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news

Dear Friends...

Well, it's the time of year again to wish you all happy Hanucah, Christmas, second Eid, Divali and the like. The second half of the year seems to have been far busier than the first which explains why I haven't managed to do a newsletter since June. The obvious month to write it, August, suddenly went bananas in my diary.

As promised in the June newsletter, I now have a website www.adamsamuel.com. All suggestions as to how it can be improved will be gratefully received. It contains details, of what I do, who I am and some papers that I have written for conferences in the last couple of years.

On a lighter note, I can report the sighting of a good restaurant in Stirling, the Austrian-Scottish Hermanns, and the excellent CityLife Guidebook to Manchester.

Adam Samuel

Compliance

This field is being quietly dominated by COBS, FSA's proposed Conduct of Business Rules. There is nothing very drastic in them. As foreshadowed in the last newsletter, they insist that reason-why letters include an explanation of the risks involved in the transactions recommended. Further on, though, the rules run away from requiring a clear statement of the charges in the reason why letter. This is a shame because the price you pay for everything is a very fundamental part of the transaction. The Key Features documents in which such information should be found are usually difficult to read. Still, good advisers will, I hope, give a brief statement of the current charges in the "Suitability Letter", to use the COBS terminology. This may be the simple answer to the FSA's recent consultation paper about what to do about key features and the fact that nobody reads them.

In training fact-find checkers and advisers, I am increasingly aware that it isn't good enough just to tell advisers of compliance breaches they may have committed. Consultants hate being told of their form-filling inadequacies. They mind less when the problem is fundamental. The challenge for compliance staff is to explain why an incomplete fact-find is damaging their ability to do business.

An interesting if extreme example of this was a pension set up to use past reliefs by an adviser who came by the business through arranging the client's employer's group scheme. The absence of a fact-find on the individual transaction was striking. The adviser essentially replied by asking who the fact-find checker thought he was to query one of the firm's top pension's experts. Half way through a compliance workshop, a member of staff revealed that the employer had complained recently about the same adviser's lack of attention to detail in handling the GPP! A calm but full explanation to the adviser was probably needed of precisely how he was missing business and putting his client at risk accompanied by a list of the various sanctions that regulators and Ombudsman Bureaus could take against him if the sale went wrong.

A common problem that advisers complain about is that clients do not want to do a full fact-find. The difficulty is that the execution-only rules for the FSAVC review make it clear that the client needs to confirm this in a letter in their own handwriting. The adviser actually is throwing good business away by not doing a complete fact-find. But perhaps, he woould be giving up a client by insisting on it. Either way, an adviser would not be really safe without obtaining a jargon-free letter from the client indicating the scope of the advice and fact-finding required.

Failing to obtaining background documentation to justify sales is an age-old weakness. Some recent files illustrate this. When recommending a mortgage product, the mortgage offer was missing. It was needed to prove that the sale matched the mortgage. In another case, when

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Compliance continued

re-broking life assurance, an adviser did not have the original policy document and had not considered the options under it. The replacement of a flexible whole of life policy with term assurance may well have been justified on the basis that the latter contract was cheaper and the clients did not need the investment content of the whole of life contract. Unfortunately the latter schedule was not on file and there was no evidence of any call to the life office to check whether it would reduce the premium on its contract to take into account the client's (new) non-smoking status. Nor was there evidence of whether the same level of cover could not be achieved under the existing policy more cheaply by switching to a lower investment content.

The compliance challenge in these types of cases is not just to tell the adviser of the missing documents but to explain how their absence can land everyone in trouble. Inviting advisers to training sessions on compliance has to make sense.

It is interesting to note that the ABI is going to look again at with profit bonds. The lack of transparency of with profits products worried LAUTRO from its earliest days. It expressed concern that such bonds were being sold as low risk investments which in many ways they are not. Any initial charges, market value adjustments and early surrender penalties can have disturbing effects.

Another difficult aspect of single premium business generally is the false impression that some products give of having no set up costs. These can be disguised as exit penalties, higher fund management charges or adjustments to the bonus structure. Either way, a regulator will be rightly concerned at switch selling when these "charges" in the broadest sense are not disclosed properly and the new product cannot be shown to be likely to be significantly better than the old one. (The adviser's commission has to come from somewhere.)

Personally, I left one IFA and declined to use another. The first adviser did an update fact-find by writing on the original one, thereby making it impossible to know which information was recorded when. The second adviser had a provision in its Terms of Business claiming fees in the event that the client cancelled any policy. His failure to exempt cases where policies were cancelled within the 14 day period is illegal as chilling the statutory right to cancel. That is also a breach of the PIA Rule 4.5.

Complaints

Currently, the story here is all about endowments. The problem is that the focus is at the wrong end. Everyone is rightly worried about policies that will not meet their targets. However, from a complaints perspective, we are interested in people who should not have been sold such policies in the first place: singles, over 45s, people without mortgages, low risk investors, foreigners, people wanting to repay early, anyone needing their mortgage to go into retirement and people who have previously lapsed one. The Financial Ombudsman Service in its paper placed a great deal of emphasis on the client's risk profile which is important but perhaps not nearly as critical as the client's ability to sustain a regular payment commitment over the policy life. That was left to the penultimate paragraph of the report.

On compensation, the FOS paper does not make it clear that product providers have to provide a refund plus interest on missold policies regardless of whether a loss has been suffered. Such contracts are voidable for non-disclosure or misrepresentation and the law requires the return of the client's money in that situation. This rule should not apply to IFAs since they are not a party to the endowment contract. Like insurers, they have to put the client in the position in which he would have been had he received compliant advice. This means reducing his mortgage by the amount that would have been repaid from a capital repayment loan and compensation for the extra cost of life cover and any switching costs. There's paper on my website on this.

Finally, FOS rightly emphasised the fact that if the client could prove that the adviser guaranteed fund performance orally or in writing, the firm would be bound by it.

A continuing headache in all companies concerns the identification of regulated complaints. I did my first four courses devoted exclusively to this subject in the summer. It affects anyone with a telephone in a regulated company. Bizarrely, there is still no consensus as to what activity exactly is regulated. It should be the firm's conduct of investment business. That includes anything involving the company's setting up, changing or ending of the policy. The messy distinction between admin and sales complaints disguises the fact that a fair number of the former are regulated. Anyway, any organization which tries to run different systems for the two types of cases risks missing a huge number of admin cases and losing corresponding numbers of clients.

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FSA Consultative Paper 49 is a damp squib in this area. It seems to alter the definition of complaint, but does not tackle the issue of what is regulated. It creates a two-tier system. Firms have to demonstrate that they have adequate procedures for all types of cases but only have to log regulated complaints. These involve the client indicating that he has or might have suffered financial loss. This is in practice the same as the current definition of "might be seeking redress".

The Pension Review

This continues to throw up its fair share of problems. A nasty one relates to rebate only policies. Paragraph 36 of the Guidance says that you have to review every situation where the rebate re-starts. This means that the usual rule that liability ends on the client joining a scheme will not apply here. The rebate will re-start when the client moves from a contracted-out scheme to employment without such membership. Yet, the client is not usually offered advice at each such point. So, it is hard to say that firms should ever be liable once a client has joined a scheme (so long as it was not by accident or the firm has given subsequent advice). In practice, the vast majority of clients will continue to be scheme members once they have joined one, assuming no later advice. Consequently, firms are being put to a great deal of unnecessary trouble checking scheme membership.

Firms continue to be erratic in their handling of staff sales. Neither regulators nor PIAOB has

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The FSAVC Review

The big news is the start of the FSAVC review (and my new course on that subject!). Until the mailing process is completed, the big issues relate to requested reviews and, in particular, previously closed complaints. The problem is that the Guidance treats these cases as an afterthought. Many of the rules have not been thought out fully.

The first question is: what past complaints constitute requests for a review? The Guidance is silent. Clearly, anything relating to the sale of the policy should be included. It is a regulatory requirement under rule 7.2.1(3)(c) PIA Rules not to limit a complaint to its precise terms. Investment performance and over-funding objections should be included for the same reasons. A complaint unrelated to the setting up or selling of the policy would be excluded. It falls outside the areas where the regulators have any power to regulate. So, one can assume that unless the regulator asks firms to review these cases pro-actively, they will be excluded. In the regulatory vacuum, I would put the limit on whether the complaint relates to the setting up or amending of the policy by the assurer or IFA concerned.

As with the pension review, the regulators have struggled to decide whether increment policies need to be mailed. IFAs are angry that a recent Bulletin indicates that an increment to an FSAVC with a different provider must be mailed while if the same company is used, it isn't. This favours product providers. In fact, the regulators should have included all increments. However, they wanted to reduce the work that firms have to do to find reviewable policies and so complete the review. Some of the boundaries on these projects are inevitably random.

The big hole in the Guidance relates to over-funding. There are cases where redress will cause the policy to exceed safe limits. More commonly, though, at the point of sale, there was an over-funding problem or a failure to disclose the risks of it. The FSA when told of this problem (and given a proposed solution) basically urged firms to deal with such cases "in the usual way". Since none exists, all one can do is suggest one! The purist answer would be to refund contributions with growth at the rate that a PEP would have provided had the money gone there with further compensation of about 22% for the loss of the tax wrapper and the set-up costs of a future investment. Perhaps, more in tune with the Guidance would be to replace PEP growth with the CAPS benchmark index.

There are a couple of interesting glitches in the FSAVC Guidance and subsequent material issued on it. As with the Pension Review, one can exclude cases settled by an Ombudsman's Decision. FSA Bulletin 2 extends this to provisional assessments of the PIAOB and initial view letters of the IOB. Unfortunately, the latter never issued any such thing. Anyway, anyone knowing how many of these assessments are reversed by Ombudsmen would not feel comfortable about allowing firms to rely on them. Watch out for forthcoming FSA Bulletins.

In the pension review, chaos is caused by FSA Bulletin's insistence that liability is assumed to come to an end following a change of employment where another adviser gives advice at or prior to the change of employment. The FSAVC guidance leaves out the words "prior to". This creates a tiny window (between the date of leaving the old job and starting the new one) for the exception. A communication from the FSA suggests that the window is even smaller in that the example of advice at the change of employment is described as just a situation where "a firm may feel that their liability ceases". If the interpretation here is correct, it will bring the guidance reasonably close in practice to the legal position (no break caused by a new adviser if the client doesn't stop the FSAVC and start paying AVC premiums). The danger is that some firms will continue to apply the superficially similar pension review approach.

In over funding cases, firms should probably refund contributions with growth based on the CAPS bench mark index with further compensation of about 22% for the loss of the tax wrapper and the set up cost for future investment.

The Pension Review continued

been coherent on this. There would not be a pension review if firms had not misled their staff on the merits of personal pensions. Otherwise, the misselling would not have been so widespread. So, firms should be told to pay up in these cases on the basis of Test 4.

Some companies are creating unnecessary problems by offering clients a choice between reinstatement and top-ups in opt-out or non-joiner cases. The Guidance is reasonably clear in indicating that a top-up can only be offered where reinstatement is either impossible or unreasonably expensive. In the race to meet a deadline, one firm unfortunately demonstrated the merits of this rule. It offered a top-up to a client as an alternative to reinstatement while unaware that another firm had already reinstated for the same period. The client selected a top-up thereby making it difficult for the company to undo its over-generous offer.

A tough area concerns customers with two sources of employment. The customer typically re-joins one scheme and continues paying personal pension premiums with respect to the other work. The Guidance says that you must not use the second employment premiums for the purposes of reinstatement or calculating redress. This is easier said than done. Typically, the proposal only refers to the first employment. There are a number of ways of solving this identification problem and very few have any adverse effect on the client. First, check that the customer could not have joined the scheme at the second employment. (Option 2 companies would be well advised not to try to use that option here!) If not, offer the client a choice. This could be (1) to treat the contributions as all attributable to the first job (2), do (1) except as regards the contributions after joining or (3) allot the amounts equivalent to the main scheme contributions on the first job and the rest to the second. Giving a wide range of compliant choices avoids some of the sillier disputes that arise in this area.

On the subject of silliness, a rule that is commonly broken requires firms to put any discharge of liability in both the offer and the acceptance form. Some firms leave it out of the former. This is unfortunate if the client objects to the wording of the acceptance form. It takes away the option of just telling the client to write in to indicate their agreement with the offer.

More seriously, there appears to be serious under-reporting of complaints relating to the pension review. Any rejection (as opposed to query) of an offer must be an expression of dissatisfaction indicating that the client might be seeking redress and should be logged as a complaint. Clients indicating during the course of the review that they might be seeking redress are also complainants. Since the complaint deadlines do not apply at least before the offer is issued, this puts the firm to very little trouble (logging and adding to the return) and enables the firm to refer the client directly to the Ombudsman in the offer.

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Finally, we are starting to see customers retiring and asking firms to re-open no-loss calculations correctly done in the past. The regulators cannot insist on this. However, the PIAOB can and must. The Ombudsman can only apply the Guidance in preference to the law where an offer was ever made. She cannot do so where no offer has been made. Since the customer has lost out as a result of the original bad advice, I cannot see why he should not be properly compensated if he complains within a reasonable time of discovering the loss.

It remains only for me to ask you to contact me with any thoughts you may have about this newsletter and my website and for me to wish you all the best for 2001.

Equitable Life vs Hyman

It is terrible to applaud a court decision which costs good people jobs. Nevertheless, this was a defining judicial moment for the financial services industry. The House of Lords rejected the notion "the large print giveth and the small print taketh away". The company had offered clients the option of having their with profit pension funds paid out using a guaranteed annuity rate. The court said that they could not declare a lower terminal bonus for such investors to nullify the effect of the guarantee. Their Lordships implied into the contract that the company would not use its normal discretion on bonus rates to undermine a provision of the contract used to attract customers. How far this heralds a general concept of fairness in contracts is difficult to tell. It could be the first step towards forcing companies to declare bonuses in an open and rational way. The idea of a contract whose return to one side depends entirely on the other side's discretion is curious. Greater openness would also make it easier to give accurate risk profiles to with profits products.