



House of Commons
Treasury Committee

**Responses to the
Committee's Fifth
Report: Restoring
confidence in long-
term savings:
Endowment mortgages
(HC 394)**

**Fifth Special Report
of Session 2003–04**

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The Treasury Committee

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Fifth Special Report

On 11 March 2004, we published our Fifth Report, *Restoring confidence in long-term savings: Endowment mortgages*, as House of Commons paper No. 394. We have now received responses from the Government (dated 7 June 2004 appended below as Appendix 1) and the Financial Services Authority (dated 2 June 2004, appended below¹ as Appendix 2).

APPENDIX 1

GOVERNMENT RESPONSE TO THE FIFTH REPORT OF THE TREASURY COMMITTEE, SESSION 2003–04 (HC 394)

This memorandum sets out the Government's response to the Treasury Committee's report on Endowment Mortgages.

2. The Government thanks the Committee for bringing to public attention the serious issues for large numbers of people arising from endowment mortgages. The Government welcomes the actions being taken by the Financial Services Authority (FSA), and the industry, to resolve these issues.

Endowment mortgages

3. Buying a home represents the largest single financial transaction most people undertake. The Committee's report provides a valuable assessment of the development of the market for endowment mortgages and the influences and practices that led such products to be sold in large numbers to consumers during the 1980s and 1990s.

4. As with all financial transactions, it is an important principle that consumers fully understand both the risks involved and the protections they are entitled to. By their nature endowment mortgages carry the inherent risk that the policy might not repay the mortgage at the end of the term. The decline in inflation and interest rates through the 1990s has resulted in many endowment policies underperforming against what have proved to be over optimistic projections. It is clear that while some consumers understood the risks involved, many did not or were not fully informed of the risk involved.

5. In considering the extent to which consumer detriment has occurred, it is important to differentiate between those consumers who purchased an endowment mortgage in the full knowledge that the product's performance was dependent on the stock market, and those who did not have the risks in the product properly explained by providers or advisers or were wrongly advised about their suitability for them.

¹ See page 10

6. The Government recognises the vital role played by the financial services industry in the UK economy and the need to maintain justifiable confidence both in the market as a whole and firms and consumers who are active in it. The Government's approach to the financial services sector as a whole is premised on the twin convictions that industry should treat its customers fairly and consumers should secure a fair deal.

7. It is for this reason that the Government brought forward legislation in 1997 creating a single regulator, the Financial Services Authority (FSA). The FSA's statutory objectives include maintaining confidence in the market, promoting public awareness and the protection of consumers. Key aspects of the FSA's responsibilities are to protect consumers from mis-selling while ensuring the management of financial services firms have responsibilities for treating consumers fairly. In order to meet its statutory objectives, the FSA has founded its approach to regulation on analysis of risk, that seeks to balance the sometimes competing needs of industry and consumers. The Government welcomes this approach, in particular that it seeks to recognise the proper responsibilities of consumers themselves and of the industry's own management.

8. In this context, the Government supports the FSA's proposals in CP 207 for the fair treatment of with-profits policyholders. The proposals, which seek to improve transparency for policyholders, include rules and guidance on the management of funds, payouts, surrender values and market value reductions. Consumers can have confidence their interests will be considered and that firms have met their obligation to treat customers fairly.

9. The Committee believes that the tax system operating at the time of high sales of endowment mortgages enticed many consumers to purchase these products rather than comparable but simpler products such as repayment mortgages. The Committee endorses Ron Sandler's call for reducing complexity and distortions in the taxation of savings products. The Government has accepted the recommendations in Ron Sandler's report, in particular, his emphasis on minimising tax-generated distortions and of the desirability of a more level tax playing field for retail financial products. The Government will continue to look at Sandler's tax proposals in the wider context of tax issues affecting the market for life insurance and other pooled investment products such as unit trusts.

10. The Committee questions the effectiveness of appointed actuaries in their approach to investment issues, calling for more proactive and independently minded actuarial advice within the insurance industry. The Government supports the FSA's proposed reforms in this regard. In response to Lord Penrose's report of the Equitable Life inquiry, the Government announced an independent review into the actuarial profession. The review is being conducted by Sir Derek Morris, the former Chairman of the Competition Commission. The terms of reference for the review are to consider what professional and/or other regulatory framework would best promote recognised, high-quality and continuously developing actuarial standards, openness in the application of actuarial skills, transparency in the professional conduct of actuaries, accountability for their actions and an open and competitive market for actuarial advice in the UK. The review commenced on 1st May 2004 and is due to report by Spring 2005.

Endowment Mortgage mis-selling

11. There have clearly been problems in a significant number of cases with the sale of endowment mortgages. The Government considers the response of the FSA has been both proportionate and consistent, with the primary focus of its efforts being on securing fair treatment for consumers. It is important that the FSA continues to act based on an assessment of risk and full cost benefit analysis, while balancing its statutory objectives to maintain market confidence and protect consumers.

12. Given the passage of time since the majority of endowment policies were sold and the lack of contemporaneous records of the advice given at the time, the Government shares the Committee's view that it is difficult to be certain of the number of consumers who were mis-sold their policy. The Government supports moves by the FSA to take forward a programme of research to form a better understanding of the size and extent of the shortfalls facing consumers. It is vital to ensure there is accurate information of the number of policies still in force that are linked to a mortgage; action taken by consumers to address shortfalls, particularly in light of the increased numbers of policies with a projected shortfall and the characteristics of those affected; and the proportion of consumers who have complained and their reasons for complaining.

13. Where the FSA has been able to identify specific examples of mis-selling of financial services it has acted in a proportionate manner, while seeking to maintain market confidence. FSA action to date has resulted in 24 firms having paid or set aside £673.5m to go to those 430,000 consumers who it has been shown were victims of misselling.

14. It was as a direct result of the FSA's actions that the industry issued 'reprojection' letters to all policyholders informing them whether or not the policy was likely to fall short. This has resulted in over 450,000 complaints being made about the misselling of endowment mortgages (as at March 2004).

15. The Government also welcomes the efforts of the FSA to raise awareness among consumers both of the need to take action to deal with projected shortfalls and of their rights to complain if they believe they were mis-sold the policy. The steps agreed by the industry to provide clear messages to consumers will help. The Government urges the FSA to maintain and increase these efforts if its research finds that this information is failing to reach consumers.

16. The Sandler review recognised the need for closer alignment of consumer and provider interests in the area of financial services. The Government believes that many of the problems that arise subsequently can be addressed through the timely provision of information to consumers before and at the time of purchase.

17. The forthcoming suite of stakeholder products will have the necessary safeguards and will be sufficiently transparent to ensure consumers understand what they are paying for and how much they are paying. The selling regime in combination with the existence of regulated products, with a clear ceiling on the charges applied, will increase consumer confidence in savings in general and equity-based products in particular. The absence of exit penalties will act as a strong incentive to the industry to retain customers by ensuring

that they are treated fairly, while setting the charge cap at an appropriate level will encourage providers to compete for business.

18. The FSA's proposals to remove polarisation restrictions and the development of the menu approach for disclosing commission costs will provide a much more transparent regime than exists currently, and should encourage consumers to shop around for advice.

19. The Government also looks forward to the results of the ABI's initiative to look at the way in which long-term savings are sold, and particularly the role of commission. It is encouraging that the ABI intends that this will be an objective and fact-based analysis of how the present system performs and how it might develop in the light of regulatory and commercial changes.

Shortfalls

20. As the Committee recognises, any product linked to equities carries an element of risk, and this applies in respect of endowment policies. The expectation of a shortfall, therefore, is not an indication the consumer was mis-sold or that compensation is due. That said, it is an important principle that consumers or investors of whatever type should expect to be informed at regular intervals of the performance of their investments. This is essential so that consumers can consider fully or seek advice on the options available to maximise their returns.

21. The performance of the stock market in recent years, together with a period of low inflation and low interest rates, does mean that many consumers who purchased endowment policies in the 1980s and 1990s will not receive the returns they expected. The level of individual shortfalls and the impact on individual consumers is difficult to calculate as some of the projected losses may be mitigated by other factors, such as increases in house prices, and the current circumstances consumers find themselves in. This may explain in part why some consumers, who believe they were missold an endowment policy, have not complained. However, the Government accepts that many consumers may not realise they need to act. We therefore welcome further initiatives announced recently by the FSA and industry to raise awareness.

22. That some consumers are prepared to carry the shortfall or do not consider they were mis-sold the endowment policy, does not mean that all consumers will be able to cope. The Government has asked the FSA, as part of its further research into the effects of mortgage endowments, to identify those vulnerable consumers who may be particularly hard hit by projected shortfalls and/or unable to take action to correct these. With greater clarity of the extent of shortfalls and the numbers of consumers who may face significant hardship as a result, the Government, the FSA and industry will be better able to assess the most appropriate method of dealing with these problems.

23. In dealing with all consumers who face a shortfall, the Government will look to the industry to provide more specific information and personalised illustrations on the options for addressing the shortfall. We would also expect the industry to produce workable and economical solutions to allow consumers who reach the end of the mortgage term with a shortfall to deal with the outstanding debt, such as providing options to extend the loan or defer repayment until the property is sold.

Advice to consumers

24. The Government agrees with the Committee that it is important that consumers who believe they have been mis-sold endowment policies are given adequate opportunity to complain. It is equally important that those consumers whose endowment policy is projected to fall short, act quickly to address this. Recent announcements by the FSA and the ABI are welcome in this respect.

25. As the Committee recognises, the passage of time since most endowment policies were sold and the lack of contemporaneous records of the advice provided mean that it is difficult to properly assess the numbers of consumers who might be affected. The Government supports the efforts of the FSA both to raise awareness among all endowment policy holders of their rights to complain and to conduct research to provide a more accurate assessment of the position of different groups of consumers.

26. Figures from the FSA suggests that while consumers have higher awareness of endowments than other financial issues, levels of complaints are currently around 6% of all policyholders. While the proportion of policyholders who have so far complained appears low, there may be further factors other than low awareness affecting the propensity of consumers to complain. Many endowments policies sold in the early 1980s will, typically, be smaller than the average because house prices were lower. This may result in lower than average shortfalls, which when offset against a tripling of the average house price since 1988, may lead many consumers to decide that the shortfall is manageable in face of other factors.

27. The Government welcomes the ABI's recently revised code of practice which sets minimum standards for providers to inform consumers of their rights to complain and insists that all reprojection letters must include the relevant FSA factsheets on entitlement and method of complaining. This is an important and welcome step in ensuring consumers are aware of the steps they can take in addressing a shortfall or making a complaint against possible mis-selling. The Government also welcomes the rule change which the FSA has introduced which means that, in future, consumers will not face the time barring of their complaints unless they have first been explicitly told of the time they have to complain before they face being time barred.

28. Where no clear indication of a time limit has been given previously, the Government supports the FSA suggestion that firms either not invoke the time limit or voluntarily extend it and commends the attitude of some providers who have decided that they will not seek to time bar complaints from consumers concerning endowments. It is a fundamental principle that consumers should be made clearly aware and in timely manner of their ability to complain if they believe they were mis-sold an endowment policy.

29. To ensure consumers who need to take urgent corrective action receive the advice and guidance they seek, the Government fully supports and is working collaboratively with the FSA to develop a national strategy for raising financial capability. The Government welcomes the recent FSA publication "Building financial capability in the UK" which sets out the initial priorities to improve financial capability among consumers. A key aspect of this work will be to find innovative ways of delivering advice and information to consumers. The Government is also currently consulting on changes to the regulatory

regime to clarify the position of advice centres. Our intention is that advice centres, such as Citizens' Advice will be confident that they are allowed to give financial advice and information to help endowment policyholders and other investors.

Complaints and compensation

30. The ability of consumers who believe they were mis-sold an endowment policy to make complaints depends on a number of factors: when they purchased the policy, from whom and when they first became aware the policy is likely to fall short.

Endowment sales prior to 29 April 1988

31. Regulation of the selling of financial services began on 29 April 1988, with the Financial Services Act 1986. The Financial Services and Markets Act 2000 did not extend jurisdiction retrospectively beyond 29 April 1998. Complaints about endowment policies sold directly by providers such as banks and building societies pre-1988 are eligible for consideration by the FOS if these firms were part of a voluntary scheme.

32. Pre-1988 there was no voluntary code or scheme covering the activities of IFAs and other intermediaries. Consequently, the FOS is unable to consider complaints from consumers who were mis-sold endowments policies by IFAs and other intermediaries before 29 April 1988.

33. Initial FSA research estimates that of the 8.5 million endowment policies currently (as at December 2003) in force 2.7 million of these were sold before 29 April 1998. Around 45% of all endowment policies were sold through an IFA and so are not subject to the pre-1988 jurisdiction of the FOS. This gives a total of around 1.2 million policies sold by an IFA pre-1988. Further factors to be considered in respect of pre-1988 IFA-sold policies and the propensity of consumers to complain include:

- Pre-1988 endowments will, typically, be smaller than the average because house prices were lower. Average house prices rose from £17,000 in 1979 to £29,000 in 1984²
- The pre-1988 period can be cut into two halves. Early policies (sold from 1979 to 1984) have a lower incidence of shortfalls, and where there are shortfalls these are typically much smaller (up to around £500)³
- 1/3 of all pre-1988 policies still in force were sold in 1984 or earlier and so are unlikely to have a significant shortfall.
- The average house price has now risen to around £160,000⁴, a further tripling on 1988 levels.

2 (Nationwide figures)

3 (Indicative figure only from DSA data firms December 2003)

4 (This is an average based on figures available from rightmove-£180,000, Nationwide £140,000)

- Mortgage interest rates are now only half the level prevailing in the 1980s, substantially reducing the cost of servicing a mortgage loan.

34. While the number of consumers who were mis-sold an endowment policy pre-1988, which is forecast to shortfall, may be smaller than initially thought, there will still be a significant number of consumers for whom there is no avenue of redress. The Government has discussed this issue with the FSA and welcomes the FSA's plans to conduct further analysis to establish a clearer picture of the numbers of consumers affected. It is also important to assess the relative abilities of consumers in this group to cope with a shortfall.

35. The options for extending existing avenues of redress or seeking voluntary agreement from industry to deal with such complaints are limited. Under its own rule-making powers the FSA cannot extend, retrospectively, the scope of the regulatory regime (and hence the FOS's jurisdiction) to cover this group of consumers.

36. Many of the IFA firms who mis-sold endowment policies have departed the industry since the late 1980s, which further reduces the scope of consumers to complain. While the policy provider could agree to look voluntarily at such complaints, as these are not responsible for the misselling, this will depend on the attitude of individual providers. The FSA is aware that seeking to impose such a solution on providers is legally unjustifiable. The Government supports the efforts of the FSA and industry to explore the scope for voluntary action to help consumers in this situation.

37. The Government does not believe it is appropriate to introduce retrospective legislation.

Endowment sales after 29 April 1988

38. Consumers who believe they were mis-sold endowment policies linked to mortgages after 29 April 1988 can rely upon the complaint mechanism introduced by the Financial Services and Markets Act 2000. This allows for the consumer to refer the complaint to the Financial Ombudsman Service (FOS), after the firm has had opportunity to consider the case, up until either:

- within six years of the date the policy was sold; or
- within three years from the date when the consumer ought reasonably to have become aware that they had grounds for believing they were missold

whichever is the later.

39. In general, the three-year time limit is deemed to run from the time the consumer first received a 'red' re-projection letter warning that there is a high risk of shortfall. The time limit is extended so that it ends six months from the date when the complainant receives a second 'red' letter.

40. The ABI's revised code of practice calls for greater prominence and clarity in the letters to consumers warning of projected shortfalls. The Government welcomes this initiative and urges all parts of the industry to adopt this approach, including the use of red

ink for headline messages such as “Red Alert: High Risk of Shortfall” to further encourage consumers to act.

Time-barred consumers

41. Those consumers who received two red reprojection letters in the first two waves issued by the industry in 2000/01 and 2002/03, had until six months after the second letter was received to make a complaint for misselling. The Government is aware that consumers may not have been aware of the limitation and understands that out of a total population of 8.5 million policyholders, an estimated 700,000 could already be time-barred if they wished to make a complaint.

42. As such, the Government welcomes the FSA announcement of a change in its rules which means going forward that firms will normally only be able to reject a complaint on time bar grounds if they have first provided a warning, at least six months in advance, to the consumer of the effect of limitation and provided notice of a ‘final date’ before which any complaint regarding the original sale of the policy must be made.

43. While this measure will provide protection to most policyholders, it will not protect those already potentially time barred. We strongly encourage firms to consider such cases and to review sympathetically the circumstances of each case. The Government supports the FSA in undertaking further discussions with firms and the industry on this and other voluntary initiatives.

Not yet time barred

44. As noted, the Government welcomes the rule change made by the FSA which means that, in future, consumers will not face the time barring of their complaints unless they have first been given advance notice of a date after which they would or may lose their right to make a complaint—i.e. “You have until XXXX to complain”. The effect of this change is to require firms to provide this specific information to consumers before they invoke limitation.

Compensation

45. The Financial Ombudsman Service (FOS) was set up in recognition that consumers want a speedy, fair and inexpensive method of resolving disputes. There can be little doubt that the FOS has and continues to meet this aim—over 61,000 complaints of all types were considered by the FOS last year.

46. The Government, however, acknowledges that some in the industry have raised concerns about the decision making process of the FOS. On 4 November, the Government announced, as part of the two-year review of the Financial Services and Markets Act 2000, that the FOS and the FSA will jointly review when regulatory action by the FSA should replace decisions on individual cases by the FOS and on the possibility of appeals of FOS decisions. The review process is underway and the FSA and the FOS are due to publish a consultation document on these issues in June.

47. The Government acknowledges that consumers who believe they were mis-sold an endowment policy by an IFA prior to 1988 face an additional hurdle in obtaining redress.

Lessons for the future

48. The Government is grateful to the Committee for its detailed examination of the circumstances surrounding the selling on endowment mortgages. The report has highlighted a number of problems that existed in the market for financial services. It is of fundamental importance that all users of financial markets understand and accept the risks involved, on the basis of all relevant information being provided and understood.

49. It is also clear that the industry owes a continuing duty of care to its customers, which does not end at the point of sale. This, and the ability of consumers to obtain speedy redress when things go wrong, are essential requirements for building trust and confidence in the UK financial services market.

50. The Government believes that the necessary regulatory changes have been introduced to deal with these issues going forward. It is working with the FSA to assess more accurately the scope of any outstanding problems caused and ensure that they can be dealt with effectively. The Government welcomes action by the industry to address the concerns raised by the Committee.

51. The Government will continue to work with all parties, consumers, the FSA and the industry to ensure that UK consumers are well served by an efficient financial services industry.

HM Treasury

7 June 2004

APPENDIX 2

RESPONSE BY THE FINANCIAL SERVICES AUTHORITY

Introduction

1. This note is submitted in response to the Committee's fifth report of the 2003-04 session on mortgage endowments. A number of recommendations were directed at the FSA. In response to these we refer to the relevant paragraphs in the report.

With-Profits policies (paragraph 12)

2. We agree with the Committee's conclusion that the development of simpler, more transparent products is a big challenge for the industry. In terms of our actions, we are introducing a series of changes which will benefit with-profits policyholders. One of the key components of the programme of reform for with-profits is for firms to articulate and publish the degree of discretion that they are allowed to exercise in the management of funds and to disclose how discretion has been exercised.

3. Improving transparency for existing and potential policyholders and treating customers fairly are the cornerstones of the changes being introduced. These include:

- giving informed users, including those who advise consumers on their investments, a better understanding of the way in which the with-profits fund is run, through the production of a document called the Principles and Practices of Financial Management (PPFM). We will also require firms to produce consumer friendly PPFMs later this year ;
- giving policyholders greater confidence in how firms will meet, and have met, the obligation to treat customers fairly through, for example, the report that firms are required to give to policyholders on their compliance with PPFM obligations;
- providing clearer and more transparent information for customers at—and post—point of sale on the nature and risks of their investment, and how it is performing, in relation to the published principles and practices applied in managing the fund; and
- providing informed users, including those who advise customers on their choice of investment, with improved access to information on the financial condition of firms and their with-profits funds (including the firms' ability to meet discretionary benefits such as terminal bonuses) through the publication of realistic balance sheets.

The Role of Actuaries (paragraph 18)

4. The Committee states that it is important that the FSA's reforms of the actuarial process within insurance companies are effective. We believe that they will be and we have

already sent the Committee evidence on our reforms of the role of actuaries in life insurers, which will come into effect at the end of this year. The advisory and reporting duties being placed on the actuaries performing both of the new actuarial functions should produce more proactive actuarial input to the firm's decision-making and earlier warning of any emerging problems. More independent-minded actuarial advice should also be encouraged by the steps we have taken to address the potential for conflicts of interest arising from these actuaries holding certain other positions within firms (for example, in future neither will be permitted to be chairman or chief executive, and the with-profits actuary must not sit on the board).

Paying for financial advice (paragraph 30)

5. Our work on the new disclosure regime to accompany depolarisation is aimed at aligning the interests of customers and advisers in terms of paying for financial advice. In the past, advice has normally been paid for out of the commission paid on sales via intermediaries, or from an equivalent margin for a direct sales force. Our research indicates that customers think that paying a fee for financial advice is the best way of avoiding the potential for the advice being biased by commission. However, the research also shows that few customers are prepared to pay by fee instead of commission.

6. Our proposals for a disclosure document entitled 'Key facts: A guide to the cost of our services' – also commonly known as the 'menu' – make clear to customers that both fee and commission options are available. They also include prescribed wording explaining the pros and cons of each. We propose that, in future, advisers who want to call themselves 'independent' must offer advice across the whole market and must always give their clients the opportunity to pay for the advice by fee (though they may offer a fee/ commission choice).

Asset Allocation (paragraph 33)

7. The Committee recommends that the FSA should make it a basic principle that all investors in long-term savings products are given regular information on the asset allocation policies of the product provider and how this is added to, or detracted from, the performance of the investment fund. Under our existing rules, policyholders are already provided with a range of information and we believe that the further disclosure required under the new 'Principles and Practices of Fund Management' (PPFM) documents will enhance the information available to policyholders' advisers (as well as policyholders themselves through consumer friendly PPFMs). There will be increased disclosure on, for example, a firm's investment strategy, charges to asset share, approach to payouts and how the with-profits fund is managed.

"Red" reprojction letters (paragraph 38)

8. We have agreed with the ABI that the revised ABI Code on mortgage endowment reprojction letters will include a recommendation that firms use red ink or other similarly striking means to draw to attention the key risk warning in "red" reprojction letters. For "red" letters, the risk warning should also be headed up with the words "Red Alert: High risk of shortfall".

Realistic reprojection rates (paragraph 41)

9. We agree that it is important for customers to receive realistic rejections of the likely future value of their policy. We have made clear that it is the responsibility of firms to ensure that the reprojection rates used are a realistic reflection of the nature and composition of the underlying funds and of the asset share of any particular policy in those funds. This is a complex judgement, and so we expect firms to keep the assessments and assumptions they use under constant challenge and review. This is the message we communicated to them in our Dear CEO letter of June 2003. We highlighted a range of factors that we expect firms to consider when deciding their reprojection rates. These include the ratio between equities and non-equity assets in the underlying funds and any guarantees or bonuses attached to a particular policy that may impact upon its value.

10. We will be carrying out focused periodic reviews and sampling of firms' methods during 2004–05 on a risk assessed basis.

Policyholders in closed funds (paragraph 51)

11. The Committee has highlighted its concern for policyholders in closed with-profits funds. There are a number of steps that we have taken or are in the process of taking to help address this. It is worth noting, however, that the fact that a fund has closed does not of itself mean that policyholders are being treated unfairly—some closed funds have performed well and closure has in fact been in the interests of policyholders. Questions of fairness have more to do with the financial strength of a firm and how the management have responded to this rather than closure itself, although we appreciate that financial weakness has in some cases resulted in closure.

12. Our programme of reform of the with-profits sector addresses both closed and open funds, and some of our proposals were designed specifically with closed funds in mind. Our recent consultation—Treating with-profits policyholders fairly—made a number of proposals on the treatment of policyholders in closed funds. These include better communication with policyholders (particularly in terms of explaining why the fund has closed and setting out policyholders' options) and better planning for the run-off of the fund. The consultation also contains proposals that are designed to ensure surrender values are fair—both to policyholders surrendering their policies and those who remain in the fund.

13. The Committee recommends that policyholders should be given the opportunity to switch without penalty to another similar fund when their fund closes—as opposed to taking a surrender value or continuing to maturity—and that shareholders should bear the costs. As noted above, closure is not always detrimental to policyholders' interests and similarly closure is not itself evidence of the mismanagement of a fund for which shareholders may be liable. It is unlikely that a shareholder could therefore be compelled to fund these proposals, and even if there were a case for shareholder support it is difficult to see why only policyholders choosing to switch should benefit from this.

14. There are a number of further considerations that must be taken into account with the proposal of a policy by policy move even if FSA could require it. These include, for example, the willingness of another provider with a fund to take on these policies and the

administrative costs associated with them, and the differences between with-profits contracts (for example, the type of guarantees and bonus policy offered in the fund that closes may be hard, and costly, to replicate in the receiving fund). A policy by policy transfer would also require clarity on any future liabilities for any mis-selling of the contract in the first place.

15. There is, however, scope for market-based solutions to address concerns about closed funds and we are encouraged that the industry is actively exploring innovations in this area. Chief amongst these is the sale of closed funds, effectively transferring a whole fund to another firm through a sale rather than on a policy by policy basis. This would involve firms that are interested in divesting their with-profits business selling their closed books to new or established players in the market. Although there is increasing interest among market participants in developing such solutions for some closed funds, this is not straightforward as it requires some careful balancing between the discount the vendor is willing to accept; the equity return that the purchaser requires; and the regulatory imperative for companies to treat their customers fairly.

16. The sale of an entire fund also addresses some of the difficulties associated with the Committee's proposed transfer solution. For example, economies of scale may be achieved through the sale of a complete book which would not be achieved on a policy by policy basis. This too is not without its difficulties as with-profits contracts and the legacy systems which support them differ across the sector and cannot simply be merged. These are significant obstacles that would need to be overcome to derive the full benefits. A sale may also mean that the fund is able to maintain the same terms and guarantees for policyholders, or alternatively the fund could be restructured. Finally, responsibility for mis-selling liabilities could be made clear before any deal was finalised. We cannot, however, require closed funds to be sold.

17. In the past, the lack of clarity and transparency surrounding the risks carried by some life funds has made them relatively unattractive to potential purchasers. However, greater transparency brought about by the recent introduction of PPFM (which closed funds are also required to produce) and the new capital adequacy reforms has meant that purchasers can quantify and price such risks more accurately. We would expect to see some consolidation among closed funds, with policyholders standing to benefit even if their fund remained closed.

Aligning company and consumer interests (commission and fees) (paragraph 53)

18. The Committee points out that a structure in which the fees charged by product providers are tied to the product meeting set investment targets would service the consumer better and recommend that the industry and the FSA investigate this.

19. We place a clear responsibility on the senior management of firms to treat their customers fairly. We are engaged in a series of studies with a range of companies about how best to encourage them to deliver on these responsibilities. The Committee will also be aware that the ABI has commissioned Charles River Associates to look at the way in which long term savings are sold, and in particular the role of commission. Our interest is to find ways of encouraging and rewarding best practice as a constructive means of making

progress – a much more productive relationship between the FSA and a regulated company than one based on failure to comply with rules accompanied by enforcement action.

Advice on financial services generally (paragraph 60)

20. We welcome the Committee's reference to the Financial Capability Steering Group. On 27 May 2004 it published a document, Building financial capability in the UK, which sets out a shared approach being taken by a wide range of national strategy partner organisations.

21. The Steering Group has identified seven priorities in order to improve people's ability to make financial decisions. One of these is a project to examine how to make the provision of accessible and affordable generic advice more widespread. This project is being lead by the FSA, and an Advisory Group of key stakeholders has begun this work. The others areas the Group will be looking at are: schools, young adults, work, families, borrowing and retirement.

22. The FSA also continues to stress the need for the financial services industry to treat their customers fairly and explain what they are selling in terms that buyers will understand.

Complaints and Factsheet on complaints (paragraphs 63 and 64)

23. Our research indicated that 86% of endowment policyholders recalled receiving a re-projection letter, rising to 99% among those people who had, according to firms' own records, received a re-projection letter in the last six months. With each of these letters, policyholders will have received an FSA factsheet 'Your endowment mortgage—time to decide' which will have helped them to decide whether they needed to take action and what they might do. The leaflet also provided information to help customers determine whether they should make a complaint and provided information on how to do this.

24. We are again updating our literature and policyholders will receive further information from us with the next round of re-projection letters. This will include further information for customers to explain what they can complain about and how they would go about making a complaint.

25. Under the revised ABI Code, the re-projection letters will include clearer, crisper text. The wording of the shortfall risk warning has been made more punchy and given greater visual impact through the use of red ink or other similar measures.

26. Our original consumer awareness research quoted above was undertaken about 18 months ago. Since then further re-projection letters, growing shortfalls and the awareness initiatives by us and other bodies may have changed many consumers' intentions, appetite for action and general awareness. We are undertaking further research to quantify and characterise these developments more precisely. The results will help us gauge the effectiveness of our past actions and guide us in refining our ongoing programme of work.

Time bars (paragraph 65)

27. Our message to customers has always been to ‘Act Now’—for example to take action to ensure that they will be able to repay their mortgage and/or to make a complaint. Our literature has reflected this, coupled with warnings of the consequences of delay.

28. In Phase 2 of the reprojection exercise (from Feb 2002) all reprojection letters included an FSA factsheet containing the warning, "If you think you have a valid complaint, take action now – if you delay, you could lose the right to some or all of any compensation..."

29. In Phase 3 (from Dec 2003) a revised FSA leaflet was sent with the warning, "If the risks relating to your endowment mortgage were not explained....you may have a valid complaint. But time may be running out. If you want to complain—do it now. Otherwise, you may be too late or the amount of compensation you can claim might be reduced...."

30. We have introduced new rules to ensure that all customers are fully aware of the time limits that apply to making complaints if they feel they have been mis-sold, as suggested by the Committee.

31. From 1 June 2004, our new rules mean that before they can be time barred, customers will receive letters which make clear what their position is and the final date before which a complaint must be made to prevent time barring. This notice must be given at least six months in advance.

32. We have also introduced transitional arrangements to protect consumers who have already received information from their providers and could, potentially, be time barred in the coming period. Firms will be required to provide these consumers with two months notice that time is about to expire. We have engaged in close dialogue with the ABI to achieve simultaneous changes to their mortgage endowments Code.

33. These measures will not be retrospective and will not affect consumers who are already time barred. A number of firms have decided not to impose time bars for these customers and others. We have discussed with the industry what more can be done on this and other voluntary initiatives (such as the reduction or waiving of charges normally entailed by switching a mortgage or paying off the outstanding balance early). We will be following up these discussions in the coming months.

Companies’ handling of complaints (paragraphs 69 and 71)

34. We note the Committee’s recommendation that the FSA needs to be more rigorous in ensuring that its policies and strategies are being effectively implemented by the financial services industry. Our general policy is that firms’ senior management should take responsibility for compliance with regulatory requirements. We have said on a number of occasions—for example in our Business Plan for 2004/05—that many firms still do not give sufficient priority to the regulatory requirement to treat customers fairly. We regard it as a core part of senior management’s responsibility to embed this principle throughout firms’ culture and to implement it in their strategies. Checking that firms do this is an important focus of our supervision of firms selling to retail customers. Where we discover firms seriously failing to treat their customers fairly, we take enforcement action.

35. The FSA continues to monitor firms' complaints handling performance very closely and we will not hesitate to take action where we believe that firms' complaints handling processes are inadequate or unsatisfactory. For example, we fined Allied Dunbar £725,000 in March this year and Friends Provident £675,000 in December last year for mishandling mortgage endowment complaints.

Cases prior to 1988 (paragraph 73)

36. Pre-1988 sales made by most major endowment providers are covered by the FOS's current jurisdiction since they agreed when joining the PIA Ombudsman scheme that pre-1988 complaints could be considered under the then voluntary jurisdiction. When the Financial Services and Markets Act 2000 took full effect in 2001 the existing scope of jurisdiction of the former ombudsman schemes was fixed and rolled over into the FOS's Compulsory Jurisdiction. But IFAs in the main did not sign up to this previously voluntary arrangement and so their pre-1988 complaints are not now covered by FOS.

37. Since this issue arises from the way the original regulatory regime was put in place, it is not something the FSA can change. Any effort to address this issue in a mandatory way would require significant change to the legislation setting the scope of the FOS Compulsory Jurisdiction in relation to pre-N2 complaints. We are, however, in dialogue with the industry to explore whether there is scope for some non-mandatory action that might help in cases prior to 1988.

Financial Services Authority
2 June 2004

List of Reports from the Treasury Committee since 2001

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Fifth Report	Restoring confidence in long-term savings: Endowment mortgages	HC 394	HC 655
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Seventh Report	The Administrative Costs of Tax Compliance	HC 269	awaited

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Ninth Report	Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC 1189	—

* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.