their investments." However, keeping consumers informed at regular intervals has been one of the significant failings of the financial services industry.

The government added: *"The performance of the stock market in recent years, together with a period of low inflation and low interest rates, does mean that many consumers who purchased endowment policies in the 1980s and 1990s will not receive the returns they expected. The level of individual shortfall and the impact on individual consumers is difficult to calculate as some of the of the projected losses may be mitigated by other factors … However, the government accepts that many consumers may not realise they need to act … The government has asked the FSA, as part of its further research into the effects of mortgage endowments, to identify those vulnerable consumers who may be particularly hard hit by projected shortfalls and/or unable to take action to correct these. With greater clarity of the extent of shortfalls and the numbers of consumers who may face significant hardship as a result, the government, the FSA, and the industry will be better able to assess the most appropriate method of dealing with these problems."*

On the subject of advice to consumers, the government told the Treasury Select Committee that: *The passage of time since most endowment policies were sold and the lack of contemporaneous records of the advice provided mean that it is difficult to properly assess the numbers of consumers who might be affected. The Government supports the efforts of the FSA both to raise awareness among all endowment policy holders of their right to complain and to conduct research to provide a more accurate assessment of the position of different groups of consumers."*

Seeking to explain the relatively low incidence of complaints by consumers, the government told the committee that *"levels of complaints are currently around 6% of all policyholders. While the proportion ... who have so far complained appears low, there may be further factors other than low awareness affecting the propensity of consumers to complain. Many endowments sold in the early 1980s will, typically, be smaller than the average because house prices were lower. This may result in lower than average shortfalls, which when offset against a tripling of average house prices since 1988, may lead many consumers to decide that the shortfall is manageable in the face of other factors."*

The position relating to pre-"A Day" sales of endowments was very helpfully explained by the government in its response to the committee. The government explained that:

"Regulation of the selling of financial services began on 29 April 1988, with the Financial services Act 1986. The Financial Services and Markets

Act 2000 did not extend jurisdiction retrospectively beyond 29 April 1988. Complaints about endowment policies sold directly by providers such as banks and building societies pre-1988 are eligible for consideration by the ombudsman service if these firms were part of a voluntary scheme. Pre-1988 there was no voluntary code or scheme covering the activities of IFAs and other intermediaries. Consequently, the ombudsman service is unable to consider complaints from consumers who were mis-sold endowment policies by IFAs and other intermediaries before 29 April 1988. Initial FSA research estimates that of the 8.5 million endowment policies currently [as at December 2003] in force 2.7 million of these were sold before 29 April 1988. Around 45% of all endowment policies were sold through an IFA and so are not subject to the pre-1988 jurisdiction of the ombudsman service. This gives a total of around 1.2 million policies sold by an IFA pre-1988."

Addressing this issue, the government said: *"While the number of consumers who were mis-sold an endowment policy pre-1988, which is forecast to shortfall, may be smaller than initially thought, there will still be a significant number of consumers for whom there is no avenue of redress. The government has discussed the issue with the FSA and welcomes the FSA's plans to conduct further analysis to establish a clearer picture of the numbers of consumers affected. It is also important to assess the relative abilities of consumers in this group to cope with a shortfall."*

However, the government then went on to say that: *"The options for extending existing avenues of redress or seeking voluntary agreement from the industry to deal with such complaints are limited. Under its own rule making powers the FSA cannot extend, retrospectively, the scope of the regulatory regime (and hence the ombudsman's jurisdiction) to cover this group of consumers. Many IFA firms who mis-sold endowment policies have departed the industry since the late 1980s, which further reduces the scope of consumers to complain. While the policy provider could agree to look voluntarily at such complaints, as these are not responsible for the mis-selling, this will depend on the attitude of individual providers. The FSA is aware that seeking to impose such a solution on providers is legally unjustifiable. The government supports the efforts of the FSA and the industry to explore the scope for voluntary action to help consumers in this situation."*

The Treasury Select Committee also published the response which it had received from the FSA. In the light of the committee's concerns, the FSA had accepted the committee's recommendation about red "re-projection" letters, saying: *"We have agreed with the ABI that the revised ABI Code on mortgage endowment re-projection letters will include a recommendation that firms use red ink or other similarly striking means to draw to attention the key risk warning in red re-projection letters. For red letters, the risk warning should also be headed up with the words 'red alert: high risk of shortfall.'"*

In relation to the effectiveness of the measures to draw the complaints mechanism to the attention of consumers, the FSA told the committee: *"Our research indicated that 86% of endowment*

policyholders recalled receiving a re-projection letter, rising to 99% among those people who had, according to firms' own records, received a re-projection letter in the last six months." The FSA pointed to the fact that these letters would have informed the consumer of their right to complain – although, as already noted, some regarded the information about the right to complain as insufficiently robust.

The FSA explained: *"We are again updating our literature and policyholders will receive further information from us with the next round of re-projection letters. This will include further information for customers to explain what they can complain about and how they should go about making a complaint."*

The FSA said that since its original consumer research, further "re-projection" letters, growing shortfalls, and awareness measures might have changed consumers' intentions and general awareness – and so it was "*undertaking further research to quantify and characterise these developments more precisely. The results will help us gauge the effectiveness of our past actions and guide us in refining our ongoing programme of work."*

The Treasury Select Committee had also expressed concerns about time barring of consumers. On this, the FSA said that its "*… message to consumers has always been to 'Act Now' – for example to take action to ensure that they will be able to repay their mortgage and/or make a complaint. Our literature has reflected this, coupled with warnings of the consequences of delay. In phase 2 of the re-projection exercise (from February 2002) a revised FSA leaflet was sent with the warning, 'If the risks relating to your endowment mortgage were not explained ... you may have a valid complaint. But time may be running out. If you want to complain – do it now. Otherwise, you may be too later or the amount of compensation you can claim may be reduced.'"*

In response to the committee's urgings, the FSA had also changed its rules to make sure that consumers were made aware of the time limits on complaining. In practical terms, this would mean that from 1 June 2004, "*… customers would have to receive letters which make clear what their position is and the final date before which a complaint must be made to prevent time barring. This notice must be given at least six months in advance."*

There could, of course, be consumers who had already received information from their providers and who could potentially be time barred in the coming period. The FSA had made rules requiring that firms should give these consumers two months' notice of the impending time bar. The FSA explained that these measures would not be retrospective – and so would not affect consumers who had already been time barred.

The FSA added that: "*a number of firms have decided not to impose time bars for these customers and others. We have discussed with the*

industry what more can be done on this and other voluntary initiatives (such as reducing or waiving charges normally entailed by switching a mortgage or paying off the outstanding balance early). We will be following up these discussions in the coming months."

Finally, the FSA said it noted the committee's recommendation that the regulator needed to be more rigorous in ensuring that its policies and strategies were being effectively implemented by the industry. The FSA was very soon to take further action in this respect, as its supervision work revealed that there were still shortcomings in complaints handling by some firms.

the FSA has to issue another reminder to firms

In December 2004 the FSA found it necessary to write again to firms in the mortgage endowment market about their complaints handling. The letter noted that a "*… significant amount of work has been undertaken by the majority of the industry to improve both the standards and the speed of dealing with complaints* "since John Tiner, the then chief executive of the FSA, had written in April 2002 about the poor standards of complaints handling in much of the industry. Despite this progress, the FSA said that some firms were still failing to meet the required standards for complaints handling – and it was this that had prompted the FSA to send a further letter in order to:

- cover issues which had come to the FSA's attention which firms were not handling properly;
- remind firms to handle complaints in a way that was consistent with treating customers fairly, including the need to ensure that as far as possible complaints were dealt with by the firm rather than the ombudsman service;
- warn firms that where the FSA became aware of problems in complaints handling, it would pursue this with the firm concerned and consider whether enforcement action would be appropriate.

In this letter the FSA mentioned its concern that the ombudsman had reported to it that not only was it continuing to face a rising number of endowment complaints, but also that it was upholding a very high proportion of complaints from some firms. This suggested that those firms might not be handling complaints properly or fairly.

The FSA warned that firms should not manage their own complaints caseload by allowing an excessive number of cases to flow through to the ombudsman service. Moreover, the cases which were actually reaching the ombudsman service might represent only the tip of the iceberg – as some consumers who

had their complaints rejected by these firms might not have decided to pursue their case further through the ombudsman service.

Although not mentioned in the FSA's letter, it is possible that the poor handling of complaints by firms may have been one of the contributory factors in the growth of claims-management companies. From late 2004 there was a steep rise in the number of endowment complaints where a claims-management company represented the consumer. Although a large number of these companies were active in handling endowment complaints, just 12 of them were responsible for the majority of cases taken to the ombudsman service where the consumer was represented by a commercial third party.

Another concern was that firms were in some cases repeatedly turning down complaints on grounds which appeared only slightly different from those used in connection with earlier batches of cases, which had already been upheld by the ombudsman service – suggesting inconsistent decisions being taken within firms. A number of other concerns were also covered by the FSA in an annex to its letter to the industry of December 2004.

It appears that the cumulative effect of the Treasury Select Committee's report, the campaign by Which?, extensive media coverage, and the repeated warnings by the FSA, were starting to have some effect on the way in which the industry dealt with mortgage endowment complaints. From the end of 2004, the proportion of cases in which the outcome for the consumer was changed after taking a complaint to the ombudsman service began to decline markedly – suggesting that firms were now starting to give proper attention to the complaints they received.

the ombudsman service takes stock

In February 2005 the executive team of the Financial Ombudsman Service was able to report to its board that the FSA had issued its "dear CEO" letter to firms about the quality of their complaints handling. The board also considered a report on the decision of the Financial Services and Markets Tribunal in the case of Legal & General Assurance.

In brief, the tribunal concluded that while Legal & General had mis-sold some endowments during the 1990s, the FSA had failed to show that the enforcement action it took against the company, and the level of the fine it levied on it, were justified. The ombudsman service concluded that the tribunal's decision did not have any significant implications for its own approach to cases.

In particular, the board drew comfort from the tribunal's comments that its decision about disciplinary action did not necessarily mean a consumer was not entitled to compensation: *"a decision about compensation … is decided by a separate process which applies standards more favourable to customers than those which govern a disciplinary case."*

The board also noted that the proportion of complaints referred to the ombudsman service by a "third party", usually a claims-management company, had risen to 12% for endowments (compared to just 5% for the general run of complaints). Although some of the claims-management companies were thought to handle matters in a professional way, there were concerns that this may not be true for all of the companies setting up businesses of this nature.

The board was informed that the ombudsman service planned to host a seminar for the main claims-management companies – to clarify the ombudsman's approach on endowment cases and to explain the service's operational practices.

change of chairman at the ombudsman service

In 2005 Sir Christopher Kelly took over from Sue Slipman as chairman of the Financial Ombudsman Service. In the annual review for the year ending March 2005 Sir Christopher commented: *"The last year has seen another significant increase in the workload of the ombudsman service, caused entirely by the continuing flood of mortgage endowment complaints. Meeting the demands of that this has involved has posed considerable operational challenges. Complaints-handling resource is not a tap that can just be turned on and off. We have mounted an intensive recruitment and training programme, and our staff have responded magnificently at all levels. But the stresses this imposes on the organisation are considerable. If we are to continue to provide a fair and effective service … complaints-handling by some firms must improve, so that a smaller proportion of disputes need to be referred to the ombudsman service."*

Sir Christopher also explained the process of prioritising cases which the ombudsman service had necessarily had to undertake: "*Part of our strategy has been to prioritise complaints other than those about mortgage endowments – so as not to let the surge in endowment complaints overwhelm all our other work. But is does mean that mortgage endowment cases are taking longer for us to resolve than we would like. I am grateful to consumers for their patience when we explain this to them."*

The annual review also reported that during the year a record 69,737 new endowment complaints had been received – and that endowments now accounted for 63% of all the complaints being considered by the ombudsman service. However, as the report

also noted, this constant increase in complaints was not likely to continue indefinitely because of time barring: *"Increasingly… the time limit rules will have an impact on the number of new mortgage endowment complaints that the ombudsman service is able to look into."*

The annual review also reflected on the quality of complaints handling by firms – and referred to the FSA's "dear CEO" letter of January 2005, which gave firms feedback that the ombudsman service had passed to the FSA on how firms were dealing with complaints.

At the April 2005 meeting of the board of the Financial Ombudsman Service, it was reported that firms were trialling the new red "re-projection" letters, containing a "final date" by which a complaint needed to be made. Anecdotal evidence was that the new letters were leading to an upsurge in complaint numbers. However, the executive team was also able to report that – as a result of the FSA's "dear CEO" letter and the follow-up action which the FSA had taken with some major firms – it was hoped the flow of new endowment complaints to the ombudsman service might be reduced.

more fines

May and June 2005 saw two more major financial service companies being fined by the FSA. Both cases were important in different ways.

Abbey National was fined £800,000 for the mishandling of its mortgage endowment complaints, for providing inaccurate information about its complaints handling when it responded to the FSA's "dear CEO" letter, and for failing to treat its customers with due skill, care and diligence. The FSA found that between 2001 and 2003 Abbey had mishandled around 5,000 complaints – including 3,500 which were rejected when they should have been upheld, causing estimated losses of up to £19 million to the 3,500 customers concerned.

The fact that the FSA fine was not for a greater amount reflected the fact that Abbey quickly settled the case with the FSA – and in addition reviewed all the cases which it had rejected since January 2000, paying redress when due, and carried out a major overhaul of its complaints-handling procedures.

The other case was that of Legal & General – as mentioned above – where the firm was eventually fined £575,000 for sales procedures which were defective and led to some mis-selling. This case was remarkable for the fact that it was the only one where a major firm pressed its side of the case to the Financial Services Tribunal

(effectively a "court of appeal" against disciplinary decisions of the regulator).

an update for the Financial Ombudsman Service's board

In May 2005 the board of the Financial Ombudsman Service received an update from the executive team on the strategy for dealing with the heavy caseload. This included a report on the progress in implementing earlier action-plans; the options for further expansion of the ombudsman service's capacity to deal with complaints; the actions underway at industry level, to try and improve its complaints-handling performance; and consideration of a large number of more radical options for the dealing with the endowment situation, should there be no improvement.

FSA calls a round-table meeting

By June 2005 the FSA had reached the conclusion that it should invite the various industry and regulatory parties to a joint mortgage endowment forum – to discuss recent developments, including the challenge which the issue of new "re-projection" letters might create. The meeting took place in July 2005. The FSA said it wanted to get a better understanding of how the industry was gearing up to tackle the increased volume of complaints likely to be generated by the new-style "re-projection" letters.

In particular, the FSA wanted to know how the industry would be sequencing the despatch of the new letters to consumers, to manage the volumes; how they would be communicating with other companies and intermediaries who might be affected by the impact of the letters on consumers; and how they proposed to maintain the standards expected by the FSA's complaints rules. A particular concern, which the ombudsman service had raised with the FSA, was that the ombudsman service might face unacceptable levels of operational risk, if it had to face unmanageable peaks of complaints as a result of unanticipated dove-tailing of providers' "re-projection" letters.

the FSA's 2005 progress report

In July 2005 the FSA published its report, *"Mortgage endowments: progress report and next steps"*. In this report, the FSA said that: *"It is important for consumers that firms handle complaints fairly, effectively and promptly. Where firms fail to do so, the FSA will encourage and where necessary, insist on appropriate action."* The document went on to report on the FSA's recent actions – and set out the regulator's future plans and expectations of firms in relation to mortgage endowment complaint handling. The FSA said that its plans had been informed by its latest consumer

research, *"Mortgage endowments – shortfalls and consumer action"*, which it published at the same time.

The FSA reported: *"Firms that sold endowment policies have improved and strengthened their communications so consumers understand whether their policy is on track to repay their mortgage. There has been a sustained effort by the industry to handle complaints and provide appropriate redress for any mis-selling. At the end of 2004 major firms had handled more than 695,000 complaints and paid around £1.1 billion in redress."* This would not have given the complete picture because, as the FSA pointed out, its figures were based on 110 firms.

The FSA added: *"We will now be focusing our effort on those few firms that have not yet established appropriate complaint handling standards, and working with all firms to ensure that any increase in complaints over the next period can be handled by them fairly, effectively and promptly … In addition we are broadening our work to include a wider range of smaller firms involved with mortgage endowments, to check that they have taken on board the requirement to handle complaints properly."*

The FSA also said that it was *"… establishing key performance criteria and collecting qualitative and quantitative date from firms to assess performance."* It warned firms' senior management of the need for them to engage fully with the issues: *"Looking forward, all firms must ensure that they are able to handle any increase in complaints that may arise as a result of the sending out of 'red' re-projection letters, and of time bars implemented by some firms. Firms' senior management must act now to ensure that they have adequate contingency plans in place. We are asking a range of firms for their contingency plans. And we will also use the performance criteria we are establishing to monitor the performance of all firms in the event of an increase in complaints."*

Commenting in more detail on its assessment of the performance of firms, the FSA said: *"We already collect data from the largest firms, but we will extend this to include some medium-sized firms and large distributors (so covering a greater proportion of market sales). We are setting objective criteria against which to assess the performance of firms. This will allow us to determine which firms we need to focus on."*
The FSA went on to explain that the assessment criteria would cover timeliness, uphold rates, and the number of complaints received by the ombudsman service about each firm in relation to that firm's market share.

Another move by the FSA was to improve co-ordination among the various parties by *"… convening a forum of senior industry representatives, the Financial Ombudsman Service and the Financial Services Compensation Scheme (FSCS) to consider these issues (the management of the volume of complaints and the impact any significant increase might have on consumers) and to identify possible solutions."*

Commenting on its latest consumer research, the FSA said: *"the results are encouraging, and are consistent with our earlier research in 2002 … Most of those with endowment policies showing a potential shortfall and are still linked to a mortgage have now reviewed their situation. Many have taken action to restructure their loan, endowment or savings (around 48%), or made a complaint or taken advice (around 21%)."*

The FSA went on to say that some consumers (around 14%) had not taken action but planned to do so. A further 9% of consumers took the view that they did not have a problem.

This still left, in the FSA's words, "*… around 11% (of consumers) who believe that they cannot afford to do anything. This group is small and difficult to characterise and so difficult to reach. We plan to work with the industry and other agencies to find ways to identify these consumers and, where possible, encourage them to take action to deal with their projected shortfalls. But some consumers will have no option to act now and will therefore be facing a residual debt at the end of their mortgage term. We will be encouraging firms to find ways to help these consumers understand how they can manage this situation.*"

round-table meeting

The September 2005 meeting of the board of the Financial Ombudsman Service considered a report from the executive team on the round-table meeting convened by the FSA on 15 July 2005 – at which the ombudsman service, the FSCS, various trade associations and some major firms had been represented. Among other things, the board heard that, although the data was not complete, the ABI had reported that the peak for issuing the new style "re-projection" letters had now passed.

It remained unclear, however, how consumers might react to the new-style "re-projection" letters – and the views of the participants at the round-table meeting had been mixed on this topic. Some felt that consumers might start complaining in large numbers immediately on receipt of the new style letters. Others suggested that consumers might wait until the "final date" mentioned in the letter. Alternatively, there might simply not be a large number of new complaints in response to the new letters.

endowment liaison committee

In September 2005 the so-called endowment liaison committee met for the first time, under the chairmanship of the ABI. The committee included members from other trade associations, as well from the Financial Ombudsman Service, the FSA and the FSCS.

The committee noted that the number of complaints to firms was still continuing to rise significantly. As a result, firms' backlogs were increasing. It was noted that the increase in the number of complaints was despite the fact that the number of "re-projection" letters had fallen. A number of possible reasons for this were advanced. The most plausible appeared to be that *"… including a time-barring date in the letter is having an impact and is encouraging consumers to complain."*

The ABI also noted that there were significant variations in the uphold rate, where firms had complaints referred to the ombudsman service. There appear to be two explanations for these variations – differences among firms in the quality of their endowment sales; and differences among firms in the way in which they dealt with consumers' complaints.

The committee noted that the FSA had received the contingency plans it had asked for from 55 firms. A trend in these plans was the significant number of firms that proposed to use out-sourcing firms to deal with any sudden upsurge in complaint volumes. It was reported that out-sourcing firms were planning to increase their staffing levels by 10% to 30% over the coming six months. It was felt that this raised questions about the ability of the out-sourcers themselves to absorb sudden and large increases in complaints.

The endowment liaison committee agreed to meet a number of times in the months to come – to monitor the planning and co-ordination work among the various parties involved in the mortgage endowments exercise.

further ombudsman developments

The October 2005 meeting of the board of the Financial Ombudsman Service considered the draft corporate plan and budget proposals for the financial year 2006/07. The executive team told the board that, for the first time, the number of new mortgage endowment complaints was now consistently being matched by the number of endowment cases being resolved and closed. Increased capacity had meant that the ombudsman service had been able to significantly reduce the number of complaints awaiting attention.

It was noted, however, that because of the volume of cases awaiting attention, the number of cases that had been with the ombudsman service for over 12 months would continue to grow through the remainder of 2005/06 – before stabilising and starting to reduce throughout 2006/07.

It was noted at the November 2005 meeting of the board of the Financial Ombudsman Service that the FSA had issued guidance on its "eight week rule", which stressed the need for firms to reach a view on consumers' complaints within eight weeks – not just on liability, but also on the calculation of redress (if necessary, the redress figure could be an approximate one). It was anticipated that this would cause firms some problems, bearing in mind that data available to the ABI had suggested that in 2004/05 only 56% of endowment cases handled by insurers were resolved within eight weeks.

There was, however, some good news to report to the board at its meeting in November 2005. The executive team had set up an internal project, to satisfy itself that the approach taken by adjudicators and ombudsmen to redress in mortgage endowment complaints was consistent across a range of scenarios. Various external stakeholders had been kept in touch with this work. The plan was to publish case studies and technical briefing to help firms better understand the ombudsman approach to redress in these scenarios.

The endowment liaison committee also met again in November 2005. The committee reviewed data about matters such as complaints volumes, the pattern of time barring of complaints, and uphold rates. The ABI noted the increasing proportion of complaints reaching insurers involving claims-management companies. The Council of Mortgage Lenders (CML) reported a similar position. The committee also heard that a separate endowment-shortfall working party, to be chaired by the CML, was being set up, to "*… develop strategies around endowment shortfalls and to encourage vulnerable consumers identified by the FSA's consumer research to take action.*"

At this meeting, the board also reviewed the likely trend of future volumes of complaints, in the light of the latest information on the impact of the new-style "re-projection" letters being sent to consumers. Through the endowment liaison committee, data had been collected which appeared to suggest that, over the course of 2006, around 50,000 to 100,000 policies each month would reach the "final date" by which the consumer could complain. One blip in this data involved a major firm which had imposed a common "final date" for some 300,000 of its customers – and there were concerns that, as many of this firm's products had been sold by IFAs and lenders, they might not be able to cope with a sudden influx of new complaints and enquiries. The FSA and ABI were looking to see what might be done to mitigate any problems arising from this situation.

Issue 50 of *ombudsman news* (November/December 2005) noted that the ombudsman service was continuing to receive a large number of queries from both firms and consumers about time

bars. The ombudsman service said: "*Consumers often say the firm has treated them unfairly if it tells them it will object to our considering the merits of their complaint because the complaint is time-barred. When this happens, we explain the rules about time limits and check that the firm has applied the rules correctly. We also look to see if the consumer can point to exceptional circumstances that prevented them from complaining within the time limit. If we are satisfied that their failure to comply with the time limit was the result of exceptional circumstances, we can consider the complaint.*"

This issue of *ombudsman news* went on to explain that the new FSA rules on time bars, which required firms to give consumer a "final date" for making a complaint, applied only to cases that were not *already* out of time on 31 May 2004: "*That means many consumers continue to be subject to a time bar without having received any prior notice of a deadline. These consumers often find the rules difficult to understand. They frequently question whether the firm can restrict access to the ombudsman service in this way.*"

The *ombudsman news* article urged firms to help reduce the number of complaints reaching the ombudsman service, by giving a clear explanation of the time limits: "*Clear and complete explanations in the firm's final decision letters can help minimise the number of complaints about time limits that are referred to us.*" The article went on to give firms a number of case studies on time limits – as the ombudsman service was still finding cases where it was not apparent that the case had been correctly time barred, and as a result the ombudsman service had to spend time investigating the case further.

In February 2006 the endowment liaison committee met once again. The committee looked at data on various aspects of the handling of endowment complaints. Significant features of this data included the continued rise in the proportion of mortgage endowment complaints involving claims-management companies (up to 37.9% in the fourth quarter of 2005). However, in terms of the proportion of successful complaints, the uphold figure for cases represented by claims-management companies was 48%, compared with an uphold rate of 64% for those complaints which came direct from the customer.

On the effect of time bars, the ABI reported that since June 2004 the number of complaints which had been time barred was almost 321,000. Its data suggested that by August 2006 about 50% of endowment policies would be time barred.

This figure would reach 80% by November 2007, and 85% by April 2008. The FSCS was also reporting another sharp increase in the number of claims – and in its case, claims-management companies were involved in about a third of the claims.

another fine

On 9 January 2006 the FSA fined Guardian Assurance £750,000 for systemic failings in handling its endowment complaints over a two year period. According to the FSA, Guardian was aware in advance that changes to its complaints-handling process would be likely to reduce, very significantly, the proportion of complaints which it upheld.

In the event, following the introduction of its new procedures in 2003 (that is, after the so-called "dear CEO" letter from the FSA) the firm's uphold rate fell to an overall figure of 22.6% in the first half of 2003, compared to an overall rate in the second half of 2002 of 71%. There was also a significant increase from April 2003 in the proportion of its decisions to reject complaints which were overturned by the ombudsman service –rising to an overturn rate in excess of 80% during 2004.

building societies

As the board of the Financial Ombudsman Service heard at its meeting in March 2006, significant issues in relation to mortgage endowments could arise with particular sectors of the industry. Building societies accounted for only a relatively small number of the complaints referred to the ombudsman service. Only one society featured among the "top 25" financial services groups that were responsible collectively for the majority of mortgage endowment complaints referred to the ombudsman service.

Possibly because of this relatively low volume of complaints, some building societies were unsighted on the approach taken by the ombudsman service. As a result, the board was told, a number of "myths" appeared to have spread among societies about the ombudsman's work on mortgage endowment complaints. The board had, for information, a copy of a presentation which had recently been made to building societies – which sought to separate the myths from the reality.

The presentation made clear the overall affect of mortgage endowment complaints on the ombudsman service. Two thirds of the caseload were now endowment cases. The ombudsman service needed to settle a mortgage endowment complaint every two minutes of each working day – just to keep pace with the flow of new complaints.

To cope with the workload, staff numbers at the ombudsman service had grown from 350 to nearly 1,000 in just a few years. Despite the increase in staffing, some endowment work was being delayed so as to maintain standards in other areas of complaints

work – but customer satisfaction levels had still broadly been maintained.

The first "myth" which the ombudsman service sought to dispel was that it had shifted position on endowment complaints over time – so that whereas firms used to "win" all cases, they now "lost" them all. The ombudsman service pointed out that in 2005 only 5% of complaints involved societies (and that proportion had been fairly stable since 2003). More significantly, the figures showed no dramatic change in uphold rates over time. The overall uphold rate for mortgage endowment complaints relating to building societies was close to the industry average – with 40% of cases in favour of the consumer. However, within the building society sector there was significant variation in uphold rates – from 12% to over 70%.

The second "myth" that the ombudsman service wanted to dispel was that it always upheld complaints relating to pre-"A Day" cases involving building societies. The facts showed that the difference in uphold rates between *pre*-"A Day" cases and *post*-"A Day" cases was not as great as some societies seemed to imagine. Some 44% of *pre*-"A Day" complaints to the ombudsman service had been upheld – compared with 37% for complaints about *post*-"A Day" sales and advice.

The ombudsman service pointed to the conflicting views it typically heard from the parties to a dispute. Some societies said that all consumers had "demanded" endowment mortgages. On the other hand, consumers generally insisted that the society they dealt with had mis-sold their endowment. The ombudsman service had to drill down to the actual facts in each case. It would look at the consumer's testimony and the circumstances at the time of the sale. It would also listen to any arguments and materials the society wished to submit. If the society no longer had documents to submit (for example, because they no longer existed) it did not follow that the ombudsman service would automatically find in favour of the consumer. It was a similar situation on the question as to whether or not any advice had been given. Some societies claimed they never gave advice. Some consumers said their building society specifically advised them to take out the endowment.

The ombudsman service explained that it would look at all the circumstances surrounding the sale. Did the society limit its dealings to facts and figures – or go further and provide a recommendation? How plausible is the consumer's recollection of events? How many meetings were there? Was there any indication of an advisory relationship? What were the arrangements for commission – and the level of commission? What was the society's promotional material saying about the service it offered?

The third "myth" – and not one confined to building societies – is that the ombudsman service is inconsistent, reaching different outcomes on cases with similar circumstances. As the ombudsman service pointed out, in most of the mortgage endowment complaints it dealt with, it was looking to assess the individual consumer's actual understanding of risk.

The ombudsman service therefore pointed out that it did not uphold consumers' complaints where it was clear, from what they said, that consumers appreciated there might be some risk of a shortfall. This meant that it was not unusual to have different outcomes in similar circumstances – because in one case, the ombudsman service was satisfied that the consumer had understood there was a risk, and had accepted this risk, and in another case, the consumer was not aware of the risk.

The information which the ombudsman service had given about uphold rates must surely have dispelled the final "myth" – that the ombudsman service always sided with the consumer.

The societies were then given some tips. When an adjudicator gave an initial view on a case, it was just that – and a society could defend the case, if it continued to believe that it was in the right. But societies should not expect the ombudsman service to make the arguments for the firm – just as the consumer could not expect that. Moreover, societies should address the specific points in each individual case and be consistent with what they had told the consumer in their final decision letters.

2006-2007 – *light at the end of the tunnel*

good news at last

At the meeting of the board of the Financial Ombudsman Service held in April 2006, it was reported that a significant decline was starting to be seen in the rate at which the ombudsman service was upholding mortgage endowment complaints against larger firms. There was also a slowdown in the number of cases being referred to the ombudsman service about these firms. This was largely as a result of the dialogue that the ombudsman service had initiated with the firms concerned, to resolve their issues. Much more effort was now being focused on smaller firms, to clarify misunderstandings about how the ombudsman service dealt with mortgage endowment cases.

The meeting the following month heard that, having worked with the 20 largest firms to resolve their issues over endowment complaints, attention was now switching to the smaller firms. The lead ombudsman for endowments reported that: "*A different*

approach was required for smaller firms as it was not feasible to meet each one individually, as had been possible with the largest firms. A small group of firms had been identified and meetings were being arranged as part of a move to give this sector the same attention as the larger firms had been given."

It was anticipated that progress with these smaller firms would be hard, as many had entrenched views. Some claimed that they had not advised customers to take an endowment, despite contemporaneous documents retained by the customers themselves that showed otherwise. On another issue, that of time bars, the board heard that it was still proving difficult to gauge the effect of time bars on workload. It also seemed to be the case that some smaller firms were confused by the changes that the FSA had made to the time bar limits.

From September 2006 the front-line consumer-contact team in the Excel unit at the ombudsman service started to deal with all "jurisdiction" cases. This necessitated taking a further ten staff into the team because, with the passage of time and the growing complexity of cases, the issues as to whether or not a case was within the jurisdiction of the ombudsman service had grown more difficult.

During 2006 the ombudsman service also established a smaller firms taskforce – to look at further ways of trying to improve the difficult task of dealing with a large number of smaller businesses. The ombudsman service had, in fact, already done much over the years to try to foster understanding with smaller firms such as IFAs. But the difficulty it faced was that there are thousands of such firms, spread across the whole country. And the size of these firms generally meant that they had few endowment complaints to handle.

As a result of the smaller firms taskforce initiative, some 50 IFA firms, each with a larger number of endowment complaints, were given a named contact within the Excel team with whom they could discuss issues. This helped the ombudsman service to encourage firms to settle more complaints following discussion with an adjudicator, rather than insisting on an ombudsman's decision in every case.

The meeting of the board of the Financial Ombudsman Service in October 2006 was, one might imagine, the occasion for some mild rejoicing. The board had before it the draft corporate plan and budget for the coming financial year 2007/08. And for the first time in the ombudsman service's history, this anticipated a reduction in the number of new mortgage endowment complaints reaching the ombudsman service. But falling workloads would bring their challenges too, and there was uncertainty over the pattern of decrease in casework.

The ombudsman service would be faced with the challenge of continuing to handle high numbers of complaints in progress – while at the same time gradually matching its resources to a declining inflow of new cases. There would also be other complicating factors. Many of the mortgage endowment complaints to reach the ombudsman service during 2007/08 were likely to be time-barred. This would mean that the ombudsman service might not be able to charge the firms case fees – to cover the work that would still be still needed, to process the cases and to explain to the consumers involved that the ombudsman would not be able to look at the merits of their complaints.

the FSA's 2006 progress report

In December 2006 the FSA published its report, *"Mortgage endowments – delivering higher standards."* In this report, the FSA documented the work it had carried out since its July 2005 statement – including reviewing the speed and quality of firms' complaints handling, the quality of firms' communications with customers, and the contingency plans that firms had in place for handling a potential complaints "bubble" arising from the combination of more prominent warnings in "re-projection" letters and more firms time- barring complaints.

The review of the speed and quality of firms' complaints handling looked at a group of 52 firms accounting for some 90% of the endowment market. Among these, the FSA said it had identified 22 firms where aspects of their mortgage endowment complaints-handling caused concern. Of these 22 firms, 14 were required to take remedial action – to improve the quality of their complaints handling. The FSA reported that, as a result of this remedial action, over 100,000 complaints that had previously been rejected had now been (or were in the process of being) reviewed – and that, so far, 75% of the cases reviewed by the firms had now been found in favour of the consumer. This had resulted in compensation of over £120 million being paid.

The FSA first announced its strategy for dealing with endowment shortfalls in 1999. In 2002 it had to warn firms about the poor quality of their complaints handling. It did so again in 2004. Almost seven years later, the FSA found that a significant number of firms still had complaints-handling arrangements which were so poor that they were forced to take remedial action.

The findings from the FSA's review of firms' communications with their customers were published separately by the FSA in its report, *"Mortgage endowment complaints: the quality of firms' communications."*

The FSA said that its review of firms' contingency plans to cope with a possible upsurge in complaints during 2006, on top of the already existing high volumes, were adequate – although it added that eight firms had been required to *"… review and strengthen their existing arrangements in some areas."* The FSA said its confidence in the adequacy of contingency plans had been borne out by the fact that, since July 2005, firms had received record numbers of complaints but had managed to maintain the speed and quality of their complaints handling.

The FSA also said in its report that: *"As a result of all the above, the risk of poor complaint handling is lessening (and we expect it to continue to do so as time goes on). This allows us to begin to move back to monitoring firms' endowment complaints as part of our normal supervisory work. And, more immediately, we will reduce our more detailed reporting requirements for some firms."*

the FSA and time barring

In January 2007 the FSA published on its website the results of some focused "thematic" work it had undertaken with firms – to test whether the approaches firms were taking to time-bar mortgage endowment complaints were appropriate and fair. The FSA explained that in February 2003 and June 2004 it had made rules to cover the specific and special features of mortgage endowment complaints. These rules had linked the time-barring of a complaint to the receipt by consumers of specific letters issued by firms. This was in accordance with the ABI's mortgage endowment "re-projection"-letters procedure (the "ABI Code letters") which warned of the increasing possibility of a shortfall in the targeted sum at the end of the policy term.

The FSA went on to describe its findings: " *The passage of time and the issuance by now of millions of 'red' ABI Code letters (and latterly specific warnings of imminent time bar 'final dates') means that by the end of 2007 up to two-thirds of live endowment policies could be time barred by firms where consumers made subsequent complaints. And in the last 15 months, firms have rejected 100,000 endowment complaints as being out of time. It is particularly important that we are confident that firms which are time barring endowment complaints do so fairly … We tested this in a small sample of firms, that our figures showed had time barred a comparatively high proportion of endowment complaints and/or whose time barring practices had otherwise come to our attention through our supervisory work. We found that in the great majority of time barred complaint rejections, the firms' decisions were based on procedures related to 'red' ABI Code letters and appeared to be fair … In a small number of cases, some firms sought to time bar complaints on a basis other than the ABI Code letter. It was in our review of this smaller number of cases that we found rule breaches and practices which challenged the principle of treating the customer fairly. In light of this information all firms dealing with mortgage endowment complaints will*

no doubt wish to consider whether their own complaint handling is treating their customers fairly."

turning point

In the annual review for the year ending March 2007, the chairman of the Financial Ombudsman Service was at last able to report that after five consecutive years of substantial increases in the numbers of complaints a turning point had been reached: "*For the first time, the overall volume of new complaints reduced during the year – by 16%. This figure means that our overall workload is still three times the size it was when the Financial Ombudsman Service was first set up".*

The chairman then went on to reflect on the cause of the difficulties for the ombudsman service over previous years: "*It was the seismic effect of mortgage endowment complaints that created the mountain we have climbed in recent years – a mountain that has cast a deep shadow across the landscape for both the ombudsman and the financial services sector more generally. In the last few years, the ombudsman service has now handled well over a quarter of a million mortgage endowment disputes – probably around one in eight of such complaints dealt with by the financial services industry itself."*

The reduction was not, of course, unexpected – as the ombudsman service had warned in previous annual reviews that, as "time barring" started to bite, consumers would run out of time to bring a mortgage endowment dispute to the ombudsman.

In his contribution to the annual review, the chief ombudsman noted that 2007 had seen the completion of over 500,000 disputes since the Financial Ombudsman Service started – around half of the disputes relating to mortgage endowments.

Although many thousands of endowment cases remained for the ombudsman service to resolve, the chief ombudsman was able to end with an optimistic vision for the future: *"We are not alone among public bodies in focusing on ways in which we can improve our service to customers. Currently, there is hardly a service-delivery organisation in the UK that is not emphasising its commitment to improving its service standards. Some are relying on new technology and modern systems to provide the promised higher service levels. But while efficiently functioning systems are clearly important, it is the people who work for the organisation who can make all the difference for their customers. This can be a difference between a positive, connected experience – or just a dull and bureaucratic transaction. So we must look both at the procedural aspects of what the ombudsman offers - and at how to make real for customers the values to which we are committed. By necessity, the huge volumes of mortgage endowment complaints which we have had to cope with over the past five years have forced us to concentrate on systems and processes, to drive through the numbers. But my vision for the ombudsman service in the coming years is one that will*

allow us to connect more personally with the businesses and consumers who constitute our 'customers'."

more grief for consumers

It would be comforting to report that all consumers who have complained about the mortgage endowment they were sold had their complaint resolved satisfactorily – one way or another. Unfortunately, that is not true for all consumers. Once the Financial Ombudsman Service has issued a decision on a case, that tends to be the end of its involvement – unless the consumer contacts the ombudsman service again and requests assistance. If the decision involves a firm having to pay compensation to a consumer, there is no automatic follow-up by the ombudsman service, to ensure that the award is paid in a timely manner.

If an ombudsman award is not complied with, the consumer has to seek enforcement of the award through the courts. Given that the establishment of the ombudsman scheme was intended to avoid recourse to the courts, this is unfortunate. There is a risk that the courts might provide a firm with the opportunity to have a second bite of the cherry – allowing it to argue that any award made by the ombudsman should be reduced or even struck out.

If a consumer has to seek enforcement of an ombudsman award in the courts, it may not, of course, come to the attention of either the FSA or the Financial Ombudsman Service – so it is not possible to put a number to cases such as this that reach the courts. On the basis of those cases which do become known to the ombudsman, the number is thought to be very small – and to involve exclusively IFA firms.

The ombudsman service has to tell the consumer in these circumstances that the ombudsman *"… only has the power to decide your complaint. We have no power to enforce the decision. Instead the law allows you to ask the courts to enforce it for you"*. In these cases, the consumer has to obtain from their local court the forms they need to make a claim. If the consumer needs help in filling out these forms, they are recommended to seek it from the court, or from an advice agency.

More recently, the ombudsman service has looked at providing some additional help to consumers in these circumstances – including providing more information about the basis on which the regulator expects compensation in endowment complaints to be calculated. It is hoped that the courts would have regard to this.

Assuming the court decides in favour of the consumer – and agrees with the decision of the ombudsman service – it will issue an order against the firm. There remains the possibility that the firm will also fail to comply with the court's order, in

which case the consumer has to go back once again to the court for enforcement.

Another area where consumers can suffer further grief is where a firm is unable (rather than unwilling) to pay redress – or where the firm which gave the advice to the consumer simply cannot be traced. This affects a much larger number of consumers, as is indicated by the fact that – over the years – some 1,500 firms of IFAs have been declared "in default" by the Financial Services Compensation Scheme (FSCS), the "final safety net" for customers of regulated financial businesses that are unable to pay what they owe. Consumers in this position are then faced with a separate process – making a claim to the FSCS.

part 3: the impact on the Financial Ombudsman Service – and reflections

the effect on the ombudsman service as an organisation

It will be clear from the preceding chronological narrative of events, as set out in part 2 of this report, that coping with the flood of mortgage endowment complaints presented the Financial Ombudsman Service with a major organisational challenge. Moreover, that challenge came against a background of other significant challenges on other fronts.

The announcement by the FSA of its proposed approach to mortgage endowments came at a time when the new Financial Ombudsman Service was just being set up. This was a major task in its own right – involving the integration of the staff of the existing separate complaints bodies, relocating them, and maintaining the operations of the existing schemes to acceptable standards – while at the same time preparing for the new statutory framework under which the new ombudsman service would be operating.

In addition, other major areas of new complaints-handling work came the way of the ombudsman service during the time that it was dealing with the deluge of mortgage endowment cases. In particular, it took on responsibility during this period for settling disputes relating to mortgage and general insurance mediation.

During the period, the ombudsman service was also subject to a major review of the way in which the new legislation – under which the Financial Ombudsman Service and the FSA were established – was operating in practice, two years on (the so-called "N2+2" review).

In terms of the structure of the organisation, the ombudsman service initially moved from the framework it inherited from the predecessor complaints schemes – to one which involved multi-disciplinary teams capable of handling complaints from across the entire range of the ombudsman service's remit. This gave the ombudsman service much greater flexibility in the way it handled its fluctuating caseload.

This might have remained the structure of the Financial Ombudsman Service – had it not been for the pressures imposed by dealing with the huge volumes of mortgage endowment complaints. This substantial shift in workload necessitated the ombudsman service moving to a new structure where one division, Excel, specialised in just one type of complaint.

Moreover, within Excel itself, the division of labour and organisation of processes became highly specialised. For example, a separate front-line team was established to manage consumers' expectations, and the writing of formal decisions became specialised in one area. While these organisational and process changes – that were forced on the ombudsman service as a result of mortgage endowments – resulted in considerable business improvements through economies of scale, they may also have undermined the traditional ombudsman preference for personal ownership of a case from start to finish, replacing it instead with a "factory" approach to handling cases.

people

People are the key resource for any organisation. People make the difference between success and failure in achieving the objectives of the organisation. This report has recorded earlier the substantial growth in the number of people employed by the ombudsman service, principally in consequence of the ever-increasing workload from mortgage endowment complaints.

The significant growth in the number of adjudicators needed to keep up with the endowment workload, led to the risk of an "experience gap" – as new joiners became an ever greater proportion of workforce as a whole.

Commenting on this, the report by the Personal Finance Research Centre said: "*The expansion required to manage this growth has undoubtedly placed strains on the organisation. There is a limit to the number of new staff that any organisation can absorb: too many new recruits can create instability and can lower standards; too few recruits can produce an increase in backlogs, unacceptable work pressures on existing staff and, once again, a lowering of standards. The Financial Ombudsman Service has, we believe, managed this period of rapid growth successfully.*"

At one stage, the executive team of the ombudsman service considered whether outsourcing work might be a solution to deal with the wave of mortgage endowment complaints. This was, for example, the approach later adopted by the Financial Services Compensation Scheme (FSCS).

Commenting on the use of outsourcing, one of the ombudsmen told the board in 2004: "*The risks are that the management efforts to set up and administer the requisite contracts, training and quality controls would be a huge distraction – and would not be repaid. Moreover, any agency to whom we might outsource would have to recruit – and might simply end up poaching our own staff to do the same job at twice the price and half the quality.*"

It might be added that had the ombudsman service gone down the outsourcing route, there could have been an external perception of unacceptable conflicts of interest on the part of the outsourcing agencies involved. Most agencies would have been in the position – at one and the same time – of handling complaints both for regulated firms and for the ombudsman service. It is an interesting question whether an outsourcing agency which had advised a regulated firm to *reject* a complaint could then change positions and *uphold* that same complaint if it reached the ombudsman.

premises

A people-intensive organisation will need space in which to accommodate its staff. As explained in part 2 of this report, the Financial Ombudsman Service re-located the staff of the predecessor complaints organisations in single premises at South Quay in London's Docklands in 2000. Its corporate plan and budget for the financial year 2001/02 pointed out that the offices were originally planned to accommodate 400 people. The increasing workload, and the consequent increase in staff numbers, had initially been absorbed by removing various conference and meeting rooms – allowing a further 30 to 40 more people to be accommodated.

However, the ombudsman service anticipated that it might start to run out of space to accommodate staff by April 2001. It was suggested that the long-term solution to the pressure on accommodation would be to introduce low-cost off-site working – such as home working and case-handler satellite units. But it would take some time to develop this capacity. To cope with the immediate need for space, the ombudsman service therefore proposed taking an additional floor at South Quay. This would cost in the region of £350,000 to £400, 000, which the ombudsman service had already built into its budget. The budget document explained that "*… our overall accommodation strategy is to cap any further central London accommodation and to use off-site working for any possible further expansion.*"

In fact, some of the plans set out in the ombudsman service's 2001/02 budget were overtaken by events. As the workload increased dramatically, the ombudsman service had no option but to look for additional space in Docklands, to accommodate its burgeoning staff numbers. It was good fortune that further

office accommodation became available at its existing South Quay premises – at the very time the ombudsman service needed it. This meant that it was possible to accommodate all staff in the same building. The ombudsman service subsequently took over part of the seventh floor of its office building in December 2003, the whole of the ninth floor in May 2004, and part of the eighth floor in April 2005.

Obtaining the necessary additional floor-space was only part of the story. The new space had to be fitted out, with the partitions and separate offices of the previous occupants removed – to give the open-plan lay-out needed by the ombudsman service, to make the maximum use of the space. Floors had to be re-cabled for computer and other equipment.

In some cases, the ombudsman service was even able to negotiate taking over the previous occupants' furniture and fittings – to keep refit costs to a minimum. The flexibility of the open-plan office space reflected the need for a flexible workforce. On one occasion alone, the premises and IT teams at the ombudsman service moved two-thirds of staff over one weekend – as part of an organisational re-structure.

information technology

One of the key tools for improving productivity, consistency and quality in a modern business is the use of information technology (IT). A high priority for the Financial Ombudsman Service when it was set up was the introduction of the necessary high-quality IT – to replace the legacy systems which it had inherited from the predecessor complaints schemes, and to provide the support that its staff would need, to make the new system work smoothly and efficiently.

In its corporate plan and budget for 2001/02, the Financial Ombudsman Service said that it had bought a new software system, which was being tailored to its individual casework needs. The aim was to have the new system rolled out and in use by all staff at the ombudsman service by the summer of 2001 – with further upgrades during the remainder of the year. It was anticipated that this new IT system, underpinning the casework system, would make a major contribution to the improved efficiencies and cost effectiveness planned for the new service.

A couple of years later, in its corporate plan and budget for 2003/04, it was noted that the work of the ombudsman service involved dealing with very large amounts of correspondence and other documents. The ombudsman service wanted to reduce its reliance on paper files, by scanning material and exchanging information electronically where possible.

It was also explained that the decision to move away from casework divisions structured around the predecessor complaints schemes meant that staff had to develop their skills in dealing with complaints about a variety of products. This had led to the establishment of a "knowledge management" project – to create an easily accessible knowledge-base for the organisation. This system would also help to ensure consistency, as it would pull together information about the approach to complaints across the different industry sectors.

The following year, in its plan and budget for 2004/05, the ombudsman service noted that work was continuing on developing the knowledge management system, to help improve consistency and efficiency. In addition, structured documentation was starting to be introduced, for use by adjudicators in those areas where there were a large number of complaints. It was anticipated that this would help to train staff in areas of work which were new to them – and so give the ombudsman service greater flexibility in the deployment of its staff.

In the corporate plan and budget for 2005/06, the ombudsman service reflected that "*… our current computer systems have coped well with the organisation's expansion and adaptation. But, like all systems, they have a limited life.*" It therefore announced that it had set up a team to plan for "next generation" information and telephony systems which could both support flexible casework-processes and communication channels, and be secure, resilient, scalable and easy to modify. The team would also review the effectiveness of the disaster recovery and business continuity plans for the existing business.

training

As the Financial Ombudsman Service's first plan and budget (for the financial year 2001/02) noted, the move to a unified organisation – with new systems and new ways of working – had created a huge challenge for all staff. To help them meet the challenges, the ombudsman service was investing heavily in training. In fact, in that year it expected to spend a total of 2,000 days, undertaking training covering technology, appraisal and performance management and other skills. It was anticipated that training would continue at a similar level in 2001/02, when it would have a particular focus on the new business-process for handling casework.

By the time of the publication of the plan and budget for 2002/03, it was reported that the ombudsman service now anticipated that, by the end of the financial year, it would have spent the equivalent of 2,500 days on training, considerably in excess of what had been

anticipated the previous year. The ombudsman service said it would continue to make training a high priority – with particular emphasis on developing the skills of managers, as well as the skills of adjudicators whose work involved dispute-resolution over the phone.

As a result of the new organisational structure which the ombudsman service had put in place in October 2002, the focus of training shifted – to provide more cross-training to adjudicators, so that they would be able to deal with a broader range of complaints. This training was expected to have a short-term adverse effect on productivity – but it was anticipated this would be compensated for by the longer term gains in productivity, which would be secured by having a more flexible organisation able to respond more effectively to the changing pattern of complaints.

forecasts and budgets

A thread running through the annual reviews and budget consultation papers, published by the Financial Ombudsman Service since 2001, is the difficulty of forecasting future complaints trends and volumes.

The plan and budget for the financial year 2001/02 stated that: *"It must be emphasised that forecasting cases is a difficult area, and research undertaken during the year indicates that there is no predictable pattern to the growth in complaints."* In the light of what was to happen in the following years in terms of volumes of complaints, this rather understated the case.

Yet if the ombudsman service's forecasts frequently turned out to be adrift of what actually happened, that cannot be put down to the ombudsman alone reading the future wrong. Each year, as part of its budget consultation process, the ombudsman service set out the assumptions it had made on future workloads – and publicly invited comments on whether or not those assumptions were realistic. It therefore appears that there was a collective and persistent failure on the part of all external stakeholders to offer any better insight on likely future complaints volumes.

For example, the plan and budget for 2001/02 reported that mortgage endowment complaints were growing sharply – and it was estimated that by the end of the year some 55% of the complaints against PIA-regulated firms would involve endowments. However, this view did not take account of the impact of the regulatory guidance published by the FSA in October 2000 on the volume of mortgage endowment complaints to the ombudsman service.

In the plan and budget for 2003/04 the ombudsman service sounded less apologetic about the fact that the forecast number of cases often turned out to be wide of the mark by the following year: *"The difficulties involved in predicting numbers and patterns when forecasting new complaints are universally accepted."*

As the ombudsman service pointed out: *"The number of complaints … is affected by many different factors, including consumer experience and behaviour, product performance, the conduct of firms and the way in which firms deal with complaints. Anecdotal evidence suggests that consumers in general are far more likely to voice their grievances than they were … however, we need to look for more concrete factors when we forecast the likely levels of complaints."*

Specifically in respect of mortgage endowment complaints, the plan and budget for 2003/04 said: *" It is certain there will be a significant increase in complaints … although exactly when it will reach us and how large it will be is less easy to predict. Insurance companies have been sending out re-projection letters to their … policyholders, and they will need to complete this before the summer of 2003. This is not likely to impact on the ombudsman service until some months after policyholders receive their letters. It seems very likely that these letters will reveal greater shortfalls than before, leading to more complaints. In addition, fears about the potential impact of a time bar may drive larger numbers of customers to complain to us – at an earlier stage – than might otherwise be the case."*

It is perhaps no surprise that, commenting on complaint trends, the ombudsman service's plan and budget for 2004/05 started with the familiar refrain: *"As we are acutely aware, predicting the numbers of new complaints is not an exact science. It can be affected by many different factors, including the firm's attitude to a certain type of complaint, the state of the economy and the stock market, and media coverage. Given the unexpected increase in complaints this year, we will particularly value feedback on our workload assumptions."*

The document went on to explain that in the past, the ombudsman service had attempted to validate its assumptions about the likely numbers of future complaints by consulting with the FSA, industry bodies, consumer groups and firms. The ombudsman service now planned to formalise this process, by recruiting a new member of staff, whose specific role would be to analyse external and internal data with the aim of increasing the accuracy of forecasting.

Looking just at the area of mortgage endowments, the plan and budget for 2004/05 said that it expected to receive complaints at a similar level as in the previous year – until the second half of 2004/05, when it expected to see a slow reduction in new cases. The ombudsman service anticipated that the reduction would be driven by new rules "waivers" given to some firms, and a return

to normal complaints-handling timescales for others; a reducing pool of mortgage endowment policyholders who had not yet complained; and the time limits that would start to bite, rendering potential complaints "out of time".

Anyone expecting that the plan and budget would contain the customary warning about the difficulty in estimating the future trend in the number of complaints would not have been disappointed. The document explained that the working assumption for 2005/06 was that total complaints would be 6% higher than in the previous year. This increase was anticipated to arise principally from mortgage endowments, as well as the extension of the ombudsman service's remit to cover mortgage and general insurance brokers.

Specifically on mortgage endowments, the ombudsman service warned that numbers would be affected by the recent requirement that the FSA had imposed on firms, to send out red "re-projection" letters that clearly spelt out the date after which any complaint the consumer might wish to make would be time barred. The ombudsman service did not know to what extent this might prompt consumers into making a complaint.

In the 2005/06 corporate plan and budget, the ombudsman described itself as a "demand led" service. As such, its workload could rise and fall rapidly – for many reasons, in ways which could be difficult to predict, and all outside the control of the ombudsman service itself. As the document commented: "*Managing our workload is not just a question of overall numbers. Surges in the number of cases about particular (and sometimes new) products also place demands on specialist expertise.*"

The plan mused in very general terms about specific factors affecting the number of complaints. In a section which must have had endowment complaints in mind, but did not specifically mention them, the document said: "*Campaigns directed at consumers by consumer bodies – or by those with a financial interest, such as claims intermediaries – may affect complaint numbers. And press coverage of a financial 'scandal' appears to increase consumers' propensity to complain, too, about other – unrelated- financial products.*"

On this occasion, the ombudsman service did feel that it could give itself a slight pat on the back in relation to its forecasts – saying that despite the uncertainties, "*… our forecasts have been remarkably accurate*". However, it added that it would continue to improve the model it used to estimate the nature and extent of incoming work.

Looking forward, the corporate plan for 2005/06 said that for the next financial year, 2006/07, it had been assumed that the number of complaints about mortgage endowments would reduce slightly – mainly because of an increase in the proportion of cases that

were time barred. This could, however, be offset to some extent by the possibility of a last minute rush of complaints from those consumers who were about to be time barred and had only just been alerted to that fact.

In other areas, too, there could be a "swings and roundabouts" affect. The document commented that: "*Following regulatory action by the FSA, we have seen a reduction in the number of mortgage endowment cases brought to us involving larger firms. However, an increase in the number of cases involving smaller firms has resulted in the overall number of … cases reaching us remaining largely the same. This has an effect on productivity, as there can be economies of scale in dealing with batches of complaints from larger firms.*"

Overall, however, the corporate plan for 2005/06 seemed cautiously optimistic that the corner might have been turned. It reported that: "*Currently, the number of cases … that we resolve and close in a week matches the number of cases we receive. On the basis of our current assumptions about new … cases in 2006/07 we expect during the year to resolve and close more cases than we receive. This should lead to a steady reduction of work-in-progress.*"

The corporate plan for 2005/06 also reported that the total number of staff had risen from 350 – when the Financial Ombudsman Service was first established in 2000 – to about 1,000 in 2005/06, making the scheme the biggest of its kind in the world.

It is not surprising that the problems in forecasting the likely future workload of the Financial Ombudsman Service with any degree of accuracy also created a problem for setting a budget. But here one factor worked in favour of the ombudsman service – so that it did not face the financial strain faced by many other organisations undergoing rapid and substantial expansion. This factor was its funding basis.

The Financial Ombudsman Service is funded by a combination of a general levy on the entire financial services industry, coupled with case fees which it charges to the individual firms concerned when it receives a complaint from one of that firm's customers. This flexible funding approach meant that as the volume of new cases increased, the ombudsman service was at all times in a position to fund the cost of dealing with those additional cases.

It is clear, however, that the ombudsman service did not abuse this ability to raise finance by case fees. As explained earlier in this report, the ombudsman service could have treated as chargeable "complaints" the numerous enquiries it received from consumers, asking for advice on the offers they had been made by firms as redress for endowment mis-selling. In fact, these enquiries were dealt with – and a considerable proportion resolved – by the

ombudsman service's front-line customer contact division. This avoided them becoming chargeable cases.

The ombudsman service has also taken the decision to allow each firm a small number of "free" complaints each year. This operates very much to the advantage of smaller firms, whose scale of business is such that they receive fewer complaints.

reflections

It is worth repeating that some very simple questions underpin the whole mortgage endowment issue:

- was the consumer made aware that a mortgage endowment carried the risk that it might not generate enough money to repay the mortgage loan?
- if the consumer was given advice, was an attempt made to establish whether or not the consumer was prepared to take a risk that the mortgage loan might not be repaid in full from the endowment proceeds?
- if the consumer was aware that there was a risk, and was prepared to take some risk, what was the extent of the consumer's risk appetite?
- if there was a mis-sale, was there a financial loss to the consumer?

In the announcements it made in 1999 and 2000, the FSA pointed to the fact that many consumers had done well from their endowments. The ABI similarly made this point in its evidence to the Treasury Select Committee. In many cases, this will have been in spite of the actions of financial services firms. The favourable results which some consumers obtained from their endowments were a piece of serendipity, resulting from favourable economic circumstances. They masked any failures by advisers to properly assess the risk appetite of their customers – or indeed to inform customers that there was a risk.

One of the myths which some in the industry like to foster is that retrospective standards have been applied in considering complaints about mortgage endowment mis-selling. As has been discussed earlier in this report, prior to 1988 those who gave advice were always under some common law obligations to use due skill and care – though some industry players appear at the time to have been ignorant of the fact.

It was as early as 1985 that the new regulatory bodies started to spell out in detail the standards of advice which would be expected of firms when the Financial Services Act came into force. The rules on "fact finding ", "suitability" and record keeping were in the rule books of FIMBRA, and the other regulators, from "day one". Firms had until 1988 – when regulation began – to try and put their house in order. Many did not do so.

The main failing was that many firms simply did not explore with customers whether they wanted the certainty of their mortgage being repaid – or whether they were prepared to take some risk, in the hope that they would not only be able to repay the mortgage loan but would also be in line for a bonus on top.

An indication of how slowly many in the financial services industry adjusted their selling standards can be seen by comparing statistics on the proportion of complaints upheld and rejected by the ombudsman service. This shows that complaints brought to the ombudsman service involving sales made *before* the Financial Services Act 1986 came into effect were rejected in 41.4% of cases. After the implementation of the Financial Services Act in 1988 – and until the formation of the PIA – the rejection rate barely improved, rising slightly to 44.9%.

It was not until the PIA was in operation that there was a significant increase in the number of complaints which the ombudsman service found in favour of firms rather than the consumer – with 61.3% of complaints relating to sales *after* 1994 being rejected. Speculating on the reasons for the change, these might include the introduction by the PIA of training and competence arrangements for advisers, individual contracts, the "suitability letter" and "key features" – which were required to contain a clear warning of risks.

The mortgage endowment exercise has clearly had a major impact on the scale and nature of the Financial Ombudsman Service. It was set up to take over the responsibilities of a number of existing complaints-handling bodies. The intention was that it would acquire new areas of responsibility over time – so it was always going to be a very much larger organisation than its predecessors.

If mortgage endowments had not happened, however, the Financial Ombudsman Service might have been different in a number of respects. First and foremost, it would probably have retained the character originally conceived for it – of an organisation which gave consideration to the merits of an individual case, referred to it after the firm complained of had itself given due consideration to the complaint from its customer and had failed to reach agreement with that customer.

Instead, the ombudsman service has – so far as mortgage endowment complaints are concerned – become something of a "factory" for the processing of large volumes of disputes with similar characteristics, many of which have been dealt with through a "bulk" process with some of the larger financial firms, rather than by a detailed consideration of each and every case.

In addition, the ombudsman service has clearly been used by some firms as an easier and cheaper complaints-handling alternative to handling complaints from their customers properly themselves. This attitude might have been driven by one or more factors: the time pressure to deal with complaints within the eight week time-limit set by the FSA rules; taking a chance that the majority of customers would "go away" if their complaint was turned down, and would not take the trouble to pursue the complaint further through the ombudsman service; and calculating that it would be cheaper to pay the occasional ombudsman case fee, and possibly redress, than incur the costs of a thorough investigation – whether in-house or by using an out-sourcing agency – of each and every case reaching the firm. From 1 November 2007 the FSA toughened its guidance to the industry, to the effect that it expected firms to have substantially addressed almost all complaints within eight weeks – and it would assess a firm not just against its speed of complaints handling but also its quality.

It is possible that, in the absence of the mortgage endowment problem, the Financial Ombudsman Service would have experienced a happier relationship with some sections of the financial services industry. With the large number of complaints reaching the ombudsman service, and the fact that the ombudsman found it necessary to uphold the complaints in a large proportion of cases (a greater proportion than for non-endowment complaints), it was inevitable that relations with some firms would become strained. This strain has manifested itself most clearly in respect of the suggestions from some in the industry that the ombudsman service has applied standards retrospectively and that it has lacked consistency in dealing with like cases.

For smaller firms, the mortgage endowment issue has characterised itself as the case fees argument. Once the ombudsman service has decided that there is sufficient information to proceed with a case, it levies a fee on the firm concerned – regardless of the outcome on the case. Those firms which have had a number of complaints against them taken to the ombudsman service – and have "won" those cases – have naturally been upset that they have had to pay a fee in respect of the cases.

The ombudsman service has sought to address this point by giving firms a number of "free" cases each year – before charging case fees. What the endowment issue has forced the ombudsman

service to do is expend a large amount of effort in listening to the concerns of firms and their representative bodies, trying to explain the approach of the ombudsman to various issues.

This pro-active approach to stakeholder management means that the relations of the ombudsman service with the industry are probably better than they might otherwise have been, given the strain which the whole endowment issue has put on the relationship.

It is probably too early to say whether or not the mortgage endowment issue has caused any damage to consumer confidence in the ombudsman service. The customer satisfaction surveys which the ombudsman service carries out show that, in general, ombudsman has been successful in maintaining high levels of satisfaction with the service – despite the fact that there has been delay, often long delay, in dealing with some mortgage endowment cases. The impact of those delays appears to have been successfully managed by the ombudsman – through keeping consumers regularly informed of the progress of their complaints.

However, the Financial Ombudsman Service is now entering new territory. Increasingly, consumers are going to find that mortgage endowment complaints are time-barred – so that even if there is merit in the consumer's complaint, the ombudsman will have no option but to tell the consumer that their complaint cannot be considered. Time-barring could have the potential for the image of the ombudsman service to be damaged through no fault of its own. Legal challenges to time-barring could mean that the ombudsman services finds itself cast as the "villain" in the application of time bars. In fact, the ombudsman has no choice but to apply the rules on time bars which have been set for it by the FSA – although it has some discretion over time limits in "exceptional circumstances".

In the absence of the mortgage endowment issue, the Financial Ombudsman Service would almost certainly have been a smaller organisation – and one which would not have faced the potential for such strained relations with its two main stakeholders, consumers and firms. In all probability, the effective strategic oversight of the ombudsman service by its board, coupled with the strong executive team, would have ensured that even in the absence of endowments, the ombudsman service would have been as efficient and as cost-effective as it is today.

But a crisis can sometimes bring out the best not just in individuals, but in organisations too. So one might speculate that the crisis of mortgage endowments has, in fact, resulted in an organisational response to the challenge – above and beyond what might have been expected if endowments had not happened.

Consumers generally should have much to be grateful for that the Financial Ombudsman Service exists. The rules of the FSA provide for firms to investigate complaints from their customers in the first instance – but as we have seen, in some cases the way in which firms have treated their customers have been in clear breach of the rules. If the ombudsman service had not existed, the only avenue which would have been open to consumers who refused to accept a rejection from a firm would have been to take their case to the small claims court.

It is likely that few consumers would wish to find themselves in court, even in the role of the injured party. Courts are generally regarded as adversarial and formal – and preparing for a case would involve the consumer in some cost in time and money. They are also likely to involve delay.

In a speech in January 2007, the chief ombudsman drew some comparisons between the two systems: "*it is worth recording that in 2005, judges in English and Welsh county courts heard around 70,000 disputed civil claims. The average time between the issue of proceedings and hearing was a year. There are no statistics on how much these disputes cost to resolve. The extent to which the decisions reached in county courts are consistent remains to be researched. In the same period, the ombudsman service resolved 105,000 disputed claims about financial services brought by English and Welsh consumers (together with a further 14,000 for Scottish consumers). Most of these were resolved in under six months. The service to consumers is free, and the average cost of resolving those disputes was under £500 per case.*"

A charge which some in the industry make against the ombudsman service is that it lacks "consistency" in its decisions. It is an allegation which is easy to make – but more difficult for the ombudsman service to refute.

It might first be helpful to draw a parallel between the small claims procedure of the courts and the ombudsman service. Recently an issue has arisen in relation to the charges made by banks in relation to unauthorised overdrafts. A substantial number of consumers chose to take action against their bank in their local small claims court. The outcomes of some of these court cases appear to have been significantly different. It has now been necessary for a test case to be taken to the High Court, to bring some order and consistency to decisions taken in the lower courts.

There is no routine and rigorous mechanism for checking the consistency of decisions being taken in the small claims courts. In contrast, in the very first annual report of the Financial Ombudsman Service, it was made clear that consistency was one of the key objectives which the ombudsman sought to meet. Since it started, the ombudsman service has had in place procedures to

quality-check casework, including the consistency of decisions, and it has sought to improve on those procedures over time. The casework systems that adjudicators use also support consistency of approach.

Following an audit of cases handled by the ombudsman service, the Personal Finance Research Centre concluded as part of its review of the ombudsman: *" We found no evidence to suggest that lack of consistency was a significant problem within the organisation. Put another way, like cases are dealt with in like fashion."*

The ombudsman service has always made clear to firms – publicly and privately – that if they have specific concerns about, or examples of, inconsistency, then the ombudsman would be pleased to discuss them. It is difficult to see what else the ombudsman service can reasonably do. Firms might want to consider that, in the absence of the Financial Ombudsman Service, consumers would be forced to use the small claims procedure of the courts – and firms would then risk far more uncertain outcomes on similar cases.

There are three final observations I would like to make.

The first is whether section 404 of the Financial Services and Markets Act is really necessary or helpful. In the absence of such a provision, the FSA would have more flexibility to deal in the future with any new and systemic case of mis-selling. The FSA already has a number of disciplines imposed on it, such as cost benefit analysis and consultation, which would act as a constraint on it, in launching any industry-wide review. The FSA would also be subject to judicial review (as happened in the case of the PIA with the Pensions Review).

Given the existence of section 404, it seems more likely than not that the FSA will deal with any future mis-selling episode by taking the same approach it has taken for mortgage endowments – and that is likely to mean delay for consumers, and a "lottery" as to which consumers receive compensation (as some consumers will not complain at all, and others who do, may not press their case to the ombudsman if the firm turns them down).

The second issue is the interface when cases involve both the Financial Ombudsman Service and the Financial Services Compensation Scheme (FSCS). There is considerable and constructive liaison between the two organisations – but the fact remains that these bodies operate according to different rules made by the FSA and different provisions in the Financial Services and Markets Act. It must be frustrating for the consumer who has already done his or her share of form filling – to provide the ombudsman service with the information it needs – to then find

that different forms need to be completed, driven by the rules and legislation, to meet the needs of the FSCS.

A more "joined-up" approach in this area is now being adopted – with the aim that the FSCS will be able to accept some information already provided to the ombudsman service. If in future there are likely to be products or services which are going to generate a substantial number of complaints and claims to both bodies, the ombudsman service and the FSCS might establish between them what information will be needed – and design a common form to obtain it.

The third issue is also about form filling. Clearly the ombudsman service has to obtain the information it needs from people with complaints. It helps where it can in this regard, by completing as much of its standard complaint form as possible over the phone with consumers. But the ombudsman service is neutral between consumers and firms – and there are limits to the help it can give. Many consumers have difficulty with "official forms", however user-friendly their design and language. This is bound to militate against more vulnerable consumers, who may be deterred from making a complaint in the first place, or unable to present their case properly.

Currently the Treasury is awaiting a report on the prospects for a national "generic financial advice service". One role for this might be to help consumers with the "form filling" when they are concerned about a financial product they have been sold – and want to make a complaint. It is possible that had such a free and impartial "helping hand" been available for consumers with endowment complaints, there would have been less business opportunity for the commercial claims-management companies, taking up to 25% of a consumer's compensation.

Another step which might be considered – should there be any exercise on a similar scale to mortgage endowments in future – is whether the FSA should direct that a standard complaint form be used both by firms and the ombudsman service. If consumers then had to turn to any advice agency for help in completing the form, the agency concerned would not have to deal with a proliferation of different forms.

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