

Financial Services Consumer Panel
Submission to the Treasury Select Committee
On
Restoring confidence in long term savings – endowment mortgages

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A: Introduction

1. The Financial Services Consumer Panel ('the Consumer Panel') was set up by the FSA and made statutory under the Financial Services and Markets Act 2000. It currently has twelve members, and its main role is to advise the FSA on the interests and concerns of consumers and to monitor the FSA's effectiveness in this area.
2. Endowment mortgages have been a subject of interest to the Consumer Panel since it was set up in December 1998. The Consumer Panel has consistently pressed the FSA to:
 - Investigate more thoroughly the firms which have a greater concentration of problem endowments;
 - Make sure that consumers understand the issues that affect them and their savings, and are informed of their rights, as well as the limitations of compensation;
 - Help to maintain consumer confidence in financial services and savings products by having a clear and open system of redress when things go wrong;
 - Make sure that the firms carry out fully their responsibilities to keep consumers informed;
 - Monitor and review progress at regular intervals; and
 - Incorporate lessons learnt into the FSA's future regulation policy – particularly putting pressure on firms to treat customers fairly and for the FSA to get ahead of the game in investigating potential problems.
3. Overall, the Consumer Panel has been particularly concerned that, for consumers affected by the endowment mortgage problems, the two pressing issues are addressing shortfalls and, for some, achieving redress. The Consumer Panel has always emphasised the need to make a distinction between problems caused by:
 - market conditions and the consequent need to help consumers address a (projected) shortfall of their endowment; and
 - mis-selling, and therefore the need to help consumers achieve redress where due.
4. In considering the issues for consumers we have taken into account the unequal relationship between firms and consumers, consumers' need for information and advice, the impact on consumers of financial loss and risk, that consumers' experience and needs vary greatly and that costs to the industry impact on consumers.
5. There are a number of separate but related aspects of the endowment mortgage problems that the Consumer Panel has been, and continues to be, concerned about. These are:
 - consumers' need to address shortfalls (paragraphs 7-16);
 - mis-selling and consumer redress (paragraphs 17-39); and
 - lessons learnt (paragraphs 40-50).

6. The Consumer Panel sees this as an area where the scale of the problem has unfolded slowly over time – quite how many people were misled, and the impact of wider market developments have become apparent over a period of time. This paper therefore aims to discuss the background to the development of these issues, as well as examine how they have been dealt with. We then conclude with some key lessons for the future.

B: Helping consumers address shortfalls

7. The Consumer Panel believes that the largest problem for many consumers to arise out of the endowment mortgage problem is that their endowment policy is not on track to repay their mortgage loan. Unless they can make up the shortfall, they are in danger of losing their house as a result. In October 2000, the FSA was predicting that “an estimated 60% of the 11 million [policies] in force – are no longer on track to repay the mortgage loan”¹.
8. The FSA’s strategy for helping consumers understand their shortfall and how to address it has involved working with the industry on the reprojection exercise and getting information to consumers through their mortgage statement; and the FSA’s factsheets and press work.
9. The FSA has produced a series of factsheets on endowment mortgages. Some of these help consumers understand the options for addressing their shortfall, and may include mention of the complaints procedure. They also produced one factsheet specifically about redress which we discuss in paragraph 32. The FSA has convinced the industry to include the more general endowment mortgage factsheets in their correspondence about their customers’ endowment’s performance.
10. The Association of British Insurers (ABI), encouraged by the FSA, required its member companies to send re-projection letters and statements informing their customers of the projected value of their endowment at the end of its term depending on possible growth rates of 4, 6 and 8%. The letter advised whether the policyholder should take action in order to stay on target for repaying their mortgage. The box, below, explains what the consumer received.

Although the policyholder receiving the letter would not have been aware of the categorisation given to the letter, the FSA and industry categorised them as follows:

Letters showing a shortfall at 8%, 6% and 4% growth rates were called ‘red letters’. The model* letter contains the following warning: *“Your Plan Update is enclosed. Based on this we consider there is now a high risk that your Plan may not pay out enough to repay the target amount at maturity. Investment growth would need to be higher than the rates currently set by the financial services regulator. We therefore strongly suggest that you take action.”*

Letters showing a shortfall at 6% and 4% growth rates were called ‘amber letters’. The model* letter contains the following warning: *“Your Plan Update is enclosed. Based on this, we consider it is possible that your Plan may not pay out enough to repay the target amount when it matures. It would only be able to pay out the target amount if future investment growth was towards the top end of the rates currently set by the financial regulator. In view of this you may wish to think about taking action”.*

Letters showing a shortfall only at 4% growth rates were called ‘green letters’. The model* letter contains the following statement: *“Your Plan Update is enclosed. Based on this, we are pleased to confirm that we believe your Plan is currently on track to repay the target amount when it matures. It needs future investment growth towards the lower end of the current rates used for projections as set by the financial regulator. It is unlikely that you need to take any action now”.*

* Whilst the ABI produced model letters for firms to use, firms were not required to stick to them.

¹ FSA Progress Report on Mortgage Endowments, October 3rd 2003.

11. The Consumer Panel commissioned research² to: examine how consumers were reacting to the reprojected letter; whether they understood their situation; what action they were likely to take; and to check the extent and nature of any consumer detriment likely to occur as a result of the reprojected exercise.
12. We were concerned about the effectiveness of the letters in getting messages across to consumers given that the ABI was co-ordinating the mailings rather than the FSA, but our research showed that reprojected letters succeeded in this. 94% of our respondents thought that the letters were fairly or very clear and 84% kept the letter containing the reprojected policy. Understanding the options is very different, however, from being able to evaluate them and we discuss, in paragraphs 48-50, consumers' need for help, as well as information.
13. One of the Panel's concerns about the reprojected exercise was that policyholders may think their insurance company was suggesting an increase in premiums as the best option open to them and our research revealed some evidence of this. Increasing contributions to their policy was the most spontaneously mentioned course of action (46%), and seeking advice from an IFA was second (17%). However, we were somewhat reassured that, despite this, respondents in our survey were as likely to take other forms of action such as changing part of their mortgage to a repayment mortgage as they were to increase contributions to their existing policy.
14. Of those policyholders we would generally expect to be taking action to address a projected shortfall, most were, or were planning to take action including 71% of policyholders who had received a 'red letter', and 66% who had received an amber letter. Most of those not taking or intending to take action had a good reason, for example, the shortfall was small and/or they could cover it from other savings, they had already paid off the mortgage or switched part of it to a repayment mortgage etc. However, 2% of policyholders receiving red or amber letters were not taking, or intending to take, action because they thought that the letter showed their policy was on target to pay off their mortgage in full. These were more likely to be policyholders receiving amber letters and that may well reflect the more ambiguous nature of that letter.
15. We made a number of recommendations in the light of our research, including that reprojected letters should be sent out regularly. We felt that consumers needed a reminder about their options. In particular, those in receipt of amber letters would benefit from an update on their situation. The ABI had originally only agreed to require their members to send out one round of reprojected letters. However, the FSA and ABI accepted our recommendation and policyholders have now received a second reprojected letter and in future, will be sent an update at least every two years. This has proved extremely important as many policyholders' situations will have become worse since the first reprojected letter. (Our other main policy conclusion regarded mis-selling and we deal with that in the following section.)
16. After the first round of reprojected mailings, the FSA persuaded the ABI that their members should include an FSA factsheet on endowment mortgages. That factsheet did include some information on complaints but the Panel did not think it went far enough in helping consumers identify whether they had a compensatable loss, see paragraph 32.

² FS Consumer Panel, Mortgage Endowment Reprojection Research Report, Autumn 2000.

C: Mis-selling and consumer redress

Identifying mis-selling

17. Our research³ showed that 54% of respondents recalled being told at the point of sale that their endowment policy 'would definitely' or 'was guaranteed to' pay off their mortgage which suggests a mis-sale. In view of this, we have reiterated the importance of the FSA thoroughly investigating mis-selling; helping consumers understand if they are entitled to compensation; and monitoring firms' complaints handling.
18. Since the Consumer Panel's inception we have urged the FSA to act faster to investigate warnings⁴ of widespread endowment mortgage mis-selling and take appropriate action. The Consumer Panel's first consumer survey, carried out in October 1999, found that 20% of our respondents who describe themselves as financially self-assured agree with the statement 'an endowment policy is guaranteed to pay off your mortgage'⁵. Our survey also found that the endowment mortgage was by far the most commonly regretted product (10% of those who had taken one out within the last five years)⁶.
19. In September 1999 we informed the FSA and Personal Investment Authority (PIA) Boards of our view that regulatory attention in this area was long overdue. We also stressed the importance and urgency of publicly feeding back the findings of the PIA's supervisory visits on endowment mortgage sales to the industry as a preventative measure.
20. In our first year we emphasised to the FSA the value of mystery shopping as a regulatory tool and urged them to employ it more often⁷. We also expressed frustration at the regulators' continuing inability to prevent poor record keeping from hampering effective regulatory action⁸. We feel these factors played a part in the FSA's slow progress in identifying and dealing with the mis-selling of endowment mortgages.
21. The FSA made a public statement about its endowment mortgage work in December 1999 and stated its intentions for future work. It gave a progress report in October 2000. In each case, we thought more could have been achieved by that stage and criticised the FSA for the delay in investigation and the delay in reporting on their findings.

"Although the FSA was quick to issue a fact-sheet on this subject for consumers, we believe that the FSA and PIA could have acted faster to review selling practices and announce the findings"

FS Consumer Panel Annual Report 1999

"The regulators made slow progress in identifying endowment mis-selling and the FSA continues to be slow to deal with firms whose sales practices broke regulatory guidance."

FS Consumer Panel Annual Report 2000

³ FS Consumer Panel, Mortgage Endowment Reprojection Research Report, Autumn 2000.

⁴ E.g. – 'Where to go for mortgage advice?', *Which?* October 1998.

⁵ FS Consumer Panel 'Consumers in the financial market: 1999', page 40.

⁶ FS Consumer Panel 'Consumers in the financial market: 1999', page 57.

⁷ FS Consumer Panel Annual Report 1999, page 24 and page 31.

⁸ FS Consumer Panel Annual Report 1999, page 30.

Consumer redress

To receive compensation, a consumer must both have been mis-sold and suffered financial loss as a result. This is called having a 'compensatable loss'.

Compensation is based on how much worse off a consumer is now than if they had originally taken out a repayment mortgage. This means that the amount of compensation is not the same as any future 'shortfall' that is now being predicted.

22. In December 1999 the FSA stated that "on average, holders of mortgage endowments have enjoyed returns which mean they have fared at least as well as they would have done with a repayment mortgage. So there are no grounds for an industry-wide review of all past business"⁹. They reiterated this in October 2000¹⁰. As market conditions have continued to decline, the proportion of consumers who have suffered financial loss as a result of being mis-sold an endowment mortgage and therefore have a compensatable loss has increased. It has therefore been harder for the FSA to maintain this line. We are concerned that the FSA made the above justification for its approach and believe it demonstrates that they underestimated the scale of future problems for consumers.
23. There was, and is still, an absence of information to help consider the costs and benefits of different redress mechanisms in various situations. The Consumer Panel has called on the FSA to compare different models of delivering redress to understand what works best in which circumstances¹¹, and we discuss this in more detail below, paragraphs 40-43.
24. The following factors were important in our acceptance that a full-scale proactive review might not be in the interests of consumers:
- the length of time it would be likely to take to complete and deliver compensation to consumers (the pensions review has taken some ten years to complete);
 - generating false expectations of redress (and potential consequent delay in addressing a shortfall); and
 - the indirect cost to consumers of administrative costs of delivering redress.
25. We were particularly concerned about generating false expectations on the part of consumers that they would be awarded compensation to close the shortfall on their mortgage endowment. Consumers could easily misunderstand the difference between having a shortfall on their endowment, and having a compensatable loss. Furthermore, the financial loss suffered as a result of being mis-sold would not necessarily equate to the shortfall on their endowment. In addition to the distress caused by false expectations of compensation, we were concerned that consumers may delay taking action to address their shortfall in the expectation of compensation and this could cause considerable further financial loss.

⁹ FSA Press Release 'Endowments: The FSA's conclusions and actions', December 21st 1999.

¹⁰ FSA Progress report on mortgage endowments, October 3rd 2000, paragraph 4.15, page 19.

¹¹ Letter to Howard Davies from Colin Brown, then Chairman of the FS Consumer Panel, May 9th 2001.

26. The FSA has estimated that the administrative costs of a full scale proactive review would have been around £5 billion¹². We are not aware of figures to compare the costs of the targeted approach that the FSA did follow. We consider a full evaluation of the costs and benefits of the different approaches to achieving redress for consumers should be undertaken as part of the FSA's review of reviews that we have been calling for, see paragraphs 40-43.

27. In accepting the FSA's approach, we emphasised the importance of the following:

- The requirement on firms with a record of mis-selling endowment mortgages to conduct proactive reviews. (Pockets of loss)
- That consumers outside these firms were helped by firms and the FSA to identify whether they might have a compensatable loss and how to obtain redress. (Consumer understanding)
- That the FSA closely monitored firms' complaints handling with the threat that they could be required to conduct a proactive review if their complaints handling was not up to scratch.

Pockets of loss

28. We have continually pressed the FSA on the correct identification of firms to carry out a pro-active review.

“where there is evidence that firms broke the rules and mis-sold unsuitable endowments mortgages they should be required to act promptly, identify the customers affected and pro-actively review those sales”

FS Consumer Panel press release 'Consumer Panel calls for tougher action on mis-sold endowments', October 3rd 2000.

29. We suggested¹³ that poor record keeping by a firm was evidence of a poor compliance culture and indicative of poor advice and justified the FSA requiring these firms to proactively review their mortgage endowment sales. We understand that firms with poor record keeping have been subject to further investigation by the FSA's Enforcement Division.

30. In its October 2000 'Progress report', the FSA announced that it would not be requiring firms to conduct targeted reviews of any specific group of consumers across the whole industry. We disagreed with the FSA about this. Prior to the announcement, the Consumer Panel had urged¹⁴ the FSA to consider specific categories of consumers including cases where the endowment policy was set up to run into the policyholders' retirement and where the policy had lapsed. The FSA has required the firms conducting proactive reviews to particularly look for mis-selling in these cases.

31. In a letter to the Consumers' Association, published 5th June 2002, the FSA announced that 20 firms had agreed to conduct proactive reviews of their cases. We understand from the FSA that other firms have since agreed to proactively review their cases.

¹² Letter from Howard Davies to the Consumers' Association, published 5th June, 2002.

¹³ Letter from Barbara Saunders, then Chairman of the Consumer Panel, to FSA, 25th May 2000 and Panel sub-group meeting with FSA staff 4th September, 2000.

¹⁴ Panel sub-group meeting with FSA staff 4th September, 2000.

Consumers' understanding on redress

32. Although the FSA general endowment mortgage factsheets were included in firms' correspondence with policyholders, we are disappointed that the FSA did not require firms also to include the FSA factsheet, 'endowment mortgage complaints'¹⁵. We welcomed this self-help guide produced by the FSA to help consumers identify whether they may have been mis-sold an endowment and, as a result, suffered loss. Whilst we thought the guide was clear and helpful to those who already know they have an issue, we were doubtful that without being sent it, it would reach many other consumers, particularly those who need the most help in identifying whether they might have a compensation claim. The Consumer Panel was concerned that all consumers who were potentially mis-sold endowment policies should have been sent this factsheet. If the Consumer Panel's research, see paragraph 17 above, is projected to the population of 6mn households with endowment mortgages, then over 3mn consumers needed to receive this factsheet. Though not all of these will have a compensatable loss, they need the factsheet to help them understand whether they have or not. We understand that the FSA's factsheet did not get out to anywhere near this number.
33. We were further concerned about consumers' understanding of how their compensation had been calculated. In March 2001, we asked the FSA to produce a leaflet setting out the arguments that consumers would need to mount to challenge a firm's offer of compensation. We said that the FSA should then require firms to include this leaflet in letters they send to consumers explaining the outcome of their complaint to the firm.¹⁶ The FSA did not do this.
34. We raised with the FSA the issue of consumers becoming 'time-barred' from making a complaint against a firm. In most cases, consumers have three years from the point at which they first became aware of a problem within which to complain. We were concerned about the definition, in the case of endowment mortgages, of when a consumer could be deemed to have become aware of the problem, particularly in the light of press coverage. We further felt that consumers needed to be informed about the limited time in which they had to make a complaint as many may be waiting for any loss to crystallise (i.e. on the maturity of the endowment) before complaining. We discussed this with the FSA who were considering clarifying the rules and requiring firms to inform consumers of the time-bar. We persuaded the FSA that the clock should not start ticking until 6 months after a consumer received a second 'red' reprojection letter; the FSA had been minded to define it as 3 months after this point.

Firms' complaints handling

35. We view firms' complaints handling as key to the effectiveness of the FSA's approach. In October 2000, we warned that firms should devote adequate resources to dealing with complaints and that the FSA should monitor this closely¹⁷.
36. It is in all parties' interests that as many complaints as possible should be appropriately resolved by firms. To this end, the FSA issued guidance to firms on

¹⁵ FSA factsheet 'Endowment mortgage complaints', October 2000.

¹⁶ Letter from Colin Brown, then Chairman of the FS Consumer Panel, to the FSA, 6th March 2001.

¹⁷ FS Consumer Panel press release "Consumer Panel calls for tougher action on mis-sold endowments", 3rd October 2000.

how to calculate compensation and Financial Ombudsman Service (FOS) said that it would make judgements in line with this guidance. We raised with the FSA, the importance of consumers understanding the process and methodology being applied to their case. We asked the FSA to require firms to use plain language to explain to complainants what factors have been taken into account in assessing their complaint and the right to refer their case to the FOS if they were dissatisfied. We also encouraged the FSA to produce a 'ready reckoner' so that consumers can compare the redress they are being offered to see whether it falls within an appropriate range.¹⁸ The FOS did produce guidance aimed at consumers explaining how compensation is calculated. They also produced a 'decision tree' that sets out the factors which they will consider in deciding whether to uphold a complaint but it is long and detailed and we felt that many consumers would still need help working through it.

37. Despite the FSA's guidance, firms rejected a large proportion of their complaints and, at July 2002, the FOS had upheld 40-45% of cases referred to them. Whilst many of the consumers who had their complaint rejected did not refer it onto the FOS, the proportion of complaints upheld by the FOS suggests that firms may not have been fairly dealing with complaints. We queried the appropriateness of the FOS dealing with so many cases as a result of systemic failure¹⁹.

38. We raised concerns with the FSA about firms' handling of complaints following indicative findings from our 2001 research²⁰ that consumers found firms unhelpful in dealing with their complaint. As a result, John Tiner, then a Managing Director of the FSA, wrote to Chief Executive Officers of relevant firms, in April 2002, asking for complaints information. We were informed that the proportion of complaints upheld by firms increased from 25% to 50% following this letter. Whilst we were pleased that this appeared to result in a greater number of complaints being upheld, this led us to question the willingness of firms to complete the review without pressure from the FSA.

Adequacy of redress

39. We were consulted on the guidance the FSA issued to firms about calculating redress. We were concerned that the guidance allowed firms to deduct from compensation, the 'benefit' a consumer may have received by having an endowment mortgage compared to a repayment in the form of lower monthly payments. The proposed guidance allowed firms to do this if the complainant was deemed to have 'sufficient means' so that the firm could take the benefit into account. The FSA had sought legal advice on this point and suggested that there was no scope for change. However, we asked the FSA to consider and address, as far as legally possible: the dangers of firms being allowed to interpret 'sufficient means'; and the unfairness associated with the fact that the prudent consumer may be penalised for their prudence. The FSA did amend their final guidance in consumers' favour. The revised guidance said that it was not reasonable to deduct from compensation, the benefit achieved from lower monthly payments if the consumers had been advised that they would have lower monthly outgoings with an endowment mortgage, compared to a repayment, at the time of the sale.

¹⁸ Letter from then Chairman of the FS Consumer Panel, Colin Brown, to the FSA, 24 January, 2001.

¹⁹ FS Consumer Panel Annual Report, 2001-02, page 43.

²⁰ FS Consumer Panel Mortgage endowment reprojected follow up study, December 2001.

D: Lessons learnt

FSA should assess the best methods of consumer redress

40. There are a number of redress mechanisms that regulators have employed, such as in the pension review, FSAVC review, the approach regarding endowment mortgages and with large firm specific cases of mis-selling and mis-information. In May 2001, in a letter to Howard Davies, we suggested that it would be appropriate for the FSA to compare the different models and develop an analysis of what works best in a variety of circumstances.

“At this stage of the new regime’s development it might be valuable to examine the principles involved in the different approaches and how they have worked in practice.”

Letter from Colin Brown, then Chairman of the Consumer Panel, to Howard Davies,
9th May 2001

41. We reiterated this in our recent annual report.

“We feel that their [different models of redress] benefits, costs and problems – which are specific to the circumstances in which they are used – should be analysed to inform the FSA’s future choices from the regulatory toolkit”

FS Consumer Panel Annual Report, 2002/03

42. In their 2002/03 Annual Report, the FSA said it had mechanisms in place to learn from the application of different methods, but would consider whether a more formal review might be appropriate and would discuss this issue with the Panel.

43. We note that, since FSMA 2000 came into effect, past business reviews would require formal approval by the Treasury. We hope that this would not delay such a review, in future, or make it less likely that such a review would be undertaken.

FSA must put pressure on firms to treat customers fairly

44. The FSA must approach its dealings with firms with a healthy dose of cynicism. It is disturbing, but unsurprising, that it was not until the FSA put pressure on firms to raise the standards in firms’ complaint handling that they did so. (paragraph 38.)

45. The FSA’s approach may have relied too much on the industry’s reassurances that it would treat their customers fairly. The FSA was disappointed that the industry did not heed its warnings in December 1999 to improve their selling practices and should not, therefore, have been surprised that the industry did not deliver high standards in handling complaints until it received John Tiner’s April 2002 letter expressing concern and asking for further complaints handling data.

FSA must get ahead of the game

46. We criticised the FSA in December 1999 for being slow to investigate and take action on endowment mortgages. We have also criticised the FSA for being slow to act when ‘too good to be true’ products come onto the market, e.g. – precipice bonds.²¹

“Improvements in public confidence and consumer protection will depend on the FSA being able to develop faster processes for dealing with new problems in the retail market.”

Chairman’s Foreword, FS Consumer Panel Annual Report 2002/03

²¹ FS Consumer Panel Annual Report 2002/03, page 7.

47. We are pleased that the FSA has acknowledged these criticisms and is devoting more resources to monitoring the retail markets and analysing new products. In its 2003/04 plan and budget, the FSA says a key priority will be to develop its ability to identify consumer problems as early as possible and to take early action over products which could cause significant consumer detriment.²²

Consumers need help, as well as information

48. The FSA has suggested that consumers seek advice to help them understand and evaluate the options open to them to address a shortfall. We also think some consumers need advice to help them understand whether they have a compensatable loss; and how to complain and whether their offer of compensation is fair. Indeed, many consumers would need advice to understand these issues, they are far from simple.

49. Yet consumers may no longer trust commercial advisers who may have mis-sold to them in the first place and they may not have access to independent financial advice. Some consumers have turned to advice agencies to meet the need but advice agency workers may not be appropriately qualified, nor authorised, to give such advice which may include product specific advice, for example, whether to cash in their endowment mortgage.

50. The Consumer Panel, and other consumer groups, have long been calling for the wider provision of generic advice. In July 2002, we called on the Government and FSA to undertake a feasibility study into the provision of centrally funded general financial planning advice²³. It is clear that non-sales advice is needed by consumers. Whilst the FSA and the Government has seemed positive about the idea, there has been little progress.

25th November, 2003

²² FSA Plan & Budget 2003/04, page 17.

²³ FS Consumer Panel, 'Financial Planning Advice', July 2002.