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as news

Dear Friends...

It's that time of year again. I hope that you had a happy Chanukah, first Eidh, Divali or Christmas. The first six months of this year were the busiest half-year that I have ever had. Just as I was settling down to write a June newsletter, the Financial Services Authority and Financial Ombudsman Service produced major publications on endowment complaints. At the same time, I was updating the website monthly and regularly adding papers to it. There was a danger that I would spend more time writing than doing.

My website, www.adamsamuel.com now contains papers on endowments, pensions and FSAVC review compensation, complaint handling after N2 and under the pension review, limitation and deducting demutualisation benefits from compensation. I have also updated the general paper on compensation. So, the website can tell you about the various technical developments of the year. I will try to look at the bigger picture here.

Generally, my work this year has had greater variety than in the past. I now have my first pension review case to do from start to finish. I have done increasing amounts of face-to-face consulting. This mainly involves looking at difficult files where firms are stuck and some general compliance checking. Recently I added expert witness work to the repertoire.

On the tourism front, I had a classy meal at the Hundred House Hotel in Norton, just south of Telford. My continuing explorations of Liverpool have led me to an excellent two piece band playing on Tuesday nights called "Easy" in the Ye Olde Cracke pub where John Lennon and Cynthia Powell did a variety of things (depending on the guidebook your read). With a variety of friends, I have been working my way through Andrew Duncan's Favourite London Walks. There's a new expanded edition out.

Adam Samuel

Compliance

This year, I noticed an increasing connection between integrity and profitability. Firms who have done their pension and FSAVC review without cutting corners, seem to be much more advanced than their competitors. They have far less re-work. By conceding things early in the process, they have paid compensation more quickly and that has saved them money in the long run. They are now able to run down their teams more quickly. This overall emphasis on quality seems not only to reduce the risks of regulatory discipline, it also appears to protect firms more from takeover at knock-down prices or closure to new business opportunities. While there are always exceptions to these rules, this year has seen some of the less-compliant companies reduce their operations and stumble generally, leaving the way open for a better industry.

I am becoming more involved in ethics through the Institute of Financial Planning's Disciplinary Committee. I have been its Independent Investigator on the first few cases since we introduced the idea of outside scrutiny of the process. Developing a notion of what is acceptable behaviour without regard to law or customer's rights is challenging. I've published a couple of papers on this in "Financial Planning".

On the sales side, the new conduct of business rules incorporate much of what seemed to be the right approach to the old regime. One can see some technical issues on the horizon. Has anyone designed a system for comparing stakeholder pensions to AVCs, particularly those involving matched or subsidised benefits? If not, we could be looking at a re-run of the FSAVC review. Does anybody understand the new arrangements for contracting-out of SERPS and when clients should, or should not be in it? Is the risk profile for a with profits product involving an initial charge and a market value adjustment really low? Should such charges and adjustments continue to be allowed?

Recent concerns about with profits policies and the almost complete disappearance of industrial branch business are creating a product vacuum for poorer customers. It is not that those two developments are bad. With profits

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What products are available for low risk customers needing emergency access to their capital?

Compliance continued

contracts often contained risks (in the form of charges and MVAs) and opaqueness that was inconsistent with the low risk profile often attributed to them. The persistency figures and returns on IB business competed for awfulness. However, the question persists: what products are available for low risk customers needing emergency access to their capital, apart from a mini-cash ISA and national savings? For these clients, typically lower income families, the financial services industry offers very little. This makes sales to such clients hazardous. Product design is one of the problems. Could someone create a guaranteed level charged savings contract with better returns than a mini-cash ISA? Perhaps, the insurance ISA-idea could be dusted off here.

The notion of managerial responsibility under the new rules are intriguing. However, until someone prominent falls seriously foul of these rules in the consumer field, it will be difficult to know the effect of it. There is a danger that senior management will take the fall for the next level down who made the wrong decisions. One of the frustrating aspects of compliance is seeing people who have directed companies towards disciplinary action staying in their position or emerging in an equally sensitive role elsewhere. To look at things more positively, one would like to see compliance rewarded more. There need to be genuine incentives for early safe completion of the pension review, winning a high percentage of cases at the Ombudsman and preventing compliance and system failures.

Complaint Handling

The new legislation has increased interest in admin complaints, a subject I have always enjoyed training. The relationship between the customer and service provider is at the heart of these transactions. Blighted by poor-to-non-existent regulation, this subject has become a backwater for many companies. Now, product providers have every incentive to treat the subject seriously. That is reflected in greater demand for what I do in this area from both insurers and conference organizers and some stunning training feedback I received recently.

To begin with, all staff in a financial institution have to know how to identify and receive complaints properly. Thought has to go into investigating thoroughly. While most cases can be disposed of quickly, there is a surprisingly high incidence of pathological complaints which run for years. The usual cause is that the firm leapt to the decision-making phase too quickly without really knowing what happened.

Complaint handlers need clear rules to help them reach coherent results

Complaint handlers need clear rules to help them reach coherent results and explain them convincingly to clients. Yet, there is very little published on the rights of customers against their assurers and the appropriate measures of compensation. For example, most insurers insist on direct debit payments. Many think that the client has a separate duty to pay the premium. That is wrong. The client has a duty to make the funds available in the correct bank account at the collection time. If the company fails to take it, it has broken the contract not the client. The Banking Division of FOS this year has changed its stance in this direction where premiums have not been collected properly and required lenders to write off uncollected amounts.

On compensation, the simple approach is to ask what was offered to the client. If it was a guaranteed return, you must pay it. If it was a duty to exercise reasonable care, you have to place the client in the position in which he would have been had you been careful. The only possible exception to this is where it produces illegal results. The classic example currently is where a client has been promised a benefits from a pension in a form not permitted by legislation. Even then, there is scope for an argument (rejected in the past by PIAOB) that there is a collateral contract for the extra amount.

The third and most difficult aspect of admin cases is feedback to the rest of the company. Under the new rules, firms have a duty to correct systemic problems. The real challenge is for them to ensure that the company puts right the problem for the future. Otherwise, complaints are just a drag on the system.

Endowment complaints have overwhelmed almost everyone this year. The new FSA guidance and the FOS decision trees persuaded me to produce a 40 page paper on my website updated monthly. Essentially, the FSA Guidance is reasonably accurate. It virtually shuts the door to firms making deductions from the compensation due to savings from taking out an endowment as compared with a capital repayment loan. It only, though, lays down minimum standards for all firms. I am much less fond of the FOS decision-trees. The big concern, highlighted last year, is that, except for fraud, the Ombudsman has abolished the customer's normal but discretionary right to a refund of contributions, as an alternative to damages, when missold a policy by a product provider, enshrined in section 2(2) Misrepresentation Act and caselaw going back to 1776. This reduces life assurers' compensation bill considerably. However, it also drives a hole through the notion that a contract of assurance is one of good faith and that all contracts can be avoided for misrepresentation by the

Dispute Resolution

As part of my work with the Institute of Financial Planning, members in dispute with each other in relation to their investment or financial planning business will be forced to submit their disputes to arbitration with the appointment being made by the Institute. The problem is that the members of the Institute are all individuals. So, where companies are involved, members have to be required to use their best endeavours in this area.

Still, this could be a move towards more sensible informal dispute resolution involving industry participants. An arbitration arrangement for the industry as a whole would produce much fairer arrangements than at present. It would be particularly helpful for joint liability cases on complaints and the various reviews.

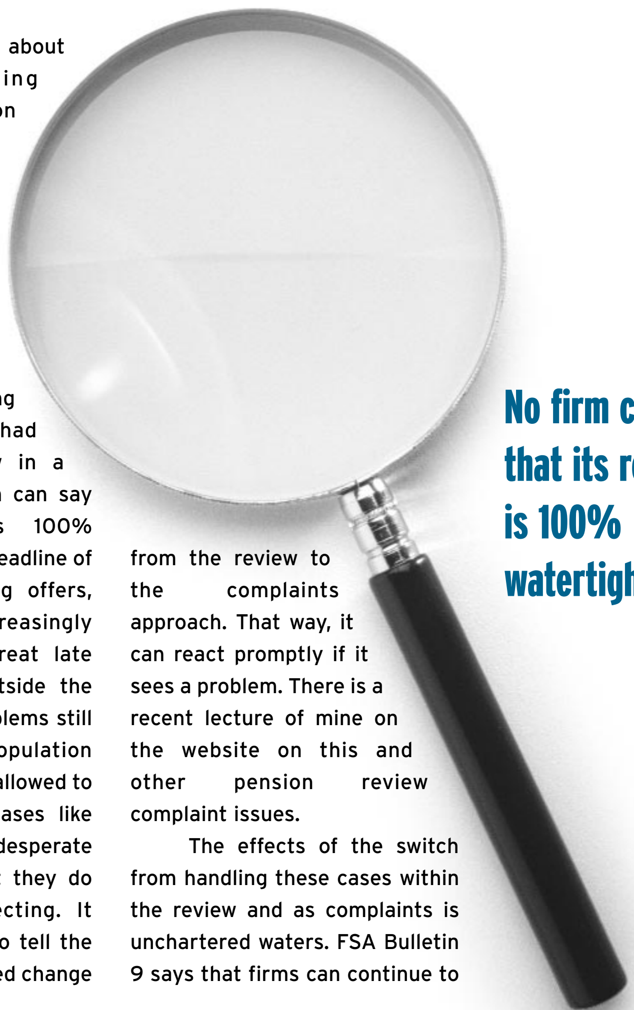
Ironically, a conversation I had this summer in the US has made me keen to try to promote less arbitration and more Ombudsman-type resolution of consumer complaints. The latter is not perfect but it gives lay clients much more protection. At the same time, by institutionalising the decision-making, one improves the predictability and publication of results. This reduces disputes.

other party. The abolition of well-established principles does at least deserve a principled explanation. Reference to an unpublished counsel's opinion procured by the FSA legal department really does not do this.

Curiously, very shortly afterwards, FOS in one of its bulletins was busy reminding firms about the client's right to avoid pension contracts. If the client should not have had a pension in the first place, this must be right. However, in other cases, judicious manipulation of the charging structure can put the problem right with much less cost to the client. Still, firms will have to remember to offer the refund as an option while pointing out the tax implications of accepting it. Pensions, like endowments, are contracts of the utmost good faith. Like all contracts, anybody misled into agreeing to them by the other party can, in law, choose to avoid the policy and receive his contributions back with interest.

The 2002 challenge for companies is to reduce the numbers of decisions overturned by FOS significantly (to 15%), reward complaint handlers for doing this and then demonstrate the benefits of this to the rest of the business in an improved service and product. A pipedream!?

Pensions and FSAVC Review



2002 will be all about decommissioning the pension review. Since 31st March 2000, firms have been entitled to require customers to complain if they want their cases reviewed. The problem is that the relevant guidance made it a condition of doing this that the firm had conducted the review in a compliant way. No firm can say that its review is 100% watertight. Yet, with a deadline of June 2002 for issuing offers, companies have increasingly little choice but to treat late requests as falling outside the review. Teams with problems still with their phase 1 population probably should not be allowed to do this. However, in cases like this, the FSA seems so desperate to end the review that they do not seem to be objecting. It makes sense, though, to tell the regulator of any proposed change from the review to the complaints approach. That way, it can react promptly if it sees a problem. There is a recent lecture of mine on the website on this and other pension review complaint issues.

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The effects of the switch from handling these cases within the review and as complaints is unchartered waters. FSA Bulletin 9 says that firms can continue to

Pensions and FSAVC Review

continued

apply the Guidance. However, the Ombudsman in non-review cases will be allowed to reach fair and reasonable results and will not be required to apply the Guidance where law or fairness otherwise indicates. Deductions for under-contribution by the investor, change of employment where another adviser is involved, over-contributions, churned transfers resolved using option 2 of FSA Bulletin 14 and replacement policies are all candidates for this treatment. So is a problem mentioned last year: no loss cases. Actually, PIAOB closed this loophole by an amendment to its Terms of Reference in secret last November but only published the change in February. This enables FOS to apply the Guidance to review complaints unless the standards do not cover the facts of the case. However, where the file falls outside the review, it would be open to the Ombudsman to part company with it. Personally, I do not see FOS being particularly keen to depart from the Guidance except in under-contribution cases. There, its correct position on endowments is inconsistent with the review guidance. However, one can never tell.

One area of the pensions review that threatens with de-commissioning to become increasingly messy is joint liability. Most substantial firms have behaved reasonably in this area up until now. As the firms close their reviews, they may be increasingly unwilling to make payments and conduct reviews where the case was drawn to their attention very late in the day.

The conclusion that a case no longer falls within a firms review should have no implications for the decision as to whether to contribute to the compensation costs. Joint liability has nothing to do with the review. It is based purely on the Civil Liability (Contribution) Act 1978. The first adviser in a case falling outside its review could legitimately require the second firm to do the work and present its claim in that way. This analysis breaks down where the second organization makes a complaint against the first company on behalf of the client. Then, both firms have to handle the case urgently and there is a duplication of effort. Then, the old review notion that the first adviser does the work makes sense.

Recent litigation on the insurance of pension review claims shed some interesting light on self-sales. Historically, PIAOB has wrongly rejected claims by experienced ex-advisers who had taken out inappropriate policies. It was effectively conceded in the Lloyds-TSB case that defective training following from non-compliant sales policy set by companies and not individual advisers were the main cause of the review problem. If firms told their advisers to recommend transfers, opt-outs, FSAVCs and the like, they should have to compensate those same people when they applied their instructions to themselves.

On the FSAVC review, the FSA finally adopted in Bulletin 4 what was suggested last year in relation to cases where the client should never have had an FSAVC: non-review type compensation to put the customer in the position he should have been in. For details of how to do this, see the FSAVC redress paper on my website www.adamsamuel.com. Generally, though, the story has been one of the FSA reducing the scope of the review and the calculations to be done to ensure that the review is completed in the shortest possible time. The newsflash and a paper on redress on the website has recorded this process. What is annoying is that it rewards those firms who have not responded to the review with the appropriate speed.

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The FSA's overall approach is to proclaim support for a pragmatic approach to the review. However, firms that do that without covering their backs by reference to the Guidance create a risk of regulatory action. Again, though, firms that have beefed up on training early and have applied the guidance to the letter appear to be making more progress with fewer staff. Higher compensation payments seem to be offset by lower staff costs, more quickly calculated redress and less re-work.

Dominating both reviews and endowments has been the court decision on demutualisation. When it was launched I expressed concerns about the test case that it could have implications for the industry well beyond the facts of the case. This has happened although not in the way predicted. A passing comment by the judge has forced the FSA to scrutinise bonus payments made to clients' policies on demutualisation and to require firms to separate them out. There is a consultation paper due out any moment now. The court decision has left the FSA with little choice but to apply the same rules to endowments and the FSAVC review. This all makes the decision to go to court look expensive particularly for the IFA and PI insurance industry.

One issue that emerged recently is that one occupational scheme is threatening firms not to reinstate pension review clients if they do not pay more money than previously agreed. The best way to scare the scheme off is by a well-reasoned response. If the scheme and the firm have a concluded contract for the reinstatement and the firm has complied with the conditions in it, there is only one issue. Did the company know that the scheme had made a mistake and fail to tell them?