

annual review

and report &
financial statements

1 April 2001 to 31 March 2002



**Financial
Ombudsman
Service**

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The photos in this annual review were taken during the year by staff at the Financial Ombudsman Service, to record different aspects of their work in resolving complaints.





chairman's statement

This is the third year in which I have reported in my capacity as chairman of the Financial Ombudsman Service, but it is the first in which I can do so as chairman of a fully empowered statutory scheme.

I first pay tribute to the forbearance and patience of the schemes from which we took over. The period of transition lasted longer than they or we had expected. We are grateful for the co-operation they showed.

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. From now on, we must expect this to happen from time to time. As consumers and the industry get used to a comprehensive statutory ombudsman, linked to a powerful regulator, issues of interest and concern will thrust us into the spotlight. The role of the board in these circumstances is to ensure that nerves remain steady, and that, above all, the independence of the ombudsmen's decision-making is recognised and secured.

The cases which attracted the most attention were only a small part of our work during the year. Most of our complaints involved routine and unremarkable disputes across the wide spectrum of financial products and services – important to the parties involved, but of little significance to the rest of the world.

At the conclusion of the year under report, seven members of the board completed their term of appointment: Michael Barnes, Ruth Evans, Maggie Lee, Oonagh MacDonald, Sylvie Pierce, John Rawlings and Charles Wilson. They served during the crucial setting-up phase of the new service and contributed greatly to its formation. I am grateful to them.

Andreas Whittam Smith

13 June 2002



chief ombudsman's report

At the beginning of the year we set ourselves the ambitious target of coping with a predicted increase of up to 40% in the number of complaints we resolved – with only a 20% increase in budget. I am pleased to report that we met this target, reducing our unit cost by 9%, while increasing the speed with which we dealt with complaints.

This is a particularly significant achievement, given that this was the year that 'N2' finally arrived – involving the introduction of a new case-handling system and the implementation of the new framework of rules under the Financial Services and Markets Act.

value for money

Following our consultation in the early months of 2001, the Financial Services Authority (FSA) approved our budget of £27.6 million for the year ended 31 March 2002. This budget was based on the assumption that:

- new cases would rise 20% – from 31,700 to 38,000;
- we would resolve and close 38,500 cases (up from 28,000);
- our total headcount (the number of employees) would increase to 470;
- we would introduce a new computerised case-handling system;
- our unit cost – the benchmark against which we judge our cost-effectiveness – would fall to £688;
- we would close 70% of cases within six months and 95% of cases within twelve months.



By 31 March 2002, the number of new cases had risen not by 20% but by 38% – to 43,330. Despite this larger than expected increase, we met the targets set out in our budget and resolved and closed 2% *more* cases than the target we had set ourselves. This meant we achieved a unit cost of £684 – better than our target figure of £688.

This increase in productivity is all the more pleasing because it took place while we were still adjusting to our new business process and case-handling system and coping with a rapidly rising number of complaints about mortgage endowments.

The chapter, *key facts and figures*, on page 13 of this review, gives more details of our productivity and our costs and income.

quality initiatives

timeliness

In last year's annual review we said we planned to raise the proportion of cases we close within six months to 70% and the proportion we settle within a year to 95%. We succeeded in meeting these targets, closing 73% of cases within six months and 96% within twelve months. We have now set new targets, aiming to close 45% of cases within three months and 75% within six months. All cases which have not been resolved within twelve months will be reported to our board.

These new timeliness targets reflect an approach that builds on the use of mediation and conciliation developed by the former Banking Ombudsman scheme. Our aim – wherever possible – is to resolve complaints at the earliest stages through informal, mutual settlements. This can reduce the need for lengthy and time-consuming investigations and formal ombudsman decisions. More information about the number of complaints we resolve at each stage of our complaints-handling process can be found in the chapter, *key facts and figures*, on page 13 of this review.

During the year we were able to resolve 41% of cases within the first three months. These were mostly disputes where we could bring the two sides together by mediation or conciliation – taking a fresh look at the facts and suggesting common ground. ...➔



← Resolving disputes can take much longer if either the consumer or the firm requests a full detailed investigation, leading to the formality of an ombudsman's decision – especially if the dispute involves particularly entrenched attitudes and complex facts. Factors such as the need to examine a large volume of paperwork (one particular complaint we handled recently involved five crates of files) or to seek expert third party opinion (for example, in medical insurance disputes) can also greatly lengthen the process. But our investigations need to be rigorous to stand up to close scrutiny, including by the courts.

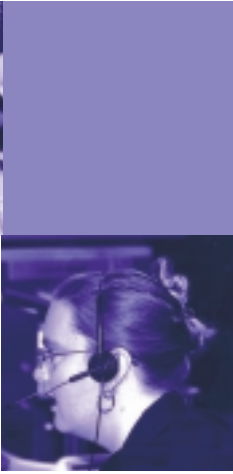
Taking into account disputes where a full investigation was needed, the average time taken during the year to resolve and close a case was just over five months.

accessibility

The ombudsman service is here for everyone, not just for the articulate, letter-writing classes. We are also mindful that, increasingly, many people do not have the time to write formal letters to express their grievances. This is why we are developing ways to make it easier for people to complain by phone and by using our website.

Consumers need to fill in our complaint form – this is the way we can find out exactly what the problem is and how the consumer wants matters put right. But we are happy to help consumers by talking them through the form over the phone. We then fill in as much of the form as possible for them, and send it to them to check and sign. People who find completing forms difficult often prefer this approach. It is also more efficient for us, because we can encourage people to stick to the key facts. And we find that people are increasingly using the web version of our complaint form – if only because many of us now prefer to type, albeit with two fingers, than to fill in forms by hand!

Our aim is to ensure that no one is discouraged from using the ombudsman service because of language barriers or other difficulties. We provide information in alternative formats such as Braille, large print and audiotape, and we use TextType.



We also now deal more frequently with calls in languages other than English, using a phone-based interpreting service. During the year we have handled calls using this service in a wide range of languages, including Welsh, Spanish and Urdu. We publish our consumer material in the ten most commonly-spoken minority languages in the UK and can handle complaints in other languages on request (this year we have received paperwork in languages ranging from Albanian to Thai).

user surveys and quality assurance project

We aim to continually improve the quality and consistency of the service we provide. We plan shortly to introduce a series of internal benchmarks that will enable us to measure and report on the quality of our service. Timeliness is an important measure of our service, but our proposed quality benchmarks will also include the accuracy and consistency of our decision-making in individual cases.

We are also starting to monitor the extent to which people who bring their complaints to us are satisfied with our service. In June 2002 we will be sending out our first consumer satisfaction questionnaire. Later in the year we will extend this survey to capture the views of firms who deal with us.

We have carried out some demographic research to find out the types of people who use our service. Some early results are shown in the chapter, *key facts and figures*, on page 13 of this review.

dealing with complaints about us – and the role of the Independent Assessor

During the year we consolidated and revised the different procedures that the separate schemes used for handling complaints about themselves. We subsequently established a new procedure, set out in the leaflet *our service standards: what to expect from us when we deal with your complaint against a financial firm*.

This procedure is available both to firms and consumers. It involves a review of *how* we have handled a complaint against a financial firm – rather than being a way of challenging a decision we have made in relation to a complaint. The procedure can involve a final review by our →



◀ Independent Assessor. The board of the Financial Ombudsman Service appointed Sir Edward Osmotherly CB (the former Local Government Ombudsman and former chairman of the British and Irish Ombudsman Association) as our Independent Assessor in the autumn of 2001. His role is to consider complaints about the *way* that we handle cases.

Under his terms of reference, the Independent Assessor can consider complaints about the investigative process and the behaviour of staff – but disagreements with the *merits* of decisions are expressly excluded from his jurisdiction. The Independent Assessor is authorised to make findings and recommendations for redress where he believes it is justified.

Between the date of his appointment and 31 March 2002, the Independent Assessor received 50 complaints. As at 31 March 2002, he had upheld 12 of these complaints in whole or in part; rejected 14; and found 8 to be outside his jurisdiction. Sixteen complaints were awaiting a decision as at 31 March 2002. The ombudsmen accepted the Independent Assessor's recommendations in all cases.

In his report to the board on his findings, the Independent Assessor said that delay or insufficient explanations were the two most frequent reasons for his upholding complaints in whole or part. In five cases, he recommended compensation ranging from £50 to £600.

The Independent Assessor has reported to the board that it was not possible for him to draw any general conclusions from the complaints he decided. He pointed out that the number of complaints was minute in comparison to the total number of cases that the Financial Ombudsman Service had dealt with. However, he gave an unqualified assurance that the cases he investigated contained no evidence of any bias on the part of the ombudsman service, either in favour of consumers or against them.

Regrettably, Sir Edward Osmotherly retired as Independent Assessor in April 2002 for health reasons. The board and I would like to thank him for his work in casting an independent eye over our complaints-handling procedures and thereby helping us to raise our standards. Michael Barnes CBE (a former board member of the Financial Ombudsman Service and former Legal Services Ombudsman) is carrying out the work of Independent Assessor on an interim basis until we have appointed a replacement.



cases with wider implications

Decisions we made in two areas during the year attracted considerable attention. The decisions – relating to TESSA savings accounts and to what became known as ‘dual’ variable rate mortgages – coincided with the introduction of the new ombudsman service. Some commentators inferred from this that we were on the look-out for high profile cases. In fact, these decisions were made under transitional rules relating back to the previous ombudsman schemes.

There is more information about these complaints – and our decisions – in the chapter, *overview of complaints trends*, on page 21 of this review.

Our decisions in these cases aroused some concern from trade associations representing banks, building societies and mortgage lenders. Although some building societies claimed to be concerned about our processes rather than our decisions, the fact that these concerns had not been expressed when we consulted on our processes suggested different worries.

Concern was expressed about the fact that, by comparison with the FSA, we are not formally required to consult. Some claimed that our structure does not make us as accountable as the FSA, and that while FSA’s disciplinary process provides the opportunity to appeal, there is no such possibility with an ombudsman decision. Some banks and building societies also suggested that in publishing our approach to common complaints we had become a quasi-regulator.

It is, of course, inevitable that our decisions can have an impact – in the sense that firms may feel the need to adjust their practice, and consumers may feel encouraged either to complain or to act more cautiously in the future. But this does not make us a regulator any more than the courts are regulators. We are quasi-judicial rather than quasi-regulatory. Adjudicatory bodies such as ourselves cannot easily be required to consult about decisions.

Accountability is a slippery concept – sometimes people use the word to mean that the body from which accountability is demanded should be capable of being influenced and controlled. But the most important feature of the ombudsman is *independence* – that is, freedom from control or →



◀ influence by those who are, or may be, parties to disputes. We *should* of course be accountable for the money we spend. And we *should* record and be open about what we do, so that people can examine and criticise us.

Adding an appeal stage would slow up the process of resolving disputes. And many would see the addition of an appeal as undermining the nature of an ombudsman scheme as a speedy and informal complaints mechanism.

The decisions we made in relation to complaints involving ‘dual’ variable rate mortgages attracted both considerable attention in the media and a formal demand, collectively from the mortgage lenders, for the FSA to intervene.

Individual lenders reacted in different ways to our decisions. That is their right. We make decisions in *individual* cases. How, or whether, our decisions are applied more widely is not a matter for us. One lender decided to apply to all similarly-placed customers the principles it saw in the individual case. Others decided not to do so. Inevitably these different approaches attracted media comment.

The FSA’s complaints-handling rules require firms to take reasonable steps to ensure that they handle complaints fairly, consistently and promptly; and to identify and remedy any recurring or systemic problems. This may mean applying a number of value judgements. Firms may be faced with difficult business decisions as to how they should approach the task of complying with this rule and dealing fairly with different classes of customers.

The media attention that our decisions attracted in relation to ‘dual’ variable rate mortgages also highlighted another feature of the way our service works. We are a *private* dispute resolution service and we do not comment on individual cases or – without specific consent – identify the parties involved. But either party is free to publicise their dealings with us if they choose to do so.



An ombudsman should not expect or court popularity with those who are the subject of decisions. But the industry is entitled to understand clearly the parameters within which our service operates. As soon as it became evident that there was substantial disquiet in banking and building society circles, I convened a series of meetings with trade bodies and representatives of the FSA. I see a continuing dialogue with all parties as important to continuing confidence in our service.

communication and information-sharing

During the year we continued our work to promote a better public understanding of the ombudsman service – and a better understanding of how complaints arise and might be avoided. We believe there are lessons to be learned by both the financial services industry and consumers, and we carry out a range of activities to share our experience and knowledge with the outside world. These activities range from organising roadshows and workshops to publishing *ombudsman news* and running our technical advice desk.

There are more details about our external liaison and communications activities in the chapter, *key facts and figures*, on page 13 of this review.

rule changes

During the year we consulted on some proposed changes to our *voluntary* jurisdiction. These changes subsequently came into effect in March 2002. They allow certain banks and general insurance companies that are based outside the UK, but within the European Economic Area, to join the ombudsman's voluntary jurisdiction – giving their UK-based customers access to the Financial Ombudsman Service. The firms involved include a number of general insurance subsidiaries of major UK firms which sell travel and loan protection policies into the UK from bases in Ireland. Several of these companies were formerly covered by the Insurance Ombudsman Bureau, and this jurisdictional change allowed coverage to continue under the new single Financial Ombudsman Service. →



extending our jurisdiction

In December 2001, HM Treasury announced that the FSA would be given responsibility in 2004 for regulating mortgage sales and administration, as well as for general insurance sales and claims. This will have the effect of bringing these areas within our *compulsory* jurisdiction. We welcome this decision. It allows us to take a significant step towards covering *everything* generally regarded as 'financial'.

But in advance of 2004, we see value for consumers and firms in our opening our *voluntary* jurisdiction, both in these areas and in some others – notably the personal loan/credit card field (known as consumer credit). In the consultation we launched in May 2002 we hope to canvass a wide spectrum of opinion from firms, trade associations, consumer organisations and self-regulatory bodies. The responses will allow us to plan for a service that will meet the needs of a wider set of firms and consumers in the coming years.

A handwritten signature in black ink, which appears to read "Walter Merricks".

Walter Merricks

13 June 2002

key facts and figures



dealing with complaints at the early stages

The Financial Ombudsman Service handles consumers' complaints that financial firms have not been able to resolve themselves. Our general message to consumers

Where consumers contact the ombudsman service *before* raising their complaint directly with the firm, our customer contact division forwards the complaint to the firm and asks it to investigate the matter under its formal complaints procedure. We remind consumers that, if the firm is unable to resolve their complaint within eight weeks, then they can ask us to get involved directly.

initial enquiries from consumers	year ended 31 March 2002	year ended 31 March 2001	year ended 31 March 2000*
phone enquiries	242,168	259,848	175,000
written enquiries	146,071	154,874	130,094
total	388,239	414,722	305,094
complaints referred on to our case-handling teams	43,330	31,347	25,000

* Complaints prior to April 2000 were handled by the separate complaints-handling schemes, before they came together as the single ombudsman service. The former separate schemes used different methods of recording statistics, so these figures are necessarily estimated.

is that they should always take their complaint to the firm first – this resolves many complaints without any need for our direct involvement.

The message appears to be getting across. The number of initial enquiries we have received from consumers has fallen slightly this year as – increasingly – consumers are giving firms the chance to put things right before approaching the ombudsman. In the past, a significant number of enquiries went to the ‘wrong’ complaints-handling scheme – as consumers phoned or wrote around, trying to find where they should go with their dispute. This problem has been eliminated now that we are a single ombudsman service, covering complaints previously dealt with by eight separate schemes.

An increasing number of consumers are also seeking the information they want directly from our website, rather than phoning or writing to us. We are now getting over 25,000 online visits a month.

Our customer contact division provides a ‘single point of entry’ for all consumer enquiries – referring new complaints to firms where appropriate and giving general advice and guidance. It also gets involved at the initial stages of the ombudsman process, actively looking for opportunities to resolve simpler complaints (for example, those which have arisen through misunderstandings or administrative errors – where matters can be put right quickly, sometimes with just a few phone calls).



For complaints where further dispute-resolution work is needed – through conciliation, or investigation and adjudication – our customer contact division acts as the gateway to our specialist case-handling teams. →

complaints referred on to our case-handling teams

In the year ended 31 March 2002, our customer contact division referred 43,330 new cases to our case-handling teams for more detailed dispute-resolution work – a 38% increase on the previous year (and 14% more cases than we had estimated in our budget).

new cases by subject matter	year ended 31 March 2002	year ended 31 March 2001
endowment policies linked to mortgages	14,595	9,067
personal pension plans	5,881	3,363
mortgage loans (including 575 complaints about 'dual' variable rate mortgages)	3,876	2,499
whole-of-life policies/non mortgage-linked endowments	3,647	2,545
other 'packaged' investment products (including 1,044 complaints about PEPs; 362 complaints about single premium investment bonds; 337 complaints about unit trusts; and 329 complaints about non-cash ISAs)	2,858	2,111
motor insurance	1,609	1,989
current accounts	1,280	793
savings and deposit accounts (including 58 complaints about cash ISAs)	1,230	1,679
buildings insurance	985	927
travel insurance	884	778
other banking services	803	518
contents insurance	780	868
stockbroking	620	843
other lending (unsecured loans <i>etc</i>)	556	442
loan protection insurance	513	711
permanent health insurance (PHI)	504	- *
portfolio and fund management	449	485
critical illness insurance	408	- *
other types of insurance (including 79 complaints about pet insurance and 48 complaints about caravan insurance)	396	377
credit cards	372	222
extended warranty insurance	335	366
private medical insurance	277	194
free-standing AVCs	198	169
legal expenses insurance	135	152
personal accident insurance	81	197
derivatives	58	52
	43,330	31,347

* separate figures for these categories of complaint were not shown in earlier annual reports published by the former ombudsman schemes.



← The chapter, *overview of complaints trends*, on page 21 of this review, gives more details and background information about the main types of new cases we received during the year.

Given the very wide-ranging nature of complaints we handle – from pet insurance to spread-betting – we have not included individual case studies in this annual review. The limited space in this document means we are unable to give a fair and representative overview of all aspects of our work.

However, we include case studies in our monthly publication, *ombudsman news*, which provides feedback on recent complaints trends, as well as commentary and briefing on our approach to different types of complaint. We hope that firms find *ombudsman news* a helpful source of reference – and that they will take its contents into account when considering how to handle complaints. To join the *ombudsman news* mailing list, please contact our communications team (*phone* 020 7964 0092).

outcome of cases

During the year we have put an increasing focus on using mediation and conciliation to resolve as many complaints as possible at the earlier stages. This can be quicker and more efficient than a formal investigation which can sometimes be quite a drawn-out process.

Where mediation is not appropriate, or does not resolve the matter satisfactorily, we usually begin a full investigation, carried out by one of our case-handlers. But even at this stage, conciliation may still be possible – especially if previously unknown facts emerge.

Otherwise, the case-handler involved will usually issue an adjudication, setting out our recommendations about whether the complaint should be upheld. In most cases, both sides accept these recommendations. But either side can instead ask for a review and final decision by an ombudsman. →

In order to present information in this annual review as consistently as possible across all types of complaint, certain statistics that were previously included only in some annual reports of the former complaints-handling schemes are no longer continued in this document. We have also had to estimate some figures relating to earlier years where the separate complaints-handling schemes used different methods of recording statistics, reflecting their individual powers and procedures. However, this data can be made available on request for research purposes.



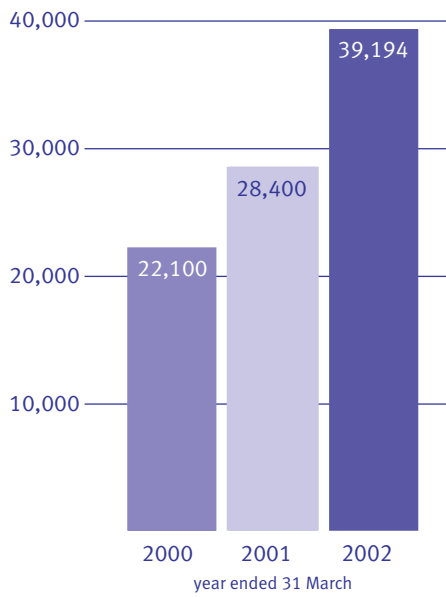
outcome of cases	year ended 31 March 2002	year ended 31 March 2001*
resolved by mediation or conciliation	45%	40%
resolved after investigation by a case-handler	40% <i>of which</i> ■ 10% mixed outcome (partial win/lose for both sides) ■ 23% in favour of the consumer ■ 67% in favour of the firm	40%
resolved by the final decision of an ombudsman	15% <i>of which</i> ■ 15% mixed outcome (partial win/lose for both sides) ■ 29% in favour of the consumer ■ 56% in favour of the firm	20%

* Complaints for the year ended 31 March 2001 were resolved using the rules of the former complaints-handling schemes – before the new ombudsman rules came into force under the Financial Services and Markets Act 2000. The former schemes had different powers and procedures – as well as separate methods for recording the outcome of complaints. For these reasons, we have been unable to produce a single set of figures that is statistically comparable to the figures we now record to show the outcome of cases.

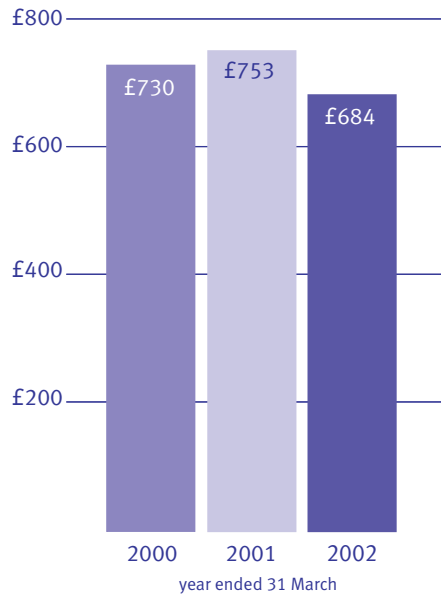


our budget and productivity

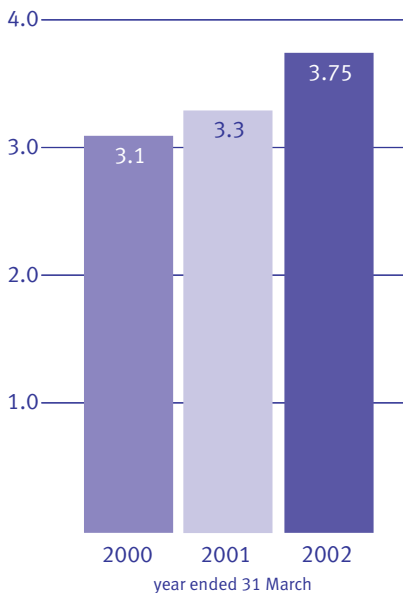
number of cases resolved and closed



our unit cost*



average number of cases resolved per week by each case-handler



* Our unit cost is calculated by dividing our total costs (before financing charges) by the number of cases we close. Total costs include the budgeted figure for depreciation, so as to remove any distortion arising from our depreciation policy.



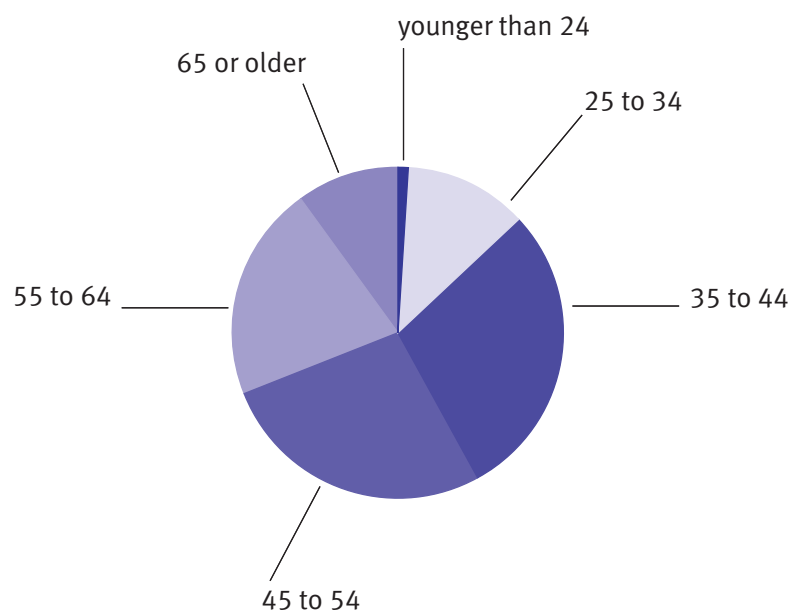
our total costs	actual year ended 31 March 2002 £ million	budget year ended 31 March 2002 £ million	actual year ended 31 March 2001 £ million
staff and staff-related costs	18.6	19.5	15.5
other costs	6.1	4.9	4.4
interest	0.7	1.1	0.6
depreciation	1.8	2.1	0.1
total costs	27.2	27.6	20.6

Our total costs for the year ended 31 March 2002 were £27.2 million, compared with a budget of £27.6 million. Our income for the year ended 31 March 2002 of £27.5 million was close to the budget. The surplus for the year of £0.3 million was transferred to reserves. The detailed financial statements are set out on pages 30 to 51 of this review.

who brings complaints to the ombudsman?

The 'average' customer of the ombudsman service is between 35 and 54 years old. This is perhaps not surprising, given that demographically this age group is likely to have wider levels of ownership of financial and investment products.

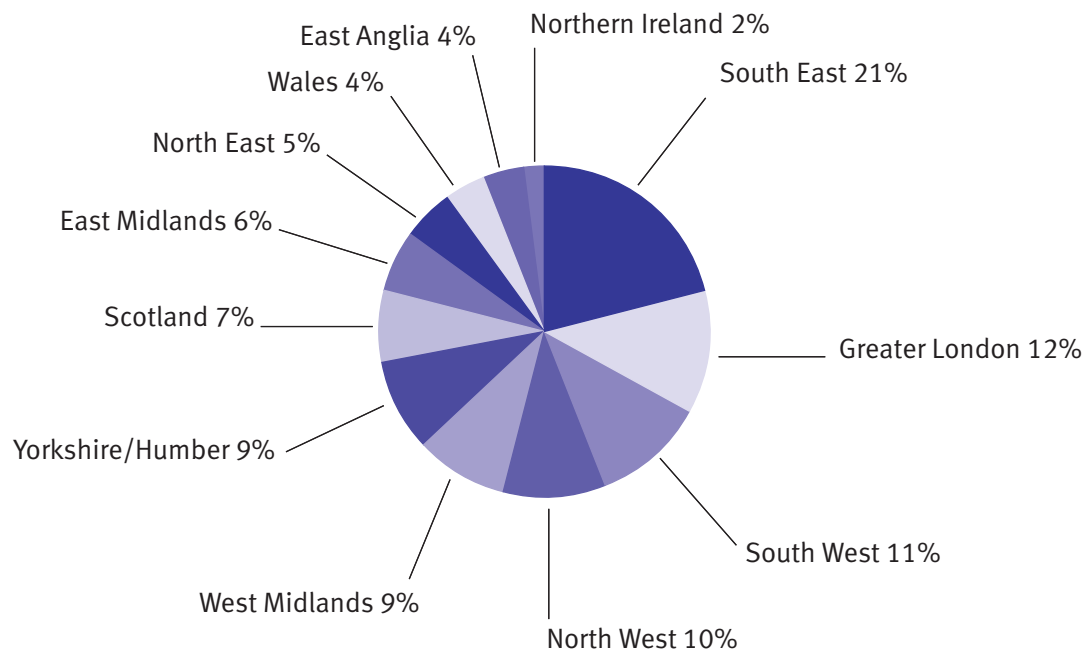
We are carrying out further research to see how ownership of financial products across the UK population as a whole compares with the patterns we see, in relation to people who bring complaints to the ombudsman service.



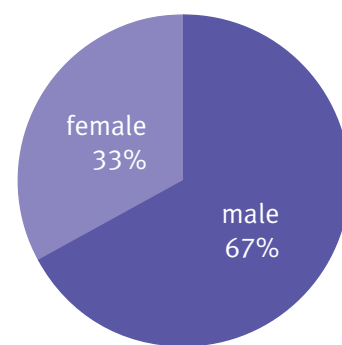
how old are people who complain to the ombudsman?



where do people who complain to the ombudsman live?



The geographical location of the people who use our service broadly reflects the overall population spread across the UK as a whole. Our research shows a variance of more than one or two percentage points in three regions only. People from East Anglia comprise 9% of the population but 4% of our customers. Conversely, people from the South West comprise 8% of the population but 11% of our customers. 21% of people who used our service came from the South East (home to 14% of the UK population). This appears to reflect the fact that there are proportionately higher levels of ownership of financial and investment products in the South East.



what gender are people who complain to the ombudsman?

A significant proportion of complaints we receive relate to policies and accounts held jointly. With joint accounts, the first-named is frequently male – and it is the first name that our system records. This may result in some bias in the data we record about the gender of people who complain to us.

getting our message across	year ending 31 March 2002
<p>our technical advice desk</p> <p><i>(general guidance and advice on ombudsman practice and procedures – for professional complaints-handlers in firms and the consumer advice sector)</i></p>	<p>Our technical advice desk handled 16,271 technical enquiries (9,330 in the previous year), comprising:</p> <ul style="list-style-type: none"> ■ 9,735 enquiries from financial services practitioners (3,712 in the previous year) ■ 5,593 enquiries from consumer advisers (4,237 in the previous year) ■ 943 calls from trade associations, researchers, official bodies <i>etc</i> (1,381 in the previous year)
<p>roadshows</p>	<p>We took part in 8 roadshows across the UK.</p>
<p>exhibitions</p>	<p>We took our exhibition stand to 15 national consumer and trade shows.</p>
<p>speeches and presentations</p>	<p>We addressed 58 conferences, seminars <i>etc</i>.</p>
<p>workshops and visits to trading standards departments and citizens advice bureaux <i>etc</i></p>	<p>We visited 84 consumer advice organisations.</p>
<p>visits and training for firms</p>	<p>We visited 250 financial services providers – from credit unions to investment banks – to explain the role of the ombudsman service.</p>
<p>industry meetings and seminars</p>	<p>We took part in 110 liaison meetings for groups of financial services practitioners – covering issues ranging from our budget and funding to EU initiatives.</p>
<p>media enquiries</p>	<p>We received over 3,000 enquiries from newspapers, magazines and TV/radio stations.</p>
<p>website</p>	<p>Over 5,000 people a week visited www.financial-ombudsman.org.uk</p>
<p>publications</p>	<p>We printed and distributed 1,750,000 copies of our publications (including 12 editions of our monthly newsletter, <i>ombudsman news</i>, and 1.5 million copies of our leaflet, <i>your complaint and the ombudsman</i>).</p>

overview of complaint trends

mortgage endowment complaints

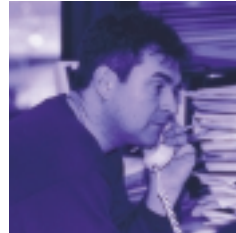
In the year ended 31 March 2002, we received 14,595 complaints about endowment policies linked to mortgages – an increase of 60% on the previous year. For a second year, these complaints accounted for around half of all the new investment-related complaints we received.

Around Spring 2002, it began to look as though the volume of mortgage endowment complaints had passed its peak, with new complaints falling to around a third of cases. However, at the time of writing this report we are now expecting an increase – in response to the second round of ‘re-projection’ letters that life insurance companies are sending to their customers.

For the year as a whole, around 40% of the mortgage endowment complaints we saw involved inappropriate action by firms. During the year, the FSA issued guidance on the calculation of redress (*Regulatory Update 89*) and we published on our website our mortgage endowment complaints *assessment guide*. This guide provided firms with a better understanding of our approach and procedures, enabling them to settle more cases in an appropriate way without our direct involvement. So we now expect to see a smaller proportion of cases coming to us where firms have acted inappropriately.

Our prime concern has been to ensure that, if a mortgage endowment policy is found to be unsuitable, the policyholder is able to switch to a capital repayment mortgage as soon as possible.

During the year, the courts considered the treatment of ‘windfall’ payments. This led to a ruling that these payments should be disregarded when calculating compensation. The FSA subsequently consulted on the correct treatment of policy enhancements – for example, additions to policies that arose as a result of a demutualisation. While this consultation has been continuing, →





← we have been able to ensure that policyholders receive – ‘upfront’ – at least the majority of any compensation due to them. This means they can arrange a repayment mortgage for the balance of their mortgage loan, with any additional compensation payable later this summer (2002) after final guidance is issued.

personal pension complaints

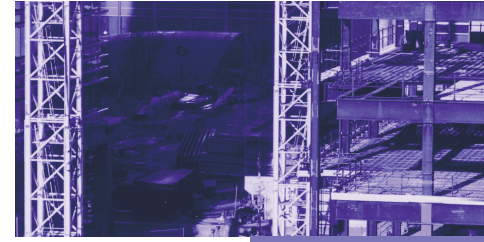
We received 5,881 complaints about personal pension plans, an increase of 75% on the previous year. This continues to be the second largest area of complaint and accounts for 14% of all complaints received by the ombudsman service.

Many of the complaints relate to cases covered by the FSA’s Pensions Review, which is due to be concluded by 30 June 2002. We are expecting a further increase in complaints in 2002/03, arising from cases at the end of the Review.

This year also saw the start of stakeholder pensions. We have agreed with the Pensions Ombudsman that, following a change to the subordinate legislation under the 1993 Pensions Act, pension complaints will be dealt with as follows:

- Where the complaint concerns the circumstances of the sale of the pension, we will handle the matter. But where it relates to the management or administration of the pension scheme, the *Pensions Ombudsman* will deal with the complaint.
- Where the *Pensions Ombudsman* is handling a complaint containing elements that we ought to handle, the complaint will be transferred to us.

This agreement applies equally to personal pension arrangements and small occupational schemes, where we receive a relatively small – though increasing – number of complaints about Executive Pension Plans and Self-Administered Pension Plans.



Equitable Life

We have received over 1,400 complaints about Equitable Life since the House of Lords' decision in December 2000 relating to Guaranteed Annuity Rate (GAR) policies. Most complaints have been from policyholders who believe they were not adequately informed of the consequences of Equitable Life losing the appeal to the House of Lords.

A compromise scheme – put forward by Equitable Life – was proposed and accepted in a vote by policyholders. After the High Court endorsed this scheme in February 2002, policies were enhanced in accordance with the scheme's proposals. We cannot consider complaints from policyholders who are covered by the compromise scheme, and we have informed the small proportion of policyholders who are in this position.

We have been in regular contact with the Equitable policyholders who have complained to us. Since February 2002 we have been seeking details from policyholders and Equitable Life, so that we can categorise the complaints. This will enable us to examine 'lead' cases for each category of complaint, with a view to applying the outcome – once established – to all other complaints in the same category. However, we have reassured individual policyholders that they will still have the opportunity to comment on the appropriateness of any view applied to their case, before it is formally determined. This means that any particular facts and circumstances relating to their case will be considered before the ombudsman makes a final decision.

complaints about 'dual' variable mortgage rates

The hottest banking topic of the year was 'dual' variable mortgage rates. Some mortgage lenders moved from having a single variable mortgage interest rate to having two variable mortgage interest rates – one higher than the other.

We received a substantial number of cases from capped-rate and discount-rate borrowers who had taken out their mortgages before the change – and who challenged their lender's contention that they were linked to the higher of the new rates, rather than the lower one. →



◀ By 31 March 2002 we had issued ombudsman final decisions in three 'lead' cases, involving three different lenders. In each of these cases we decided that the particular borrowers' mortgage contracts entitled them to be linked to the lower of the new rates.

Our decisions in these cases did not mark any change in approach from that of predecessor ombudsman schemes. They did not outlaw lenders having more than one variable mortgage rate. They did not interfere with lenders' freedom to set rates for their products. The decisions *did* say what rate should be used as a yardstick, in the circumstances of those particular cases, in order to fulfil the contractual promises the lenders had previously made to those particular borrowers.

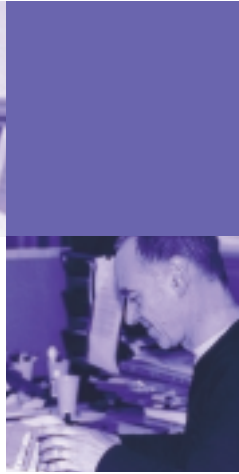
Although each decision related to individual borrowers and individual circumstances, considerable interest was generated when the parties communicated the decisions to the press – and media commentators suggested that the lenders should automatically treat other borrowers in a similar way.

One of the lenders concerned decided to do that, regardless of whether the borrowers had complained. The other two settled with the borrowers who had complained – though we later received further cases about the settlement terms that one of these lenders offered. We are considering those cases, along with further cases involving other lenders. A fuller summary of the position to date, including the basis on which the three 'lead' cases were decided, can be found in the March 2002 edition of *ombudsman news*.

complaints about other mortgage issues

Even without the 'dual' variable mortgage rate cases, mortgages would have produced the largest proportion of banking complaints this year. As in previous years, we continued to receive a significant number of cases about early repayment charges on fixed-rate and discount-rate mortgages.

Fixed-rate mortgages give borrowers the benefit of knowing there is no risk that their payments will rise if general interest rates increase. But there is almost always an early repayment charge to pay if the



borrower wants to end the fixed-rate deal early. This is because many lenders fund fixed-rate mortgages by borrowing at fixed rates in the money market. If the lender has to break its money-market deal, it may have to compensate the institution it borrowed from.

Discount-rate mortgages give borrowers a temporary reduction in cost, after which they revert to the normal rate. But there is often an early repayment charge to pay if the borrower wants to end the deal before they have paid the normal rate for some specified time. This is because the discount has to be paid for. The lender gives the discount in order to attract the business, on the basis that at least some of it will be repaid gradually once the mortgage reverts to the normal rate.

When general interest rates fall, some fixed-rate borrowers want to break the fixed rate without paying the early repayment charge. At the end of the discount period, some discount-rate borrowers do not want to go on to the normal rate or pay the early repayment charge. They complain they did not know of the charge, or that it was unfair.

We consider whether the details of the early repayment charge were made sufficiently clear and were adequately brought to the borrowers' attention when they entered into the deal. We also consider whether the charge was structured in a way that was likely to operate fairly or unfairly.

It is not the case, as some borrowers believe, that the lender must be able to show that the charge is exactly equal to the lender's loss. That is a complex formula – which might involve drafting an early repayment charge clause that no ordinary borrower could understand. What is needed is something that is clear and not out of all proportion to the lender's prospective loss.

complaints about interest paid on TESSAs

Complaints about the rates of interest paid on TESSAs (Tax Exempt Special Savings Accounts) – the hottest banking topic in our 2000/01 year – formed a significant proportion of the cases we closed in 2001/02. These cases involved complaints that some firms paid lower rates on their TESSAs than they did on their ISAs (Individual Savings Accounts). →



✦ The Banking Ombudsman Scheme and the Building Societies Ombudsman Scheme issued a briefing note in September 2000, indicating the approach that the ombudsman was likely to take on such complaints that reached the ombudsman service – including the approach to the relevant principles of the Banking Code. Banks took note of this. Some decided they would probably ‘lose’ and settled individual complaints with their customers. Others decided they were likely to ‘win’. By and large they proved to be right.

Most building societies preferred a formal ombudsman investigation. Some ‘won’ and some ‘lost’. Two of those that lost had said they would take court action if the ombudsman’s decision went against them. One of these societies, after studying the final decision in its case, decided to accept it after all. It continued to disagree with the ombudsman’s view, but settled all its other cases in line with the ombudsman’s decision. The other society asked for the ombudsman’s decision to be referred to the High Court because, it said, the decision contained errors of law. That case is unlikely to be heard until late 2002.

complaints about other savings/deposit accounts

Savings/deposit accounts ranked third in the year (after mortgages and current accounts) as a source of banking complaints. But while current account complaints involved a wide variety of issues, savings/deposit account complaints almost always centred on the fact that the rate of interest had been downgraded or was otherwise unfair.

For postal accounts, which cannot be operated at a branch, the Banking Code requires the firm to send the customer individual notice of an interest rate reduction. But for ordinary accounts that can be operated at a branch, the Banking Code says it is enough if firms put notices in branches and in newspapers – though there is additional protection for accounts that are no longer open or promoted (superseded accounts).

Based on the cases we see, we think the distinction between postal and branch-based accounts is outmoded. We hope a change will emerge from the current review of the Banking Code. Following an



independent committee's report to HM Treasury, the review process now involves an independent reviewer. The views we put to her are set out in the March 2002 issue of *ombudsman news*.

motor insurance complaints

Complaints about motor insurance have seen a welcome decline of 19% during the year. Firms are now used to our approach on most issues arising out of motor insurance disputes and have sought to minimise the number of cases referred to us unnecessarily. We have also attempted to identify – at the earliest stage of our procedure – those potential motor insurance complaints which have only arisen as a result of misunderstandings about standard insurance practice, for example involving vehicle valuations.

Disputes involving 'keys in cars' form the main issue we have dealt with during the year. In these cases, policyholders find that their claims in relation to a stolen car are rejected if they left the keys in the vehicle. We have needed to consider these cases carefully following a Court of Appeal case at the beginning of 2001. If we think the consumer was sufficiently close to the car to be able to intervene and had not 'left' the car, we will generally require the firm to meet the claim. However, where we consider that the consumer had not been this close, we will generally support the insurer. Inevitably this has required some fine judgements about the facts of each case. We are working with firms to ensure they understand our approach.

complaints about building and contents insurance

One positive feature of the year was the low level of complaints we received following the widespread flooding in 2000. Inevitably, flood-related cases are distressing for policyholders (particularly where their property is subject to multiple floods) and the necessary work of drying-out and refurbishment can take a considerable time. In general, firms seemed to respond well to the challenges of these claims. In the cases we have seen where insurers fell below standard, the main problem was usually related to the difficulties of co-ordinating the work of the various contractors. →



travel insurance complaints

There was a marked increase – by 14% – in travel insurance complaints referred to us during the year. We saw increases in all types of dispute, including baggage and medical expenses cover. Particular problems arose from the extended sales chains often associated with travel policies, and the increasingly common approach of ‘badging’ the insurance product under the name of a High Street travel agent or retailer. Normally we will treat the *insurer* as responsible for the advice given at the point of sale.

Establishing what was actually said and agreed between a customer and a firm in travel insurance disputes can be critical to the outcome of the dispute. Increasingly, many important discussions – including, for example, disclosure of pre-existing medical conditions – are handled over the telephone. Obviously this is convenient for both the firm and the customer. But we have reminded firms that we may not be able to uphold their decisions unless they can provide phone recordings to support their version of events.

medical-related and other insurance disputes

During the year we dealt with over 1,000 cases relating to critical illness, medical expenses and permanent health insurance. These medical-related policies provide a particular challenge in assessing conflicting medical opinions and dealing with personal and often distressing circumstances. These policies – and our handling of disputes about them – need to keep up to date with relevant medical advances.

Policyholders often have high expectations of the cover provided and, in the case of medical expenses policies, of the treatment they will receive. Making clear at the outset the limitations of these policies, as well as their advantages, would help to minimise scope for dispute when claims arise. This also applies to loan protection cover – a relatively small but significant part of our caseload.



We also handle complaints about many other types of general insurance, including policies covering pets, dental treatment, legal expenses, marine insurance and electrical, motor and furniture warranties.

complaints about stockbrokers and fund managers

Firms previously regulated by the Securities and Futures Authority (SFA) saw the greatest changes in complaints-handling procedures at 'N2' (1 December 2001 – the date the new rules came into force under the Financial Services and Markets Act) when their customers could complain to an ombudsman scheme for the first time.

What has not changed, however, is that we cannot deal with complaints about investment performance. Given recent stock market movements, surprisingly we have not seen an increase in performance-related complaints this year. Where these complaints appear to involve wider concerns – for example, the suitability of the product, based on the investor's attitude to risk – then we may be able to look into them.

We also investigate complaints about administrative errors and delay by stockbrokers and fund managers, especially where consumers have required investment by a specific date to obtain tax benefits.

During the year, we received a significant number of complaints about 'packaged' investment products – over 1,000 PEP complaints and more than 300 complaints each in relation to single premium investment bonds, unit trusts and non-cash ISAs. Before 'N2', these products could be regulated by different regulators with different complaints-handling arrangements. Now, complaints about all regulated products are handled by the Financial Ombudsman Service.

report and financial statements

Financial Ombudsman Service Limited
(a company limited by guarantee)

company registration no. 3725015

directors

throughout the year

Andreas Whittam Smith (*chairman*)

Brian Landers (*deputy chairman*)

Robert Crawford

Richard Thomas

Helena Wiesner

to 22 February 2002

Michael Barnes CBE

Ruth Evans

Maggie Lee

Oonagh McDonald CBE

Sylvie Pierce

John Rawlings

Charles Wilson

from 23 February 2002

Lawrence Churchill

Ed Hucks

Roger Jefferies

Sir Christopher Kelly

Kate Lampard

No director has any interests in the transactions of the company.

company secretary

Barbara Cheney

registered office

South Quay Plaza II
183 Marsh Wall
London
E14 9SR

bankers

Lloyds TSB Bank plc
City Office, PO Box 17328
11-15 Monument Street
London
EC3V 9JA

auditors

Deloitte & Touche
Stonecutter Court
1 Stonecutter Street
London
EC4A 4TR

directors' report

The directors of the Financial Ombudsman Service Limited present their report for the year ended 31 March 2002 together with audited financial statements of the company for the same period.

principal activities and business review

The Financial Ombudsman Service was created as part of the government's legislation for the financial services market and derives its statutory authority from the Financial Services and Markets Act 2000. The company was incorporated in 1999 to consolidate into a single statutory body the complaints-handling and ombudsman services formerly provided by a number of statutory and voluntary schemes:

- Office of the Banking Ombudsman
- Office of the Building Societies Ombudsman
- Insurance Ombudsman Bureau
- Personal Investment Authority Ombudsman Bureau
- Personal Insurance Arbitration Service
- Securities and Futures Authority Complaints Bureau
- Office of the Investment Ombudsman
- FSA Direct Regulation Complaints Unit

The company received its powers as the 'scheme operator' provided for in Schedule 17 of the Financial Services and Markets Act 2000 through the enactment of secondary legislation at midnight on 30 November 2001 ('N2'). Its principal activity is now the provision of an informal dispute resolution service for consumers of financial products.

financial results and review of key activities

The company presents its results for the year to 31 March 2002. During this period the company had an operating surplus after tax of £261,826 (2001: £500,707), which was transferred to reserves.

From 1 April to 30 November 2001, the Financial Ombudsman Service resolved disputes under the rules of the complaints handling schemes listed on page 32. With effect from 1 December 2001 ('N2'), the Financial Ombudsman Service began to resolve disputes using rules made under the Financial Services and Markets Act 2000.

fixed assets

The movements in fixed assets during the year are set out in note 12 to the accounts.

supplier payment policy

The Financial Ombudsman Service's policy is to pay all suppliers within 30 days of date of invoice.

employment policies

disabled employment policy

The Financial Ombudsman Service complies in the relevant areas with the contents and aims of the Code of Good Practice on the Employment of Disabled People issued by the Employment Service.

The company:

- has ensured that there is full disabled access to its offices and all facilities;
- considers all applicants for vacancies on merit. Where necessary, special arrangements are made for interviewing disabled applicants;
- is developing awareness amongst staff of the assistance needed by their disabled colleagues at work;
- is developing links with disabled persons' organisations; and
- reviews its policy annually and makes changes as required by legislation and best practice.

employee consultation

Senior members of staff meet a representative group of staff, the Employee Communication Forum, every month. The purposes of the meetings are:

- to give all staff an opportunity to raise questions, make suggestions or air matters of concern, through their representative on the forum; and
- to allow managers to consult staff on proposals prior to implementation and keep staff informed of the development of the Financial Ombudsman Service.

Additionally, regular staff meetings are held at all levels.

corporate governance

The directors are committed to high standards of best practice in corporate governance. Whilst not bound by the provisions of the Combined Code for Corporate Governance, the Financial Ombudsman Service aims to ensure that it complies with best practice in the relevant areas.

The Board consists of the chairman, the deputy chairman and eight other directors, all of whom are non-executive directors. Members of the Board are appointed by the Financial Services Authority and HM Treasury approves the appointment of the chairman. All members of the Board are appointed in the public interest and represent a wide range of business, financial and consumer expertise. Biographical details of the Board are on page 52.

The Board generally meets every month and the directors have access to all relevant information required to carry out their functions. The company secretary attends and minutes all meetings of the Board and the audit committee. Registers of directors' and ombudsmen's interests are also maintained.

audit committee

The audit committee meets at least twice a year. Its prime functions are:

- to make recommendations to the Board in respect of the external auditors' appointment;
- to review the draft report and financial statements before submission to the Board;
- to discuss with the auditors problems arising from external audits;
- to ensure compliance with all requirements governing financial reporting; and
- to review risk management controls.

Members of the audit committee were:

to 22 February 2002	from 23 February 2002
Brian Landers (<i>chairman</i>)	Brian Landers (<i>chairman</i>)
Robert Crawford	Robert Crawford
Oonagh McDonald	Ed Hucks
John Rawlings	Roger Jefferies
Richard Thomas	Richard Thomas

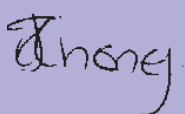
internal controls

A risk management framework has been devised in conjunction with our auditors which is compliant with the relevant areas of the Turnbull Report. The plan, which includes measures to mitigate risk, has been regularly reviewed and revised during the year.

auditors

Deloitte and Touche have expressed their willingness to continue in office as auditors. A resolution to reappoint them will be proposed at the forthcoming annual general meeting.

Approved by the Board of Directors and signed on behalf of the Board



Barbara Cheney

company secretary
13 June 2002

directors' responsibilities in respect of the financial statements

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year, and of the income and expenditure of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements comply with these requirements.

The directors are responsible for ensuring that proper accounting records are kept, which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

independent auditors' report to the members of the Financial Ombudsman Service Ltd

We have audited the financial statements of the Financial Ombudsman Service Ltd for the year ended 31 March 2002 which comprise the income and expenditure account, the balance sheet, the cash flow statement, notes 1 to 6 to the cash flow statement and notes 1 to 18 to the financial statements. These financial statements have been prepared under the accounting policies set out therein.

respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the directors' report for the above year and consider the implications for our report if we become aware of any apparent mis-statements.

basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 31 March 2002 and of its surplus for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Chartered Accountants and Registered Auditors

Stonecutter Court

1 Stonecutter Street

London

EC4A 4TR

13 June 2002

income and expenditure account for the year ended 31 March 2002

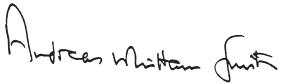
	note	2002 £'000	2001 £'000
turnover	2	27,351	21,031
other operating income		10	41
interest receivable	3	107	28
total income for the year		<u>27,468</u>	<u>21,100</u>
administrative costs	4	26,487	19,990
interest payable and similar charges	5	691	609
total costs for the year		<u>27,178</u>	<u>20,599</u>
surplus on ordinary activities before taxation	6	290	501
<i>less: tax on surplus on ordinary activities</i>	7	28	0
surplus on ordinary activities after taxation		<u>262</u>	<u>501</u>
balance of income over expenditure brought forward at 1 April		501	0
balance of income over expenditure carried forward at 31 March		<u><u>763</u></u>	<u><u>501</u></u>

All amounts relate to continuing activities.

There were no recognised gains or losses other than the reported surplus for the year.

The notes on pages 43 to 51 form part of these financial statements.

balance sheet as at 31 March 2002

	note	2002 £'000	2002 £'000	2001 £'000	2001 £'000
fixed assets					
tangible assets	12		10,587		10,109
current assets					
debtors (amounts falling due within one year)	13	4,492		2,200	
debtors – establishment cost recovery fund (falling due after more than one year)	13	3,040		4,560	
cash at bank and in hand		4,313		158	
		<u>11,845</u>		<u>6,918</u>	
current liabilities					
creditors: amounts falling due within one year	14	<u>(8,169)</u>		<u>(2,026)</u>	
net current assets			<u>3,676</u>		<u>4,892</u>
total assets less current liabilities			14,263		15,001
creditors: amounts falling due after more than one year	15		(13,500)		(14,500)
net assets			<u>763</u>		<u>501</u>
capital and reserves					
accumulated balance of the income and expenditure account			<u>763</u>		<u>501</u>
			763		501
signed on behalf of the Board of Directors			<u><u>763</u></u>		<u><u>501</u></u>
 Andreas Whittam Smith chairman					

The notes on pages 43 to 51 form an integral part of these financial statements which were approved by the Board of Directors on 13 June 2002.

cash flow statement for the year ended 31 March 2002

	note	2002 £'000	2001 £'000
net cash inflow/(outflow) from operating activities	1	7,842	(1,688)
returns on investments and servicing of finance	2	(445)	(578)
taxation	3	(5)	0
capital expenditure and financial investment	4	(2,237)	(6,370)
net cash inflow/(outflow) before financing		<u>5,155</u>	<u>(8,636)</u>
financing			
movement in long-term borrowings		(1,000)	8,500
increase/(decrease) in cash in the year		<u><u>4,155</u></u>	<u><u>(136)</u></u>

notes to the cash flow statement for the year ended 31 March 2002

1 reconciliation of surplus on ordinary activities before taxation to net cash inflow/(outflow) from operating activities

	2002 £'000	2001 £'000
surplus on ordinary activities after taxation	290	501
interest receivable	(107)	(28)
interest payable	691	609
depreciation	1,676	25
loss on disposal of tangible fixed assets	83	23
increase in establishment cost recovery fund	0	(1,637)
increase in debtors	(772)	(1,936)
increase in creditors	5,981	755
net cash inflow/(outflow) from operating activities	<u><u>7,842</u></u>	<u><u>(1,688)</u></u>

2 returns on investments and servicing of finance

	2002 £'000	2001 £'000
interest received	107	28
interest paid	(552)	(606)
	<u><u>(445)</u></u>	<u><u>(578)</u></u>

3 taxation

	2002 £'000	2001 £'000
UK corporation tax paid	(5)	0
	<u>(5)</u>	<u>0</u>

4 capital expenditure and financial investment

	2002 £'000	2001 £'000
payments to acquire tangible fixed assets	(2,237)	(6,370)
	<u>(2,237)</u>	<u>(6,370)</u>

5 reconciliation of net cash flow to movement in net debt

	2002 £'000	2001 £'000
increase/(decrease) in cash	4,155	(136)
cash inflow/(outflow) from increase/(decrease) in debt financing	<u>1,000</u>	<u>(8,500)</u>
movement in net debt for year	5,155	(8,636)
net debt at 1 April	(14,342)	(5,706)
net debt at 31 March	<u>(9,187)</u>	<u>(14,342)</u>

6 analysis of changes in net debt

	at 1 April 2001 £'000	cash flows £'000	at 31 March 2002 £'000
cash at bank and in hand	158	4,155	4,313
long-term loans	<u>(14,500)</u>	<u>1,000</u>	<u>(13,500)</u>
	<u>(14,342)</u>	<u>5,155</u>	<u>(9,187)</u>

1 status of the company

Financial Ombudsman Service Limited is a company limited by guarantee and registered in England and Wales (3725015). The liability of each of the members is limited to the amount of £1 guaranteed in the Memorandum of Association.

2 principal accounting policies

The financial statements have been prepared under the historical cost convention and in accordance with applicable Accounting Standards of the United Kingdom. A summary of the principal accounting policies is set out below.

turnover

Once the Financial Services and Markets Act came into force at midnight on 30 November 2001 ('N2'), the Financial Ombudsman Service was able to raise levies and case fees under the powers contained in the Act. Until that point, the Financial Ombudsman Service was funded as follows:

- for the period up to 31 March 2000, the Financial Ombudsman Service did not have any income and was funded by the Financial Services Authority. Costs during that period were charged to the establishment cost recovery fund (note 13). Accordingly, no amounts were shown in the income and expenditure account for that period; and
- for the period from 1 April 2000 to 'N2' the company's main income consisted of service charges receivable as a result of Service Level Agreements set up between the Financial Ombudsman Service and the former schemes under which the Financial Ombudsman Service provided management support, staffing and administration.

From 'N2' to 31 March 2002, the Financial Ombudsman Service has been funded as follows:

- although the Financial Ombudsman Service was entitled to raise levies from 'N2', it was agreed that the former schemes (except the Personal Investment Authority (PIA) Ombudsman Bureau – see below) would continue to raise funds under their own funding mechanisms to cover the period from 'N2' to 31 March 2002 and pay over the amount due for these four months to the Financial Ombudsman Service; and
- as the PIA Ombudsman Bureau was funded mainly by means of case fees, a different arrangement was agreed. The accounting policy used by the PIA Ombudsman Bureau up to 'N2' was continued in the Financial Ombudsman Service from 'N2' to 31 March 2002 whereby case fee income was recognised only at case closure. This was in respect of:
 - (a) cases transferred from the PIA Ombudsman Bureau to the Financial Ombudsman Service at 'N2' and closed between 'N2' and 31 March 2002; and
 - (b) cases converted and billed (to former members of the the PIA Ombudsman Bureau only), and closed by the Financial Ombudsman Service between 'N2' and 31 March 2002.

tangible fixed assets

Depreciation is calculated so as to write off the cost, less estimated residual value, of tangible fixed assets on a straight-line basis over the expected useful economic life of the asset concerned, starting from the beginning of the financial year following the year in which they are brought into use, and with a full annual charge in the year of disposal, as follows:

leasehold improvements	over ten years
premises fees and stamp duty	over five years
computer hardware	over three years
computer software	over five years
computer systems development and fees	over five years
office furniture and equipment	over five years*
fixtures and fittings	over ten years

* In previous years the depreciation policy on office furniture and equipment was to depreciate over three years. This policy was reviewed during the year, and in the light of the assets comprising this heading, the policy has now been changed so that costs are now written off over five years. This change of policy has not materially affected the charge for depreciation for the year.

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate that the carrying value may not be recoverable.

pension scheme payments

The company operates both a defined benefit pension scheme and a money purchase scheme, both being part of the Financial Services Authority tax-approved pension plan. The costs of the contributions to the defined benefit scheme are charged to the income and expenditure account so as to spread the cost of pensions over the service lives of employees and is determined by independent qualified actuaries undertaking formal actuarial valuations at least every three years. The costs of the contributions to the money purchase scheme are charged to the income and expenditure account as incurred.

operating lease commitments

Operating lease costs are charged to the income and expenditure account to reflect usage of the assets leased.

deferred income

The accounting policy used by the PIA Ombudsman Bureau up to 'N2' was continued in the Financial Ombudsman Service from 'N2', whereby case fees were billed to firms and credited to the deferred income account on the conversion of the case. Amounts are released to case fee income only on closure of the case. The balance in the deferred income account therefore represents the number of open cases being:

- (a) those cases originally converted and billed in the PIA Ombudsman Bureau prior to 'N2' and transferred to the Financial Ombudsman Service at 'N2'; and
- (b) those cases converted and billed in Financial Ombudsman Service between 'N2' and 31 March 2002.

3 interest receivable

	2002	2001
	£'000	£'000
bank interest	107	28
	<u>107</u>	<u>28</u>
	<u>107</u>	<u>28</u>

4 administrative costs

	2002	2001
	£'000	£'000
staff costs	17,298	13,995
staff related costs	1,284	1,542
accommodation	2,847	1,881
office costs	1,116	855
other costs	3,942	1,717
	<u>26,487</u>	<u>19,990</u>
	<u>26,487</u>	<u>19,990</u>

5 interest payable and similar charges

	2002	2001
	£'000	£'000
bank loan and overdraft	691	609
	<u>691</u>	<u>609</u>
	<u>691</u>	<u>609</u>

6 surplus on ordinary activities before taxation

	note	2002	2001
		£'000	£'000
this is stated after charging:			
staff costs	8	17,298	13,995
depreciation	12	1,676	25
loss on disposal of tangible fixed assets		83	23
other operating lease rentals		29	26
auditors' remuneration	11	55	65

7 reconciliation of current tax charge

The standard rate of current tax for the year, based on the UK standard rate of corporation tax is 20% (2001: 20%). The current tax charge for the year is lower than that resulting from applying the standard rate of corporation tax in the UK for the reasons set out in the following reconciliation:

	2002	2001
	£'000	£'000
surplus on ordinary activities before taxation	<u>290</u>	<u>501</u>
tax on surplus on ordinary activities at standard rate	58	100
factors affecting charge:		
non taxable income	(35)	(100)
prior period adjustments	<u>5</u>	<u>0</u>
current tax charge for year	<u><u>28</u></u>	<u><u>0</u></u>

8 staff costs

	note	2002 £'000	2001 £'000
salary costs		14,454	11,662
social security costs		1,309	1,117
other pension costs	9	1,535	1,216
		17,298	13,995

The average number of employees during the year in the United Kingdom was 461 (2001: 392).

9 pension costs

The Financial Ombudsman Service is part of the Financial Services Authority's tax-approved pension plan open to permanent employees. The pension plan was established on 1 April 1998 and operates on both a defined benefit and defined contribution (money purchase scheme) basis. Since 1 April 2000, all employees joining the Financial Ombudsman Service have been eligible only for the defined contribution section of the plan. The defined benefit section of the plan is non-contributory for members. The defined contribution section is part of a flexible benefits programme and members can, within limits, select the amount of their overall benefits allowance that is directed to the pension plan.

The company continues to account for pensions in accordance with Statement of Standard Accounting Practice No 24 *Accounting for Pension Costs*. A new Standard (Financial Reporting Standard No 17 *Retirement Benefits* – FRS 17) which changes the basis of accounting for pensions and other post-retirement benefits will be mandatory for the year ending 31 March 2004. This new Standard requires certain additional disclosures in accounting periods prior to its implementation.

The Financial Ombudsman Service has 108 of the 1,046 members contributing to the Financial Services Authority's defined benefit scheme, and although the ombudsman service has contributed to the Financial Services Authority's defined benefit scheme, it is impossible to identify its share of the underlying assets and liabilities. However, if FRS 17 had been implemented in full in the year to 31 March 2002 there would have been a deficit in reserves on the whole scheme (including the Financial Services Authority's members) of £31.5m. The associated pension liability will not crystallise for many years. Options for managing the pension liability will be reviewed with the Financial Services Authority in the year ending 31 March 2003.

10 directors' remuneration

Directors' remuneration payable during the year amounted to £156,688 (2001: £161,240). The chairman was paid £40,000, the deputy chairman £15,000 and all other Board members at a rate of £10,000 per annum.

11 auditors' remuneration

	2002	2001
	£'000	£'000
audit fee	25	18
other services	30	47
	<u>55</u>	<u>65</u>

12 tangible assets

	leasehold improvements	computer equipment and software	furniture and equipment	total
	£'000	£'000	£'000	£'000
cost				
at 1 April 2001	4,240	4,623	1,267	10,130
additions	248	1,835	154	2,237
disposals	0	(124)	0	(124)
at 31 March 2002	<u>4,488</u>	<u>6,334</u>	<u>1,421</u>	<u>12,243</u>
depreciation				
at 1 April 2001	0	21	0	21
charge for year	510	918	248	1,676
disposals	0	(41)	0	(41)
at 31 March 2002	<u>510</u>	<u>898</u>	<u>248</u>	<u>1,656</u>
net book value				
at 31 March 2002	<u>3,978</u>	<u>5,436</u>	<u>1,173</u>	<u>10,587</u>
at 31 March 2001	<u>4,240</u>	<u>4,602</u>	<u>1,267</u>	<u>10,109</u>

13 debtors

falling due within one year	2002	2001
	£'000	£'000
trade debtors	1,736	1,908
establishment cost recovery fund	1,520	0
other debtors	164	134
prepayments	1,072	158
	<u>4,492</u>	<u>2,200</u>
falling due after more than one year	2002	2001
	£'000	£'000
establishment cost recovery fund	3,040	4,560
	<u>3,040</u>	<u>4,560</u>

The establishment cost recovery fund costs total £4,559,909 (2001: £4,559,909) and relate to the development of the new organisational structure of the Financial Ombudsman Service. These costs will be recovered evenly over a period of three years from 1 April 2002. Accordingly, one third of the total – £1,519,970 – has been shown as falling due within one year and two-thirds – £3,039,939 – as falling due after more than one year.

14 creditors: amounts falling due within one year

	2002	2001
	£'000	£'000
trade creditors	512	526
corporation tax	23	0
other taxes and social security	405	365
other creditors	459	41
accruals and deferred income	6,770	1,094
	<u>8,169</u>	<u>2,026</u>

15 creditors: amounts falling due after more than one year

	2002 £'000	2001 £'000
bank loan	13,500	14,500
	<u>13,500</u>	<u>14,500</u>

The company took out a revolving loan facility of £25m on 30 March 2000 which was available for draw down until 30 September 2001 and which was fully repayable by means of variable annual tranches from 31 March 2002 to be fully repaid by 31 March 2011. The facility was varied by means of an Amendment Letter dated 21 May 2001 so that the revolving loan facility is now £18m which is available for draw down until 30 September 2002 and which is now repayable by means of variable annual tranches from 31 March 2003 but still to be fully repaid by 31 March 2011. The amount drawn down at 31 March 2002 was £13.5m. The interest rate payable is 0.15% per annum above London interbank offered rates. A commitment fee of 0.07% is charged on the outstanding sum on the revolving loan facility not yet drawn down. The FSA has guaranteed the loan facility.

16 operating lease commitments

The company entered into a fifteen year lease for four floors at South Quay Plaza II in November 1999 with a rent review every five years. Under the lease the company was entitled to a one year rent free period. The Financial Services Authority is a party to the lease agreement for the four floors as guarantor of performance of the lease in the sum of £1,089,798 per annum. In May 2001, the company entered into a thirteen year lease for the sixth floor with a break clause and rent review in 2004. For both leases rent has been charged from the date at which the premises became available for occupation. As at 31 March 2002, the company was committed to making the following payments during the next year in respect of operating leases:

	land and buildings	other	land and buildings	other
	2002	2002	2001	2001
	£'000	£'000	£'000	£'000
leases which expire:				
within one year	0	20	0	0
between two and five years	0	9	0	27
after five years	1,530	0	1,218	0

17 contingent liabilities

The Directors are not aware of any issues that might give rise to any contingent liabilities.

18 related party transactions

The Financial Ombudsman Service, together with the Financial Services Authority, was created as part of the Government's legislation for the financial services market and derives its statutory authority from the Financial Services and Markets Act 2000. The Financial Services Authority is regarded as a related party.

During the period from the incorporation of the Financial Ombudsman Service on 26 February 1999 to 31 March 2001, the Financial Services Authority provided short term funding to meet certain costs associated with the establishment of the Financial Ombudsman Service. In the year to 31 March 2002, no payments were made to the Financial Services Authority (2001: £2,550,149). An amount of £1,000 was due from the Financial Services Authority at 31 March 2002 (2001: £Nil). This amount is included in 'other debtors' (see note 13).

The Financial Services Authority is guarantor of the loan facility in the sum of £13,500,000 at 31 March 2002 (see note 15), and is also a party to the lease agreement for the four floors at South Quay Plaza II as guarantor of performance of the lease in the sum of £1,089,798 per annum (see note 16).

Other than disclosed above, there were no related party transactions during the year (2001: None).

the board

Andreas Whittam Smith (*chairman*)

- First Church Estates Commissioner
- President of the British Board of Film Classification
- Vice chairman of Tunbridge Wells Equitable Friendly Society
formerly
- City editor of the *Daily Telegraph*
- Founder and editor of *The Independent*

Brian Landers (*deputy chairman*)

- Chief operating officer at Pearson Education (Europe, Middle East and Africa)
formerly
- A director of Waterstone's
- First finance director of the Prison Service
- A trustee of the Royal Armouries

Lawrence Churchill

- Chairman and managing director of Unum Limited
- Chairman of the Industry Standards Group of the Association of British Insurers
formerly
- A board member of the Personal Investment Authority and the PIA Ombudsman Bureau
- A director of the Association of British Insurers
- Managing director of NatWest Life and Investments
- A trustee of the Royal Society of Arts

Robert Crawford

- Head of service quality at the Royal Bank of Scotland and NatWest
- A fellow of the Chartered Institute of Bankers in Scotland and its chief examiner for sales and service
- A director of OBO Property
formerly
- A director of the Office of the Banking Ombudsman

Ed Hucks

- A non-executive director of West Bromwich Building Society
- A member of the Council, University of Leeds
formerly
- Customer services director at NPI
- A director of the former National & Provincial Building Society

Roger Jefferies

- A council member of the Telecommunications Ombudsman Service
- A non-executive director of the National Clinical Assessment Authority
formerly
- Chairman of an NHS disciplinary tribunal
formerly
- Independent Housing Ombudsman
- Chief executive of Hounslow and Croydon London Boroughs

Sir Christopher Kelly KCB

- Chairman of the National Society for the Prevention of Cruelty to Children
- A board member of the National Consumer Council
formerly
- Permanent Secretary at the Department of Health
- Head of policy at the Department of Social Security
- Director of the budget and director of monetary policy at HM Treasury

Kate Lampard

- A trustee of the Esmée Fairbairn Foundation
- Chair of Kent and Medway Health Authority
formerly
- Chair of the Independent Housing Ombudsman Limited

Richard Thomas

- Director of public policy at Clifford Chance LLP
- A board member of the National Consumer Council
formerly
- Director of consumer affairs at the Office of Fair Trading
- Head of public affairs at the National Consumer Council
- Involved in setting up the Insurance Ombudsman Bureau and the Banking and Building Societies Ombudsman Schemes

Helena Wiesner

- A non-executive director of the Pensions, Protection and Investments Accreditation Board
- A non-executive council member of the Council for Licensed Conveyancers
formerly
- Head of economic and social research at the Consumers' Association
- Deputy chair of the Personal Investment Authority
- A non-executive director of the PIA Ombudsman Bureau
- A non-executive council member of the Insurance Ombudsman Bureau and the Banking Ombudsman Scheme
- A non-executive council member of the National Consumer Council

how do I contact the Financial Ombudsman Service?

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→ look at our website

www.financial-ombudsman.org.uk

We can help if you need information in a different format (eg Braille, audiotape etc) or in a different language. Just let us know.

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Produced by the communications team
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