December 1999

Dear Friends

Rather than sending Hannucah/Christmas/Duvali/Ramadan cards to my friends, I thought that I d try a different approach. People regularly tell me to produce a newsletter, something I ve never tried. So, this is an experiment on which I would be very grateful for your views.

Essentially, what I do can be divided into three unequal parts: (a) pension review, (b) compliance and complaint handling and (c) arbitration. Recipients of this may know me because of one or two of these but rarely three. Nevertheless, I hope that you will find things of interest in sections other than those covering your own sphere.

From a work point of view, 1999 has been a best ever. While complacency is an ever-present threat, this was the year when I felt that my business really arrived. The main reason for this is you, the readers of this. Without the bookings to do courses or write opinions, things just cannot happen. More importantly, though, through work, lectures, meetings and correspondence, I have met delightful people from all parts of the UK and abroad who in different ways I am proud to have as friends. In this respect, I am very like a well-known European politician of whom it was said about his dealings with Mrs Thatcher: He finds it hard to do business with people he doesn t regard as friends. Like all good friends, many of you are not scared to tell me where I am going wrong or what I should be doing to improve what I do. Keep it up.

This year, the business has greatly increased my knowledge of the pleasant parts of Britain. I discovered the Floosie in the Jacuzzi in Birmingham, Colin Baxter s excellent Pocket Guides to York and Edinburgh and the lovely countryside around Wilmslow. I ve also taken in an icy walk on the Bristol South Downs and a happy return to the tremendous Déjà Vu bistro in Kendal.

As anyone in the training world should do, I do my own continuing education. I passed the CII s Mortgage Adviser s Qualification and Sales Management and the Supervisory Process (H15) exams (the latter while I was having a new bathroom fitted!). I continue to plough through huge quantities of arbitration material in the hope of finally writing the second edition of my book on that subject. People shower me with things that I might find of interest to read, something for which I am always grateful.

Compliance and complaint handling

This year, every complaint handler s wish started to come true for me. A company asked me to help train advisers and supervisors to stop problems happening in the first place. I found looking at files rejected by compliance with advisers a fascinating business. The participants leave with three different sets of views: the fact-find checkers, mine and their colleagues. Since each has a different perspective, the total effect has to be good news. Good advisers are only too keen to explain how their unnamed colleagues may have slipped up. The fact that people are not inherently hypocritical makes them unlikely to make the same mistakes themselves.

There is a great deal of talk about what makes a good compliance officer. One of the people I worked with this year was described by a supervisor as awesome . Compliance officers should never receive a better compliment. Lovability is not a requirement.
1999 was a year when a number of technical issues I have been concentrating on since 1996 and before came darting up to the surface. Sales of endowments, Free Standing Additional Voluntary Contribution pensions and pension mortgages all came under fire in the press. Yet, the PIA has only issued a flawed Regulatory Update on FSAVCs in 1996 and nothing on the other two. The PIA Ombudsman flagged up the pension mortgage question. In an article in July s Money Management, I tackled the same issues. I cannot think of anyone who should have one of these loans. Increasingly, the PIAOB seems to be taking the same view.

More recently, the Institute and Faculty of Actuaries exposed the simple problem with endowment and pension mortgages. In their excellent executive summary, they make the point that in view of the risk free, simple nature of the capital repayment approach, any other method has to be demonstrably better for the customer in order for its sale to be justified. The Institute of Actuaries and the PIAOB together have probably rendered endowment loans for the over 45s impossible to justify at present. The trade press likes to draw attention to the excellent returns on endowments maturing now. Many, though, were taken out before the abolition of Life Assurance Premium Relief in March 1984 and so, one is not comparing like with like.

There are other types of people for whom mortgage endowments were never justifiable: the single and without dependants who do not need life cover and whose lifestyles typically change significantly with time, foreigners and people who have lapsed endowments in the past. Now with the reduction in investment returns, the endowment approach is not even cheaper.

After an erratic past in this area, PIAOB now seems to be consistently upholding complaints about FSAVC sales assuming that a loss has been suffered. The FSA Consultative Paper in this area confirms suspicions that the regulators are terrified of another full-scale pension review. At the same time, the report rightly indicates that very few FSAVCs will be suitable. This is particularly true when compared with a PEP/ISA (as required by RU20). By limiting the scope of the review, the regulator is shifting the pressure from those involved in that process onto complaints departments. The difficulty now is that with guidance pending, firms would be unwise to offer compensation and risk having to re-do the work. An interim statement from the regulator on this would help. Will firms run into trouble using the simplified compensation method for review cases and the purist answer for non-review files? Finally, I struggled with the approach for compensation in over-funding cases. Surely, the easy way to do this would be to agree a reasonable rate of return on premiums based on PEP fund performance and offer that instead of interest on the refund of premiums. A table could easily be produced for this purpose. The rate of return would have to contain an adjustment for the loss of the tax-free wrapper.

This year has brought its share of messy Know your customer and suitability questions. Firms still struggle to identify clearly **who** their customer is with married couples and senile parents. Increasingly, errors on the fact-find are being attributable to the adviser and not the customer. The exception is lies about age. Orlando Hernandez is now described as a 30-something baseball pitcher after Cuban divorce papers damaged his chances of a lucrative long-term contract with the New York Yankees. Otherwise, if the fact-find isn t true, only one side has a motive for this. It is not usually the client.

On the compensation side, some firms and the PIAOB struggle with the idea that the customer is entitled to pick whichever solution to which he is entitled that produces the best result. With missold policies, you have to offer a refund plus interest (subject to PSO approval in pension cases) because the contract can be avoided for non-disclosure unless the case involves a transfer from an occupational scheme or benefits have been taken. You also have to offer to put the customer where he would have been had compliant advice been given. With endowment and pension mortgage missales, this involves paying off what the customer would have re-paid from a capital repayment loan, compensating for the extra cost of life cover in the future and any mortgage switching expenses + interest. In pension mortgage cases, the PIAOB suggested a 25% deduction from the paid up or transfer value of the pension. This only makes sense where the customer should not have ended up paying both pension contributions and mortgage repayments. For this reason, it will not work in pension review cases.

If you would like copies of papers I presented to two Infoline conferences on compliance and compensation, drop me a line. At that conference, a speaker avoided answering a question four times running: How do you define a regulated complaint? The answer is that it must arise out of or in connection with investment business regulated by PIA or the firm s previous regulator. The PIA Rules send one scurrying for the Financial Services Act as regards the meaning of investment business . Selling, advising on the merits of transactions and arranging for others to buy are all in Schedule 12 of the Act. So, I reckon an allegation of errors of whatever type (including admin, DDM setting up and the like) in this area by the firm up until the investment is correctly set up or an alteration implemented must make a complaint regulated. The FSA was spotted mystery shopping in this area. So firms need to be careful. Note too that a complaint is not a complaint unless the customer or someone acting on his behalf indicates that he **may** be seeking redress.

In pathological complaint cases, the biggest problem is still avoiding Rumpolian premature adjudication . With (a sometimes abusive) customer hassling you to finish your investigation, it is only natural to reach a decision as quickly as possible. If this is done before discovering what happened, why it happened and what compensation is due, the decision will be flawed and the case may run forever. New points will keep cropping up. The senior management letter (like a decision on a pension review case) should be a full judgement stating the facts and discussing the issues so convincingly that a judge or Ombudsman Bureau can simply copy it out and use it for their decision or assessment. Without a statement of the facts, nobody apart from the casehandler and the customer knows what the case is about.

Pension Review

I have met so many awesome people in this area that I have one big test for the financial services industry. If by 2005, some of them are not compliance officers, the whole project will not have delivered all its value. It has been a fabulous if sometimes-tortuous learning experience for everyone, me included.

Some issues, though, keep cropping up. Firms cannot throw cases out of the review unless they can be satisfied that the client would not be eligible for an occupational scheme (OPS) in the foreseeable future. Checking with employers as to whether a scheme is available seems to be a must. Compliant sales frankly do not exist in this area. The same will apply for the FSAVC review.

A course participant said of the separate corroborating letter requirement for execution-only cases: Oh, isn t that the signed confession? A good answer and it reminded me of the West Midlands Serious Crimes Squad and some problems it had in that area. More seriously, staff sales must be treated as non-compliant review cases. We wouldn t be doing the review if staff had not been given misleading information during training. Regulators do not order massive reviews because of a few rogue salesmen.

Firms liability for lost pension following changes of employment has kept me busy this year. Last November s FSA Bulletin contained three and possibly four exceptions to the general rule that firms are liable. Each had an error in it. The only exception should have been where the customer has joined an OPS and stopped personal pension premiums. It is wrong to hold firms liable for future service where this has happened before the first change of employment. Likewise, the FSA cannot be right to end liability on the change where another adviser has become involved at or prior to that change. Finally, there is a hint that stopping pensions premiums might break the causal link. This seems to contradict PIA RU46 which is right on this. It is the loss of OPS benefits that are lost - in this the payment of premiums is not relevant. Members of OPSs tend to stay there by inertia even when they become short of money. As for the second exception relating to the situation where there is no scheme available after the change, that seems to have been massaged out of existence in Bulletin 3.

The second problem with the November 1998 Bulletin was that it gave firms the choice as to whether to take a pro-active approach to discovering about the later lost OPS benefits or to just invite clients to request a review for them. That this was a mistake was reflected in the FSA setting different deadlines for people using Option 2. A recent Derek Adams Project Managers Forum for which I was on the afternoon panel showed up beautifully the problems with all this and the second adviser exception to continuing liability. Where firms have chosen different options, joint liability turns the whole process into a soggy mess.

Where the client has paid more to the personal pension than the scheme required, firms sometimes seem unaware of the PIA RU46 requirement to take into account personal pension fund performance in calculating the compensation. It is wrong since one should be considering the performance of AVC funds (see PSO21 para 17), where the money should have gone, rather than the personal pension where it wrongly ended up. Nevertheless, one has to show compliance with the regulators views.

With under-contribution, we just have total mayhem. Where there is a modest under-contribution, the adviser may well have expressly guaranteed that personal pension benefits would be the same. With a large one, the PIA Ombudsman has solidly hinted that he would apply the Bowden rule to prevent firms making any deduction for the fact that the customer has contributed less to the personal pension than he would have done to the OPS. Frozen by all this, the FSA has just told firms that with large under-contributions, augmentation of the personal pension is permitted where the OPS will not reinstate customers partially.

One firm asked me to help with a standard letter to all customers in the review who might not have joined their scheme. We put in some typical features of schemes and re-jigged the company s tick-box form. It covered: customer has joined, will join, can t join and won t join and left a space under the last one for the customer to say why. The idea is to flush out the real reasons for non-joining and to be able address any misconceptions. It also pulled out at least one pension mortgage needing urgent attention.

Pension mortgages still cause problems for one simple reason. Firms try to do

the pension first. This makes the customer less likely to re-join the scheme quickly and makes the job far more difficult generally. People like to receive a wad of cash early on in a process.
One newer area relates to complaints. Any indication by him that the customer may be seeking redress is a complaint. When one has been received, the firm cannot use an internal appeals process and must refer the customer directly to the PIAOB using the Ombudsman s full name (whatever it is - silly rule). Any decision letter, on a complaint or not, should state the facts. Otherwise, mistakes will be made in the offer and nobody will know what the case is about unless they have handled it. Firms may be able to protect themselves from errors by stating that where the stated facts are not correct, the offer and any resulting agreement will be invalid. Legal departments continue to wreck perfectly good offers by insisting on useless non-admissions of liability, assignment (and worse) clauses and Latin. In this country, where the legal profession is currently outlawing the use of many Latin and Norman French terms as part of the Woolf reforms, may I wish the pension review, complaint handling and compliance parts of the financial services a Latin-free 2000. (You may note my avoidance of the word milennium !)

Arbitration

If you are a financial services person, don t switch off just yet. I continue to campaign for the industry to agree to an arbitration system to deal with disputes covering non-consumer problems: rows between assurers and advisers and the two of them with each other. One hears of so many unresolved disputes in this field that a simple low cost service might be all that it needs. The problem is that everyone needs to agree to it in advance. Decisions will have to be published (with the names omitted) and consistency ensured by centralising the process. Because of the New York Convention, companies trading in most major countries can protect themselves in this way when they find themselves in trouble with local brokerages. I would prefer a London club to a US court room any day.

I continue to do a little international arbitration work. The Soinco and Monaco hotel cases in which I was a bit part player are now published. Two bits of writing of mine appeared in print. One was a lecture on the Anglo-American arbitration legislation going back to 1689. The other was a piece in a Festschrift for my good friend Professor Jean-François Poudret about the incorporation of arbitral clauses into contracts by a general reference in the main contract. It produced a typically incisive response from the great man before I had even seen the published version! In Oxford, I gave a lecture on the real separability of arbitration clauses from the contracts in which they are contained, looking not just at the invalidity of the main agreement but ranging more into the different and distinct treatment of the two types of accord. This may well appear in print in the New Year. (Again tell me if you want a copy.)

This lecture should logically be part of the new Chapter 3 of my Jurisdictional Problems book when I manage to find time to write it. Ah well, that is one for 2000.

Best Wishes to everyone for next year

Yours

Adam Samuel

PS I do need to know particularly from Financial Services people whether they would like more of these newsletters more regularly.