The constant gardener

The FOS has the laudable aim of imparting natural justice where a consumer and a firm are in dispute. But Alan Lakey has found worrying evidence that its rulings are far from consistent

In last month's *Money Management*, Jonathan Davies, partner in law firm Reynolds Porter Chamberlain, explained how financial advisers get a raw deal from the Financial Ombudsman Service (FOS) compared to other regulators. The raw deal extends beyond just the reduction to their human rights.

The objective of the (FOS) is to be fair and reasonable and the FOS delights in extolling the virtues of its remit. This remit may conveniently be described as consistent dispute mediation outside the confines of the law. "It is important for us that we apply consistent principles of fairness to each case", declared chief ombudsman Walter Merricks on BBC's Moneybox in April 2004.

Complaints that cannot be settled may be referred to the FOS where, after an investigation, an adjudicator will reach a conclusion as to the suitability of the advice. Adjudicators have access to KIT (knowledge and information toolkit), a database that provides guidance and assists it in pronouncing judgement. Ultimately, the adjudication will be couched in standard wordings created for convenience and speed and also to promote an impression of uniformity, although each adjudicator will have his or her own favourite phrases.

Both adjudicators and ombudsmen walk a fine line. Whilst they are free to reach whatever decisions they feel appropriate, and are able to ignore statutory law, it is essential that consumers and firms receive just and even-handed treatment. It is therefore integral to the process that firms have prior knowledge of how the FOS is likely to react to a complaint. Additionally, for a body entirely funded by the financial services industry, it is only fair and reasonable to demand consistency in the process of investigation and adjudication.

In her July 2004 report on the Financial Ombudsman Service, Professor Elaine Kempson stated, "We found no evidence to suggest there was significant inconsistency in case outcomes." Firms that have dealt with the FOS on several occasions may well have a different opinion.

The anti-FOS myth

Contrary to the beliefs held by some commentators, the majority of financial adviser firms do not hold staunchly anti-FOS views. Such an arbitration service would be entirely worthy of industry support were it not for strategic design faults that erode the patina of fairness and thereby undermine adviser confidence.

I refer to the abrogation of fundamental rights, such as being presumed innocent until proven guilty, the right to be judged by a court and to enjoy the protection afforded by law. I refer to the lack of an independent appeals procedure and the inability to use the 15 year longstop against stale claims.

The FOS advises firms that its decisions are based "on the balance of probabilities – in other words, on what we consider is most likely to have happened." By way of stark contrast, during February 2007, Philip Davies, Conservative MP for Shipley, asked the Secretary of State for the home department "whether there are any offences which require a defendant to prove innocence rather than the

Case study 1 : Subjectivity vs objectivity (4138269)

One major concern is that complaints that would founder within the courthouse may be upheld by an adjudicator and/or ombudsman.

One example involves a woman aged 49 who took out a 15 year endowment to repay her mortgage. With the arrival of a 'red' reprojection letter she complained. Her specific allegations stated that she was guaranteed that the plan would repay her loan and also that the plan extended beyond her retirement age.

The adjudicator found no evidence of any guarantee; indeed she had received not one but two illustrations, each showing a 7.9% growth requirement with a shortfall and surplus at the then standard growth rates of 7% and 10.5%. The complaint regarding her retirement age was also rejected, because she had taken early retirement. The adjudicator accepted that figures for both endowment and repayment had been provided for periods of 10, 15 and 20 years. He felt that the cost of a 10 year mortgage would have been beyond affordability and 20 years beyond retirement.

Were this a court action the case would have been thrown out. However the FOS investigates the 'suitability' of the advice and upheld the complaint. They agreed that illustrations and brochures had been provided and the illustrations complied with the rules of that time. A factfind was available, admittedly not as exhaustive as such a document would be today; comparative figures were provided even though this was not then a regulatory requirement.

An Ombudsman rubber-stamped the adjudication, which centred on their belief that the complainant would not have accepted any risk - they considered that she was risk averse. So how does this square with the accepted evidence that she received two illustrations, each of which highlighted a shortfall using the lower growth rate? Was the FOS suggesting that she was too dim-witted to understand the words and the figures? Why is it that the duty of reading forms and brochures and asking questions thereof did not extend to her?

Previously, an adjudicator confirmed to a complainant (1000159086), "I do not believe a court would rely on a litigant's unsubstantiated memory of events which took place some years previously, particularly where there is contrary evidence available."

The postscript to this case is that the loss calculation showed the complainant was £2,800 adrift. FOS does not allow the reduced outgoings enjoyed with the endowment mortgage to be taken into account (although increased outgoings are factored in). Therefore £5,000 'compensation' was paid. The claimant had also received a £3,900 windfall from her insurer, so, instead of being placed back into the position in which she would have been, she is actually £6,100 better off. She has also retained the endowment and will enjoy the benefits of the final bonus addition.

prosecution having to prove guilt?" The relevant minister, Tony McNulty, replied unequivocally, "A person may only be convicted of an offence if the prosecution proves his guilt beyond reasonable doubt. It is a fundamental principle enshrined in the European Convention on Human Rights that a person is presumed innocent until proven guilty."

The definition of "natural justice" as used in the ACAS Code of Practice on discipline and grievance says that a person against whom allegations are made should have:

- Advance notice of the allegations and evidence, and
- The opportunity to challenge allegations and evidence before decisions are reached, and
- The right of appeal against any decision taken

Despite these transgressions of human rights the FOS is often found to be failing on its basic principal of consistency within its adjudications. As Norman Lamb MP succinctly put it to Walter Merricks, "You make quasi-judicial decisions that can affect people's livelihoods."

The FOS's boasts of consistency are an illusion; it delivers an unpredictable and variable service to its stakeholders, which, together with the aforementioned human rights issues, combine to create a massive erosion of rights. This is all the more unpalatable as these very same disadvantaged firms fund the entire £57m annual budget by way of an annual levy and, potentially, £400 case fees.

Inconsistency

The oft repeated defence to accusations of inconsistency is that each case is different and is judged on its merits, that subtle nuances will inform each adjudication. This will certainly be true in many instances; however there are plentiful examples where the rationality is far adrift from other adjudications.

Generally there is agreement that the consumer has a duty of care to himself, epitomised within caveat emptor. Self-responsibility extends to reading illustrations and accompanying literature and asking questions if the wordings or the concepts are unclear. Adjudicators routinely state, (3682163), "It has been held by the High Court that it was the duty of the applicant to read the answers in the proposal form before signing it, and an applicant must be taken to have read and adopted them when he signed." However, not every adjudicator accepts this viewpoint, as shown below.

Endowment maturing

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after retirement

Adjudicators often take the reasoned view that, having received an illustration, signed a form for a savings plan and received a plan schedule the complainant will have been, or ought reasonably to have been, aware of the plan duration at the outset.

However, in August 2006, one adjudicator who found in favour of the complainant was moved to say, (4478755), "The adviser would have known the complainants were age 46 and 42 at the time of sale. It is clear they would be 71 and 67 when the policy matures. This fact alone should have prompted the adviser to question the suitability of selling another endowment for a term of 25 years."

A March 2004 adjudication, which found in favour of the IFA (3620815), stated, "There is nothing to show why you could not have discovered the fact that the policy ran past your proposed retirement when you signed the application form and received the policy documents as there are no facts available now that were not available at that time."

What should an adviser read into this? Are there policyholders that cannot understand the policy duration at the outset, or is it more likely that, years later, they have realised that such an assertion enables them to claim mis-selling with the attendant possibility of a windfall compensation payment?

Where there are existing endowment policies

There is general agreement that holding one or more existing endowments implies that the complainant is prepared to accept

at least some degree of risk. Two statements from adjudicators that found in favour of the IFA were, (5031505) "It is evident that the existence of an existing endowment policy would not constitute a risk averse investor." Similarly, (4423948) "In particular you held existing endowment policies which suggests you were not risk averse investors."

Recently a worrying trend has seen adjudicators ignoring the relevance of plans purchased prior to 29 April 1988 (A-Day) as evidence of the understanding of risk. Comments of adjudicators that found in favour of the complainants were, (5856074) "They did have two existing endowment policies but they were both sold pre A-day, when the regulatory requirements of the 1986 Financial Services Act did not exist and it is therefore impossible to be sure they realised what they were taking on in 1983 and 1985. These earlier sales do not therefore in my view provide any insight into attitude to risk".

The same month another adjudicator conjectured (5869015), "Whilst it is possible that they may have gained some understanding of how such policies work, I know very little about the circumstances of the previous sale, which would have been before the implementation of the Financial Services Act. I do not believe, therefore, that I can rely on this evidence to conclude that they were sufficiently financially aware to appreciate the significance of their choice of investment in 1993."

Adjudicators acknowledge that they are piecing together a historic scenario. Why then would a claimant with a 1987 endowment be less likely to understand the concept than one with a 1989 plan? The logic is predicated on pre A-Day sales being unregulated. As one adviser dryly observed, if pre A-Day advice is deemed suspect due to lack of regulation, then all post A-Day advice must therefore be acceptable as it occurred within a regulated environment?

More logical observations came from other adjudications (4251741), "I have also considered that by 1995, having held several endowment policies for a number of years that you would have received annual statements showing bonuses being added to your policies, which would have given you some appreciation of how these policies work". Also, (5782840), "I cannot disregard the fact that you have been borrowing on an interest-only basis since 1987. In my view you would have had some awareness of how this type of mortgage worked."

Whatever your viewpoint it is apparent that adjudicators do not follow a consistent approach to the matter of existing investments.

Deferred house purchase planning

A more disquieting recent example of inconsistency related to a brother and sister who each purchased an endowment in anticipation of a future mortgage. Their situations were virtually identical and, upon the recommendation of their father, they each bought an endowment with the same provider from the same IFA firm. The adjudicator investigating the sister's complaint observed (5996871), "I have considered whether this was an inappropriate forward sale. Given the stated and documented intention, I am satisfied that on this occasion such a sale was as requested and was suitable."

In contrast, the adjudicator investigating the brother's complaint took a completely opposite stance (6018621). "An endowment policy for a single person means that the policyholder is paying for life assurance which he may not need…the problem with forward sales is that while the customer might plan to buy a house in the future, the firm cannot know at the time of the sale what the customer's attitude to risk might be in the future."

Risk averse?

Ultimately, the majority of investment complaints hinge on the question of acceptable risk. Adjudicators are uniformly of the view that a with-profits endowment is suitable for all but the risk averse investor (4851081), "not merely cautious or a low risk investor". Regrettably, most complainants, certainly those coached by claims chasers or consumer websites, assert that they were risk averse and would have opted for the repayment method had they realised that there was any risk.

They are instructed regarding the specific areas to complain about and they are at liberty to do so in the knowledge that they are free to misrepresent and lie without fear of retribution. Said an Ombudsman, finding in favour of the complainant (4138269), "In the light of her representations, I think it is therefore unlikely that that she would knowingly have exposed herself to investment risk in relation to this major financial commitment and especially for something as important as the repayment of her mortgage."

Not all adjudicators believe such assertions. Another adjudicator, finding in favour of the IFA on a matter of investment risk, said to the complainant (4521044), "A number of illustrations were provided which showed a potential shortfall at a rate of return of 5%. I can only conclude that adequate shortfall warnings were given in this instance." Also (5996871), "I consider the illustration contained enough information to enable a potential investor to make an informed judgment on whether or not to proceed".

Occupation

Occupation is taken into account when assessing a complaint. FOS does not proffer information regarding this but it appears to accept that certain occupations suggest a higher likelihood of comprehension (4873266): "…the fact that you had your own business would indicate that you were the type of investor who was prepared to take a risk with his money for potentially higher returns", said an adjudicator finding in favour of the IFA.

Another adjudicator stated (5856074), "I cannot agree with your assertion that his lifestyle and the fact that he was 'used to making financial decisions on a daily basis' has any relevance. The fact that he set up his own business is equally immaterial".

This contrasts with the adjudicator (4377990) who stated, "When the policy was sold you were a chemical engineer, which indicates to me that even in the absence of specific knowledge, you would have the intellectual ability to interpret the documentation provided in sufficient measure to realise that the maturity value of the policy was not guaranteed."

Time-barring of complaints

The rules concerning time bars on mortgage endowments are complex, having been changed twice in the past five years. Whereas the FOS is loathe to accept that anything other than a high risk letter starts the time bar clock ticking, it has no problem with what is called 'the six and three rule' in other respects: "The rules under which we operate say we cannot normally deal with complaints where: more than six years have passed since the event the customer is complaining about; or (if later) it is more than three years since the customer first became aware of the problem (or could reasonably have

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Case study 2: Retrospective legislation (42093166)

During 1993 a firm of advisers was approached by a woman to replace her existing unit linked mortgage endowment plan, her rationale being that the plan had been arranged by her ex-husband's friend.

She discussed risk with the firm and circled '3' on a risk scale of '1 to 10' and the firm subsequently recommended a Norwich Union with profit endowment plan. 10 years later she complained, her claim was rejected by the firm and she took the matter to the FOS.

The complaint was upheld by the adjudicator, who suggested that she was 'risk averse'. The firm then requested that the matter be assessed by an Ombudsman proper. Within its submission the firm pointed out numerous inconsistencies in the claimant's testimony and also factual errors within the adjudication.

Startlingly, the adjudicator had noted that while a with profit endowment was considered low risk in 1990, it was no longer considered low risk in 1993. He also incorrectly stated that the endowment was of the low-start variety.

The firm pointed out that the complainant had been risk-assessed and that she had circled the '3' within the factfind, something that she did not dispute. It further pointed out that she had claimed to have had no previous mortgage experience when, in fact, she had been party to a previous mortgage with her ex-husband. The firm also highlighted a letter to the complainant in which the discussion regarding risk was documented.

Despite these observations the Ombudsman upheld the complaint (4209316). The justification being that, "there was nothing within the firm's file which would have made her aware of the risks associated with the Norwich Union endowment policy". The Ombudsman accepted that the complainant had agreed a '3' on a risk scale of 1–10, a risk rating commensurate with a with profit endowment. The Ombudsman accepted that the Norwich Union plan was lower risk than the unit-linked plan that it replaced but accorded no weight to the proven inconsistencies within her testimony.

Contrast this with another case involving the same firm, (3597686). "I also note that you have stated in your complaint, more than once, that the firm are 'lying'. In their defence they have pointed out that in your endowment questionnaire you have stated that at the time of the endowment purchase in 1994, you were a first time buyer. They have produced documentary evidence in the form of a consent order from Liverpool County Court which orders your first wife to release you from the mortgage with Barclay's Bank and upon doing so you agree to assign your share of the endowment policy assigned to Barclay's Bank in support of the mortgage on the former matrimonial home. This appears to contradict your assertion you were a first time buyer. It would also appear you were familiar with the features and benefits of a mortgage endowment policy.

"Unfortunately, this contemporaneous documentary evidence has, I my view, seriously undermined the credibility of your case."

FOS adjudicators frequently state (614797), "we must turn to the available documentation to resolve the conflict of evidence." It is unclear what message to draw from this case other than documentation sometimes takes second place to opinion and that FOS decisions are not necessarily imbued with logic and may at best be described as capricious.

become aware of it).

"This part of your complaint appears to be outside the rules because whilst you say you were not aware that the policy term extends beyond your normal retirement date, I believe it is reasonable to say that the fact you are complaining about was ascertainable by you at the time you commenced the policy, as it would have been clear from the application form, and the policy document, when the policy matured and the date that you would have to pay the premiums to.

"Even if you were to argue that you did not read the policy documents, my view is that you could have discovered the maturity date on the policy by using reasonable diligence, which would include reading the application form and policy document."

Time-barring is governed by the Dispute Resolution Rules (DISP) set out within the FSA handbook. Rule DISP 2.3.1R(1)(c), as quoted above, is unequivocal. This rule is now being overridden by DISP 2.3.1(a)G which is not a rule, merely guidance. The guidance suggests that the time bar clock can only be started upon receipt, by the policyholder, of a high risk reprojection letter, this being where the policy is projected to miss its target using all three growth rates.

However, the feedback on CP158 (the FSA policy statement from January 2003), accepts that the time bar clock may have started for some policyholders before the institution of reprojection letters in April 2000.

Adjudicators and ombudsmen are adamant that the FSA guidance takes precedence over the FSA rule and this enables them to claim jurisdiction on cases where firms are reasonably arguing that a complaint is already time barred.

Many of these arguments revolve around contractual reviews where the providers issue regular updates and projections and, where appropriate, invite the policyholder to increase the premium to bring the plan back on course.

Logic dictates that receipt of a personalised letter, warning of the likelihood of a shortfall and encouraging the policyholder to take action, would reasonably make a policyholder aware of the risk involved. At this point the three year clock should commence ticking. However the FOS routinely rejects such arguments. It hides behind convenient interpretations of the DISP rules even when these are both illogical and unfair.

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At the FOS workshop held at the Barbican in December 2005, ombudsman Christopher Tilson stated that the FOS accepts that some providers' contractual review letters would start the time bar clock ticking. Firms see little evidence of this as all such arguments are ignored. At least this behaviour is consistent.

Summary

Inconsistency seems rife. FOS can make awards up to £100,000 yet, unlike bizarre courtroom decisions, firms have no right of appeal once an Ombudsman has deliberated. Complainants can lie, invent or distort without warning or retribution and an element of chance is involved as to whether the adjudicator will be partisan. A miscarriage of justice could easily destroy a small firm and cripple a larger one.

How can any adviser have confidence in a process that refutes established legal doctrines, which chooses to ignore factuality, which ascribes over-importance to claimants' recollections from years previous and often focuses on the views and prejudices of the adjudicator/Ombudsman?