# Appendix 1 Handling Mortgage Endowment Complaints

## 1.4 Policy reconstruction

**App 1.4.1** G This section of this appendix is primarily concerned with circumstances where the term of the mortgage and associated endowment *policy* extend beyond the individual complainant's normal retirement age in circumstances where the *firm* regards a complaint as justified because the arrangement is not affordable in retirement; and this could have, and should have, been foreseen at the time of the advice.

**App 1.4.2** G Two sets of circumstances are examined at ■ DISP App 1.4.3 G to ■ DISP App 1.4.13 G. Although these are considered in isolation, *firms* should, as part of their investigation of all of the factors involved in the complaint, consider whether either set of circumstances should be considered in conjunction with those factors examined at ■ DISP App 1.2.

### Case 1

**App 1.4.3** G If on enquiry it is found that no proper assessment of the complainant's post-retirement means had been undertaken at the time of *sale*, but if the likelihood had been that the complainant would have borrowed the same amount over a shorter term (up to retirement) using an endowment *policy* as a repayment vehicle, then an appropriate form of redress would be for the *policy* to be reconstructed with a shorter term.

**App 1.4.4** G Redress should in most cases be provided by meeting the cost of rearranging the *policy*, by way of a lump sum payment into the *policy* in respect of the higher rate of *premium* due from its inception. It may be appropriate in individual cases to take account of the lower *premiums* that the complainant will have paid to date. The *guidance* in ■ DISP App 1.2, as to the circumstances in which this will be appropriate, will be relevant here.

**App 1.4.5** G If the *policy* extends beyond retirement age and the complainant is already retired, the *policy* should be reconstructed to a maturity date as at the accepted retirement date, with the *policy* proceeds becoming immediately payable. The costs are to be borne by the *firm*, subject to any lower outgoings adjustment.

**App 1.4.6** G *Firms* should consider whether the reconstruction would have tax implications for complainants (see DISP App 1.5.8 G and DISP App 1.5.9 G).

**App 1.4.7** G The reconstruction process deals with the situation to the date the *policy* is reconstructed. The complainant will generally be responsible for paying the increased *premiums* for the remaining term.

**App 1.4.8** G At the time the complainant is advised of the revised *premium*, he should as a matter of good practice be provided with a reprojection based on the prevailing *projection* rates, which will allow him to address any projected shortfall.

**App 1.4.9** G If it is not possible for a *firm* to reconstruct a *policy*, then it should offer the investor equivalent redress, for example, by paying a cash lump sum equivalent to the amount that would have been credited to a reconstructed *policy*.

## Case 2

**App 1.4.10** G If a loan extending into retirement was on any basis not affordable, whether or not it is reconstructed to the retirement date, *firms* will need to consider whether, if proper advice had been given, the loan would have been taken out at all and, if not, consider what arrangements might now need to be made in order to reduce the amount of the complainant's borrowings.

## Mismatched loans and policy terms

**App 1.4.11** G If a complaint is regarded as justified by the *firm* on the basis that the endowment *policy* maturity date extends beyond the mortgage term expiry date and the *firm* is responsible for this situation, the *policy* should be reconstructed so that it matures at the expiry of the mortgage term.

**App 1.4.12** G In these circumstances the *guidance* given elsewhere in DISP App 1.4 will apply as appropriate.

## Examples

**App 1.4.13** G The following examples illustrate the approach to redress as described in this section.

**App 1.4.14** G Example 8

| Example 8 |
|---|
| **Term extends beyond retirement age and policy reconstruction** |
| Background |
| 45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term |

Example 8

of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th *policy* anniversary.

It has always been the intention of the complainant to retire at State retirement age 65.

Term from date of sale to retirement is 20 years and the maturity date of the mortgage is 5 years after retirement.

<u>Established facts</u>

| | |
|---|---|
| Established *premium* paid by investor on *policy* of original term (25 years): | £81.20 |
| *Premium* that would have been payable on *policy* with term from *sale* to retirement (20 years): | £111.20 |
| Actual *policy* value at time complaint assessed: | £12,500 |
| Value of an equivalent 20-year *policy* at time complaint assessed: | £21,300 |
| Difference in *policy* values at time complaint assessed: | £8,800 |
| Difference in outgoings (20 year *policy* - 25 year *policy*): | £4,320 |

<u>Basis of compensation</u>

The *policy* is reconstructed as if it had been set up originally on a term to mature at retirement age, in this example, a term of 20 years. The difference in the current value of the *policy* actually sold to the complainant and the current value of the reconstructed *policy*, as if the *premium* on the reconstructed *policy* had been paid from outset, is calculated. The complainant has gained from lower outgoings (lower *premiums*) of the actual endowment *policy* to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain.

**Redress generally if it is not unreasonable to take account of the whole of the gain from lower outgoings**

| | |
|---|---|
| Loss from current value of reconstructed *policy* less current value of actual *policy*: | (£8,800) |
| Gain from total lower outgoings under actual *policy*: | <u>£4,320</u> |
| Net loss: | (£4,480) |
| **Therefore total redress is:** | £4,480 |

**Redress if it is unreasonable to take account of gain from lower outgoings**

| | |
|---|---|
| Loss from current value of reconstructed *policy* less current value of actual *policy*: | (£8,800) |
| Gain from total lower outgoings under actual *policy*: | Ignored |
| **Therefore total redress is:** | <u>£8,800</u> |

<u>Additional Information</u>

If the *policy* is capable of reconstruction, the complainant must now fund the higher *premiums* himself for the remainder of the term of the shortened *policy* until maturity. In this example the higher *premium* could be £111.20. However the *firm* should provide the complainant with a reprojection letter based on the reconstructed

| Example 8 |
|---|
| *policy* such that the actual monthly payment required to achieve the target sum could be even higher, say £130. The reprojection letter should set out the range of options facing the complainant to deal with the projected shortfall, if any. |

**App 1.4.15** G Example 9

| Example 9 | |
|---|---|
| **Term extends beyond retirement age: example of failure to explain investment risks** | |
| Background | |
| 45 year old male non-smoker, having taken out a £50,000 loan in 1998 for a term of 25 years. Unsuitable sale identified on the grounds of affordability and complaint raised on 12th anniversary. | |
| It has always been the intention of the complainant to retire at state retirement age 65. | |
| Term from date of sale to retirement is 20 years and the maturity date of the mortgage is five years after retirement. | |
| In addition, an endowment does not meet the complainant's attitude to investment risk and a repayment mortgage would have been taken out if properly advised. | |
| Established facts | |
| *Surrender value* (on the 25 year *policy*) at time complaint assessed: | £12,500 |
| Capital repaid under repayment mortgage of term to retirement date (20 years): | £21,000 |
| *Surrender value* less capital repaid: | (£8.500) |
| Difference in outgoings (repayment - endowment): | £5,400 |
| Cost of converting from endowment mortgage to repayment mortgage: | £200 |
| Basis of compensation: | |
| The *surrender value* of the (25 year term) endowment *policy* is compared to the capital that would have been repaid to date under a repayment mortgage arranged to repay the loan at retirement age, in this example, a repayment mortgage for a term of 20 years. The complainant has gained from lower outgoings of the endowment mortgage to date. In calculating the redress, the gain may be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to take account of the gain. The conversion costs are also taken into account in calculating the redress. | |
| Redress generally | |
| Loss from *surrender value* less capital repaid: | (£8,500) |
| Gain from total lower outgoings under endowment mortgage: | £5,400 |
| Cost of converting to a repayment mortgage: | (£200) |
| Net loss: | (£3,300) |
| **Therefore total redress is:** | £3,300 |
| **Redress if it is unreasonable to take account of gain from lower outgoings** | |
| Loss from *surrender value* less capital repaid: | (£8,500) |

| Example 9 | |
|---|---|
| Gain from total lower outgoings under endowment mortgage: | Ignored |
| Cost of converting to a repayment mortgage: | (£8,700) |
| **Therefore total redress is:** | £8,700 |