Appendix 1 Handling Mortgage Endowment Complaints

1.1 Introduction

App 1.1.1 G This appendix sets out the approach and standards which *firms* should use when investigating complaints relating to the sale of endowment *policies* for the purposes of achieving capital repayment of a mortgage. It is not intended to be comprehensive. It is primarily concerned with the assessment of whether the complainant may have suffered financial loss, and if so, how much that loss is, and therefore what amount a *firm* should consider offering by way of fair and appropriate compensation in circumstances where the *firm*'s investigation of a complaint reveals:

(1) the complainant has received negligent *advice on investments*; and

(2) if this advice had not been negligent, either:

(a) the complainant would be unlikely to have acquired the endowment policy but instead would have taken out the same amount of loan on a repayment basis; or

(b) the complainant would have acquired an endowment mortgage for a shorter term.

App 1.1.2 G There will also be cases where a *firm* will conclude after investigation that, notwithstanding its own failure to give compliant and proper advice, the complainant would nevertheless have proceeded with the endowment policy as sold, in which case no compensation will be due.

App 1.1.3 G This appendix only addresses how *firms* should approach the assessment of loss and compensation where negligence on the part of the *firm* is established.

App 1.1.4 G This appendix is relevant both to the obligations arising under the complaints handling *rules* contained in ■ DISP 1 and to the *FCA*'s approach to the supervision of *firms*.

App 1.1.5 G This appendix is also relevant to complaints which the *Ombudsman* may investigate under the Compulsory Jurisdiction or *Voluntary Jurisdiction* of the *Financial Ombudsman Service* established under Part XVI of the *Act* (The Ombudsman Scheme).

App 1.1.6 G Before proceeding to assess the extent of a complainant's financial loss, a *firm* will usually have completed the following stages:

(1) gathering all relevant facts and information;

(2) making a fair and objective assessment whether it has failed to comply with a relevant duty owed to the complainant; and

(3) assessing whether any failure of duty by it was in the circumstances a material failure in the sense that if it had not occurred the complainant would have been likely to have acted differently.

App 1.1.7 G If it is concluded that the complainant would have acted differently, the *firm* should proceed to assess any direct or consequential loss.

App 1.1.8 G Nothing in this appendix relieves *firms* of the obligation to consider the particular facts and circumstances of each complaint and to consider whether the assessment of loss and compensation should, in the light of those facts and circumstances, be carried out on a different basis. If, however, the facts and circumstances make it appropriate to do so, the *FCA's* expectation is that *firms* will apply the approach and standards set out in this appendix, and where they do not, the *FCA* is likely to require them to demonstrate the adequacy and completeness of their alternative approach.

1.2 The standard approach to redress

App 1.2.1 G If there has been a failure to give compliant and proper advice, or some other breach of the duty of care, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice had not been given, or the other breach had not occurred. In many cases, although it must be a matter for inquiry and assessment in each individual case, this position is likely to have resulted in the complainant taking a repayment mortgage with accompanying life cover, and this is the assumption which underpins the standard approach to redress.

App 1.2.2 G Unless the contrary is demonstrated, it should be assumed that the complainant could have afforded the mortgage on a repayment basis.

App 1.2.3 G The measure of any financial loss suffered by the complainant will be arrived at by:

(1) comparing the complainant's current capital position with the position he would have been in had the loan been a standard repayment mortgage as at the date the *firm* decides to regard the complaint as justified; and

(2) comparing the cost of the complainant's actual monthly outgoings and those he would have made had his loan been on a standard repayment basis as at the date the *firm* decides to regard the complaint as justified.

App 1.2.4 G In some cases other factors may be included in the overall calculation, for example, if mortgage arrangement fees were waived by agreement on the occasion of the endowment *policy* being taken out.

App 1.2.5 G If, on comparing the complainant's current endowment position with the repayment alternative, the *surrender value* of the endowment *policy* exceeds the amount of the capital which the complainant would have repaid through the repayment method, then, at the point of the assessment, the complainant has suffered no capital loss (but the complainant may suffer some compensatable consequential loss associated with changing the mortgage arrangements to the repayment basis, see DISP App 1.3). Conversely, if the capital which would have been repaid on the repayment basis exceeds the *surrender value*, there is a capital loss represented by the difference between the two amounts.

App 1.2.6 G If the complainant's endowment mortgage outgoings exceed the equivalent cost for the repayment method, the complainant should be compensated for the higher payments in addition to any loss on the *surrender value* and capital repaid comparison. This means, for example, that if the endowment arrangement has been more expensive, this may result in compensatable loss even though the capital repayment against surrender comparison may be favourable to the endowment.

App 1.2.7 G If the total cost of the outgoings for the endowment calculation is less than that for the repayment calculation, the "savings" should be brought into account in assessing any overall loss unless it is unreasonable to do so.

App 1.2.8 G It is unlikely to be reasonable to bring "savings" into account in circumstances where, at the time of the sale of the *policy*:

(1) the complainant was advised or informed orally or in writing that he would have lower outgoings than would be the case under a repayment mortgage, whether or not the difference was quantified; and

(2) the complainant has dissipated those "savings" on the strength of this advice or information.

App 1.2.9 G The circumstances in which it may be appropriate to take some or all of the "savings" into account are those where, subject to DISP App 1.2.7 G, the complainant is of "sufficient means" so that it is reasonable for a *firm* to assume that the "savings" have contributed to those means.

App 1.2.10 G Where it is otherwise reasonable for "savings" to be brought into account, determining whether or not a complainant is of sufficient means and, if so, to what extent the "savings" are to be brought into account, will have to be based on the facts of each individual case. It will be appropriate to require the complainant to provide adequate information to assist the *firm* in this task. Matters to be taken into account in this assessment may include:

(1) the length of the remaining mortgage term;

(2) the complainant's current and prospective resources;

(3) the amount of the capital shortfall in proportion to the endowment outgoings balance.

App 1.2.11 G *Firms* may adopt streamlined processes to assist them in individual assessments of "sufficient means", but will have to satisfy themselves that the complainant's position is nevertheless protected. *Firms* will need to ensure that the complainant is given an opportunity to make an informed choice whether to accept the streamlined process, that the process itself is transparent, and that the *firm* is satisfied that the outcome would be fair to complainants.

App 1.2.12 G If a *firm* intends to make a deduction for all or any part of the lower endowment outgoings, the *firm* should explain clearly to the complainant in writing both how the 'sufficient means' test has been satisfied, including details of the information taken into account in reaching the decision, and how the deduction has been arrived at. The letter should further inform the complainant that if he is unhappy with the proposal to make a deduction, either in principle or as to the amount, he should give his reasons to the *firm*.

App 1.2.13 G If a complainant puts forward a case that it would be unreasonable for a deduction to be made, the *firm* should reach a fair and objective determination on the facts of all relevant matters including those set out at ■ DISP App 1.2.8 G and ■ DISP App 1.2.9 G.

App 1.2.14 G In recognition that *firms* may not wish, for practical reasons, to make individual assessments of "sufficient means", *firms* may decide not to seek to bring into account any benefit to the complainant in assessing overall compensation.

App 1.2.15 G It would not be unreasonable if a *firm* providing redress in these circumstances were to frame its offer of redress on the assumption that the complainant will agree to surrender the *policy*. However, *firms* should bear in mind that there may be circumstances where it is appropriate for the complainant to retain the *policy*, for example, where it is being retained as a savings vehicle.

App 1.2.16 G If a complainant becomes aware that he has taken out the endowment *policy* on the basis of unsuitable advice and inadequate information, he should if necessary, after taking appropriate advice, take reasonable steps to limit his loss, and may in any subsequent *claim* be unable to recover for losses which are avoidable. The complainant may have to show that he has not delayed unreasonably since becoming aware of his loss. The reasonable costs and expenses the complainant may have incurred in limiting his loss are to be taken into account in assessing his compensation. These costs and expenses are likely to include the complainant taking advice on whether he should convert from an endowment to a repayment mortgage and incurring expenses in doing so, see ■ DISP App 1.3.

App 1.2.17 G The standard approach to redress can be illustrated by the following examples, which show how redress would be calculated in certain hypothetical but typical scenarios. (Because the examples are illustrative, round numbers have been used for 'established facts' in each example. The payments should be taken as being made monthly: *firms* should not approximate by assuming that payments are made annually. If the complainant has benefited from MIRAS, the calculations should allow for the effect of MIRAS both on the endowment mortgage and the repayment comparison.)

App 1.2.18 G Table of examples of typical redress calculations

Example 1	Capital shortfall and higher endowment outgoings
Example 2	Capital shortfall partially offset by lower endowment mortgage outgoings
Example 3	Capital shortfall more than offset by lower endowment mortgage outgoings
Example 4	Capital surplus more than offset by higher endowment mortgage outgoings
Example 5	Capital surplus partially offset by higher endowment mortgage outgoings
Example 6	Capital surplus and lower endowment mortgage outgoings
Example 7	Low start endowment mortgage

App 1.2.19 G Example 1

Example 1	
Capital shortfall and higher endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 5 years	
Endowment *premium* per *month*: £75	
Established facts	
Endowment *surrender value*:	£3,200
Capital repaid under equivalent repayment mortgage:	£4,200
Surrender value less capital repaid:	(£1,000)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
Total outgoings to date	
Equivalent repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment *premium* + interest):	£22,250
Difference in outgoings (repayment - endowment):	(£300)

Example 1	
Basis of compensation	
In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid and also because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. The two losses and the conversion cost are therefore added together in order to calculate the redress.	
Redress	
Loss from *surrender value* less capital repaid:	(£1,000)
Loss from total extra outgoings under endowment mortgage:	(£300)
Cost of converting to repayment mortgage:	(£200)
Total loss:	(£1,500)
Therefore total redress is:	**£1,500**

App 1.2.20 G Example 2

Example 2	
Capital shortfall partially offset by lower endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 5 years	
Endowment *premium* per *month*: £60	
Established facts	
Endowment *surrender value*:	£2,500
Capital repaid under equivalent repayment mortgage	£4,200
Surrender value less capital repaid under equivalent repayment mortgage:	(£1,700)
Cost of converting from endowment mortgage to repayment mortgage	(£300)
Total outgoings to date:	
Repayment mortgage (capital + interest + DTA life cover):	£21,950
Endowment mortgage (endowment *premium* + interest):	£21,350
Difference in outgoings (repayment - endowment):	£600
Basis of Compensation	
In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid but has gained form the 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.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	£600

Example 2	
Cost of converting to repayment mortgage:	(£300)
Net loss:	(£1,400)
Therefore total redress is:	**£1,400**
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£1,700)
Gain from total lower outgoings under endowment mortgage:	Ignored*
Cost of converting to repayment mortgage:	(£300)
Net loss taken into account:	(£2,000)
Therefore total redress is:	£2,000
* In this example, and also in Examples 3, 7, 8 and 9, the complainant's circumstances are assumed to be such as to make it unreasonable to take account of any of the gain from lower outgoings.	

App 1.2.21 G Example 3

Example 3	
Capital shortfall more than offset by lower endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 8 years	
Endowment *premium* per *month*: £65	
Established facts	
Endowment *surrender value*:	£7,300
Capital repaid under equivalent repayment mortgage:	£7,600
Surrender value less capital repaid:	(£300)
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
Total outgoings to date:	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment *premium* + interest):	£33,990
Difference in outgoings (repayment - endowment):	£520
Basis of Compensation	
In this example, the complainant has suffered loss because the surrender value of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. In calculating 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 if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£300)

Example 3	
Gain from total lower outgoings under endowment mortgage:	£520
Cost of converting to repayment mortgage:	(£200)
Net gain:	£20
Therefore, there has been no loss and no redress is payable.	
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£300)
Gain from total lower outgoings under endowment mortgage:	Ignored
Cost of converting to repayment mortgage:	(£200)
Net loss taken into account:	(£500)
Therefore total redress is:	**£500**

App 1.2.22 G Example 4

Example 4	
Capital surplus more than offset by higher endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 8 years	
Endowment *premium* per *month*: £75	
Established facts	
Endowment *surrender value*:	£7,800
Capital repaid under equivalent repayment mortgage:	£7,600
Surrender value less capital repaid:	£200
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
Total outgoings to date:	
Repayment mortgage (capital + interest + DTA life cover):	£34,510
Endowment mortgage (endowment *premium* + interest):	£34,950
Difference in outgoings (repayment - endowment):	(£440)
Basis of Compensation	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage but has gained because the *surrender value* of the endowment is greater than the capital repaid. Since the sum of the loss and the conversion cost is greater than the gain, the redress is calculated as the difference between the two.	
Redress	

Example 4	
Gain from *surrender value* less capital repaid:	£200
Loss from total extra outgoings under endowment mortgage:	(£440)
Cost of converting to repayment mortgage:	(£250)
Net loss:	(£490)
Therefore total redress is:	**£490**

App 1.2.23 G Example 5

Example 5	
Capital surplus partially offset by higher endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 10 years	
Endowment *premium* per *month*: £75	
Established facts	
Endowment *surrender value*:	£11,800
Capital repaid under equivalent repayment mortgage	£9,700
Surrender value less capital repaid:	£2,100
Cost of converting from endowment mortgage to repayment mortgage:	(£300)
Total outgoings to date:	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment *premium* + interest):	£47,500
Difference in outgoings (repayment - endowment):	(£700)
Basis of Compensation	
In this example, the complainant has suffered loss because of the higher total outgoings to date of the endowment mortgage relative to the repayment mortgage. However the sum of this and the conversion cost is less than the complainant's gain from the difference between the *surrender value* of the endowment and the capital repaid. Thus no redress is payable.	
Redress	
Gain from *surrender value* less capital repaid:	£2,100
Loss from total extra outgoings under endowment mortgage:	(£700)
Cost of converting to repayment mortgage:	(£300)
Net gain:	£1,100
Therefore, there has been no loss and no redress is payable.	

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App 1.2.24 G Example 6

Example 6	
Capital surplus and lower endowment mortgage outgoings	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 10 years	
Endowment *premium* per *month*: £65	
Established facts	
Endowment *surrender value*:	£10,100
Capital repaid under equivalent repayment mortgage	£9,700
Surrender value less capital repaid:	£400
Cost of converting from endowment mortgage to repayment mortgage:	(£200)
Total outgoings to date:	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment *premium* + interest):	£46,300
Difference in outgoings (repayment - endowment):	£500
Basis of Compensation	
In this example, the complainant has gained both because the *surrender value* of the endowment is greater than the capital repaid and because of the lower total outgoings of the endowment mortgage. These gains are larger than the cost of converting to a repayment mortgage. Thus no further action is necessary.	
Redress	
As there has been no loss, no redress is payable.	

App 1.2.25 G Example 7

Example 7	
Low start endowment mortgage	
Background	
Capital sum of £50,000	
25 year endowment *policy*	
Duration to date: 10 years	
Endowment *premium* per *month*: starting at £35 in first year, increasing by 20% simple on each *policy* anniversary, reaching £70 after five years and then remaining at that level.	
Established facts:	
Endowment *surrender value*:	£8,200
Capital repaid under equivalent repayment mortgage:	£9,700
Surrender value less capital repaid:	(£1,500)

Example 7	
Cost of converting from endowment mortgage to repayment mortgage:	(£250)
Total outgoings to date	
Repayment mortgage (capital + interest + DTA life cover):	£46,800
Endowment mortgage (endowment *premium* + interest):	£45,640
Difference in outgoings (repayment minus endowment):	£1,160
Of this difference in outgoings, £800 arose in the five year period when the complainant was paying a low endowment *premium*.	
Basis of compensation	
In this example, the complainant has suffered loss because the *surrender value* of the endowment is less than the capital repaid but has gained from the lower total outgoings of the endowment mortgage. As in Example 3, in calculating redress the whole of the gain should be offset against the loss unless the complainant's particular circumstances are such that it would be unreasonable to do so. However, unlike Example 3, in a low start endowment mortgage the complainant may have chosen to pay a lower than usual *premium* in the early years (this would need to be established on the facts of the case). Where it has been established that the complainant chose to make lower payments, even if it is unreasonable to take account of the whole of the gain from total outgoings, the gain from paying a lower *premium* during the low start period is normally taken into account. In such cases the redress is calculated as the capital loss plus the conversion cost minus the total amount by which repayment mortgage outgoings would have exceeded the actual low start endowment mortgage outgoings during the five year low start period.	
Redress if it is not unreasonable to take account of the whole of the gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£1,500)
Gain from total lower outgoings under endowment mortgage:	£1,160
Cost of converting to repayment mortgage:	(£250)
Net loss:	(£590)
Therefore total redress is:	**£590**
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£1,500)
Gain from total lower outgoings during low start period of endowment mortgage:	£800
Cost of converting to repayment mortgage:	(£250)
Net loss taken into account:	(£950)
Therefore total redress is:	**£950**

Interest rates

App 1.2.26 G In fixing a repayment comparator, it would be appropriate to have regard to the repayment quotation actually provided at the time of sale. If more than one repayment quotation was obtained, the comparison should be with the quotation which approximates most closely to the terms of the endowment mortgage actually taken. If a repayment quotation was not provided, or is not now available, it should be assumed that the interest rate for the repayment comparison is the same as that of the mortgage endowment arrangements. *Firms* will then need to replicate interest rate changes throughout the lifetime of the comparator mortgage.

Life cover

App 1.2.27 G Unless after due inquiry there is clear evidence that the complainant with a mortgage endowment had no foreseeable need for life cover at the time the endowment arrangements were concluded, in the overall comparison between a repayment mortgage and an endowment mortgage the monthly outgoings under the repayment will include the premium for the decreasing term assurance that would have been required. This adjustment for the cost of life cover is only to be made if the *firm* is undertaking a comparison of monthly outgoings. It is not appropriate to deduct the cost of life cover from the capital loss calculation, as this would constitute double counting.

App 1.2.28 G If a deduction is to be attributed to the provision of life cover, the appropriate approach is to assume that the complainant took out the insurance quoted in the alternative repayment quotation provided at the time of the sale. If the quotation is not available, the deduction should be at the rates that would have been quoted at the time.

1.3 Remortgaging

App 1.3.1 G As already noted, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice or other breach had not occurred: for their part, the complainants should take such reasonable steps as they can to limit loss once they are informed of the position they are in because of the failure of advice at the time of sale.

App 1.3.2 G In practice, it is likely to be appropriate for a complainant whose complaint has been upheld to convert to a repayment mortgage, whether or not there is financial loss to date. It will normally be possible for complainants to do so without incurring unreasonable cost. Conversion will of course mean that the complainant no longer has a *policy*.

App 1.3.3 G *Firms* should therefore in the case of upheld complaints inform complainants that it is likely to be appropriate and necessary for them to convert to a repayment arrangement.

App 1.3.4 G *Firms* should make it clear that they will bear the costs of conversion if the rearrangement is made with the existing lender and to the equivalent repayment mortgage. If a complainant is not willing to rearrange with the existing lender, then the costs to be paid by the *firm* should normally be limited to those which would have been payable had the rearrangement been made with the existing lender and to the equivalent repayment mortgage. If it is not possible to rearrange with the existing lender, for example, if the lender has a closed book, the *firm* should pay all costs which are not unreasonable in completing the rearrangement with an alternative provider. Such costs might include an administration fee for changing the existing arrangement, redemption penalty, arrangement fee for the new mortgage and the reasonable cost of further advice if necessary.

App 1.3.5 G If the "new" mortgage is, in fact, arranged at a lower interest rate than the existing loan, the benefit to the complainant should usually be disregarded, as it is always open to complainants to change their underlying mortgage arrangements at any time.

App 1.3.6 G If the "new" mortgage is arranged at a higher interest rate than the existing loan, the increased payment should not normally be taken into account in calculating any payment to be made to the complainant.

App 1.3.7 G If the complainant takes the opportunity to increase his loan on the occasion of the remortgage, the expenses which a *firm* pays by way of compensation should be paid by reference to the capital sum due under the "old" loan.

App 1.3.8 G As stated, one aspect of the conversion process is the disposal of the endowment *policy*. The standard approach to assessing loss requires *firms* to calculate loss using the *surrender value*. However, once loss is established on this basis and *firms* move to deal with redress, they may wish to consider whether there is a role for the *policy*'s 'market value' within the traded endowment *policy* (TEP) market.

App 1.3.9 G A *firm* may arrange the sale of the endowment *policy* on the traded endowment market, provided the full implications of such a course of action are explained to the complainant and his express consent is obtained for the firm to arrange the sale. This includes informing the investor that he will continue to be the life assured under the *policy*. The complainant should be informed that such an arrangement may reduce or eliminate the amount of redress actually borne by the *firm*, but not so as to affect the amount of redress he receives.

App 1.3.10 G In the event that a complainant is willing to pursue this option, a *firm* should first have assessed the complainant's loss using the approach set out in this appendix, and the minimum amount the complainant should receive under such a sale arrangement is the sum representing the position the complainant should have been in under this appendix together with the reimbursement of remortgaging costs. In order to ensure the process does not delay the provision of redress, the *firm* must pay this minimum sum immediately the complainant agrees to the sale arrangement. To the extent that the net amount realised by the sale of the *policy* on the traded endowment market exceeds the total redress due to the complainant, this greater sum is to be paid to the complainant on completion of the sale. If the amount realised by the sale of the *policy* on the traded endowment market is less than the total redress due to the complainant, the *firm* will be responsible for the amount of the shortfall.

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App 1.3.11 G Example of assessment set out at 1.3.10

The following example illustrates the position:			
Surrender value	£10,000	TEP value	£16,000
Loss calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	£15,300		
Complainant receives £16,000 all ultimately funded from the TEP sale.			
Surrender value	£10,000	TEP value	£13,000
Redress calculated by standard approach	£5,000		
Remortgaging costs	£300		
Total	£15,300		
Complainant receives £15,300, £13,000 ultimately funded from the TEP sale and £2,300 ultimately funded from the *firm*.			

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 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.	
Established facts	
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
Basis of compensation	
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*:	£4,320
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:	£8,800
Additional Information	
If the *policy* is capable of reconstruction, the complainant must now fund the higher *premiums* himself for the remainder of the term of the	

Example 8
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 *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

Example 9	
Redress if it is unreasonable to take account of gain from lower outgoings	
Loss from *surrender value* less capital repaid:	(£8,500)
Gain from total lower outgoings under endowment mortgage:	Ignored
Cost of converting to a repayment mortgage:	(£8,700)
Therefore total redress is:	£8,700

1.5 Additional considerations

Introduction

App 1.5.1 G This section addresses issues which may be relevant to the standard redress for unsuitability cases, as well as some post-retirement cases upheld on the grounds of affordability.

Continuing life cover and other policy benefits

App 1.5.2 G *Firms* will need to consider the importance for many complainants of having life assurance in place to ensure a mortgage is paid off in the event of death.

App 1.5.3 G If a complaint is upheld and the *policy* is to be surrendered as part of the settlement, the *firm* should remind the complainant in writing that the life cover within the endowment will be terminated and that it may therefore be appropriate to take advice about the merits or otherwise of taking out a stand-alone *life policy* in substitution.

App 1.5.4 G If a need for life assurance at inception has been established so that a deduction representing its cost has been made from the redress payable under DISP App 1.2.4 G, the *firm* should advise the complainant that the *firm* would be responsible for paying any *premium* for an appropriate replacement *policy* which exceeds that used for calculating the deduction or alternatively will, where possible, provide the cover itself at that cost. If it is not possible for the *firm* to provide the cover itself at the original cost, it may choose to discharge that obligation by the payment of an appropriate lump sum. Any such amount should enable the complainant to effect the cover at the original cost, with no additional cost in respect of increased age or deterioration in health. This option may be particularly relevant if the *firm* against which the complaint has been made is an independent intermediary which cannot itself provide the cover, although it may be possible for such a *firm* to arrange for the product provider to offer cover to the complainant at the original *premium* on payment by the independent intermediary of an appropriate lump sum to meet any increased cost.

App 1.5.5 G *Firms* will not be responsible for any increased costs resulting from the complainant choosing another *product provider* or for increased *premiums* charged by another provider chosen by the complainant in respect of the risk now presented, for example, higher *premiums* charged by the other provider due to deterioration in health, unless the original *product provider* no longer writes new business and is unable to offer revised life cover on a decreasing term assurance basis.

App 1.5.6 G There can be exceptional circumstances where, in order to retain suitable life cover, the endowment *policy* has to be retained and any additional costs will be the responsibility of the *firm* that sold the endowment *policy*.

App 1.5.7 G The same considerations will apply to the establishment of the need for other *policy* benefits including critical illness cover, disability cover and waiver of *premium*.

Taxation

App 1.5.8 G *Firms* will need to consider the likely taxation implications for complainants if *policies* are surrendered or reconstructed, or any form of underpinning or guarantee is given.

App 1.5.9 G If there is potential tax liability for the complainant, it will be appropriate for *firms* to undertake in writing to the complainant to reimburse any tax payable, or which becomes payable, and make payment on production of appropriate evidence of the liability and payment having been made.

"Underpinning"

App 1.5.10 G *Firms* proposing to offer arrangements involving some form of minimum underpinning or 'guarantee' should discuss their proposals with the *FCA* and HM Revenue and Customs at the earliest possible opportunity (see ■ DISP App 1.5.8 G). The *FCA* will need to be satisfied that these proposals provide complainants with redress which is at least commensurate with the standard approaches contained in this appendix.

Reference to the guidance in firms' complaints settlement letters

App 1.5.11 G One of the reasons for introducing the *guidance* in this appendix is to seek a reduction in the number of complaints which are referred to the *Financial Ombudsman Service*. If a *firm* writes to the complainant proposing terms for settlement which are in accordance with this appendix, the letter may include a statement that the calculation of loss and redress accords with the *FCA guidance*, but should not imply that this extends to the assessment of whether or not the complaint should be upheld. *Firms* should point out that if the complainant remains dissatisfied, he may refer the complaint to the *Financial Ombudsman Service*.

App 1.5.12 G A statement under ■ DISP App 1.5.11 G should not give the impression that the proposed terms of settlement have been expressly endorsed by either the *FCA* or the *Financial Ombudsman Service*.

Identification of windfall benefits

App 1.5.13 G Windfall benefits should be determined in accordance with the principle in Needler Financial Services and Taber ('Needler'). The basic legal principle in Needler is that a windfall benefit is not to be taken into account in determining the amount of an investor's recoverable loss. The following paragraphs explain our views as to how *firms* may act in accordance with that principle.

App 1.5.14 G A windfall benefit arises where:

(1) there has been a demutualisation, distribution or reattribution of the inherited estate, or other extraordinary corporate event in a *long-term insurer*; and

(2) the event gave rise to 'relevant benefits', as defined in DISP App 1.5.15 G (below).

App 1.5.15 G 'Relevant benefits' are those benefits that fall outside what is required in order that *policyholders*' reasonable expectations at that point of sale can be fulfilled. (The phrase '*policyholders*' reasonable expectations' has technically been superseded. However, the concept now resides within the obligations imposed upon *firms* by *FCA* Principle 6 ('...a firm must pay due regard to the interests of its *customers* and treat them fairly....') Additionally, most of these benefits would have been paid prior to *commencement*, when *policyholders*' reasonable expectations would have been a consideration for a *long-term insurer*.)

App 1.5.16 G The issue of free *shares* or cash on a demutualisation, and additional bonuses and *policy* enhancements given by way of incentive to approve a reattribution or distribution of an inherited estate should, unless there is evidence to the contrary, be treated as relevant benefits for the purposes of DISP App 1.5.15 G. Whether additional bonuses and *policy* enhancements on a demutualisation are relevant benefits should be determined by applying the test in DISP App 1.5.15 G to each benefit.

App 1.5.17 G *Firms* should review the terms on which proposals were put to *policyholders* and the reasons given for a corporate event when determining whether a benefit should be treated as a relevant benefit.

App 1.5.18 G *Firms* should not normally bring windfall benefits which are relevant benefits (as defined in DISP App 1.5.14 G) to account when assessing financial loss and redress. Where a windfall benefit is in the form of a *policy* augmentation the benefit should be deducted from the overall value of the *policy* when making this assessment.

App 1.5.19 G A relevant benefit derived from a corporate event may only be brought to account if the *firm* is able to demonstrate, with written records created at the time of the advice, that:

(1) The *firm* foresaw the prospect of the event and the benefit;

(2) The *firm's* advice included a statement recommending the particular policy because of the possibility of the benefit in question; and

(3) The statement was a material factor in the context of the advice and the decision to invest.

App 1.5.20 G If a *firm* considers that it can meet this requirement, the *firm* should by letter explain clearly to the complainant the reasons why it proposes that the benefit should not be treated as a windfall and should be taken into account. The *firm* should provide the complainant with copies of the relevant documents.

App 1.5.21 G The letter should also explain how the proposed value of the benefit has been calculated and should inform the complainant that if he does not accept the proposal to take the benefit into account he may tell the *firm*, with reasons. The letter should also say that, if he remains dissatisfied with the *firm*'s response, he may refer the matter to the *Financial Ombudsman Service*.

1.6 Valuing Relevant Benefits

App 1.6.1 G If, exceptionally under the *guidance* at DISP App 1.5.13 G to DISP App 1.5.21 G, cash or *shares* derived from a corporate event are to be taken into account when assessing loss and redress, cash should be valued at the amount actually received and *shares* should be valued at their issue price. In both cases there should be no addition for interest.

App 1.6.2 G When valuing windfall augmentation benefits for the purposes of calculating loss and redress the objective is to exclude all changes arising from the windfall event. The amount of redress payable will then be equal to the amount that would have been payable if the windfall event had never occurred.

App 1.6.3 G A *product provider* should ensure that the method it adopts for valuing augmentation benefits is consistent with the statements made in the documentation published about the windfall event. Relevant documentation for the purpose of valuing such benefits will include (but is not limited to):

(1) Any description of increases in benefits in any circular to *policyholders* (and any other public information relating to the event);

(2) Any principles of financial management established for the management of the fund after the event;

(3) statements in any report produced by an *actuary* appointed under SUP 4 (Actuaries) for the event;

(4) statements in any independent *actuary* report produced for the event; and

(5) subsequent statements relating to bonus practice, calculation *surrender values*, or both.

App 1.6.4 G The method of valuation adopted should treat the complainant fairly overall.

App 1.6.5 G Where an accurate calculation of the value of an augmentation benefit either cannot be made, or would result in disproportionate expense or delay, *product providers* may adopt a simplified approach or a proxy method for calculating its value.

App 1.6.6 G A simplified approach should treat the complainants fairly overall.

App 1.6.7 G An *actuary*, appointed by a *product provider* under SUP 4 (Actuaries) should certify that the method adopted by the *product provider* for calculating the value of an augmentation benefit is in accordance with the *guidance* in DISP App 1.6.1 G to DISP App 1.6.6 G.

Implementation

App 1.6.8 G The principles set out above (in DISP App 1.6.1 G to DISP App 1.6.7 G) should be applied directly to mortgage endowment complaints where the capital loss is calculated by comparing the *surrender value* of the endowment *policy* with the capital which would have been repaid using a repayment mortgage.

App 1.6.9 G In most cases where there is a loss, the endowment *policy* will be surrendered and put towards the cost of setting up a suitable repayment mortgage. Where this is the case, that part of the *surrender value* relating to the windfall augmentation should be paid as a cash lump sum to the investor or to the investor's order as part of the redress package. Only that part of the *surrender value* which does not relate to the windfall augmentation should be put towards the cost of setting up a suitable repayment mortgage.

App 1.6.10 G There may be some circumstances in which the *policy* will not be surrendered (see DISP App 1.2.15 G). In these cases, there is no requirement to pay the value of the windfall augmentation as a cash lump sum since the value of the augmentation will become payable when the *policy* matures. However, any fund value used in the calculation of redress payable should exclude the value of the windfall augmentation.

App 1.6.11 G *Firms* are entitled to mitigate losses by making use of the Traded Endowment Policy (TEP) market (see DISP App 1.3.8 G to DISP App 1.3.10 G). This allows *firms* to *sell* policies on the TEP market to meet the costs of redress, rather than using the *surrender value*. Where this method is adopted, *firms* should pay to the investor, as part of the redress package, a cash lump sum representing that proportion of the *policy* realised which would have related to the windfall augmentation.

App 1.6.12 G As this windfall amount should be excluded from the fund value used in the calculation of loss and redress it would also be appropriate for this extra payment to be ignored when assessing whether, "the net amount realised by the sale of the *policy* on the traded endowment market exceeds the total redress due to the complainant..." (DISP App 1.3.10 G).

App 1.6.13 G There may be circumstances in which a *policy* needs to be reconstructed (see DISP App 1.4). In carrying out the required reconstruction, the windfall augmentation should be ignored in both the existing and the revised *policy*. However, the *policyholder's* revised *policy* should be credited with any windfall augmentation which would have applied if the *policy* had been set up with the revised terms from the original date of advice. This enhancement can be taken into account in assessing a suitable level for future premiums, in line with DISP App 1.4.8 G.

App 1.6.14 G DISP App 1.5.10 G provides *firms* with the opinion of underpinning benefits. *Firms* should satisfy the *FCA* that their proposals provide complainants with a level of redress that is at least commensurate with the standard approaches and, to ensure consistency, windfall augmentations should be excluded when considering whether an underpin will apply. The *FCA* will take this into account when considering proposals put forward by *firms*.

App 1.6.15 G *Product providers* with windfall benefits in the form of *policy* augmentations should tell:

(1) their own relevant *customers* (mortgage endowment complainants); and

(2) other *firms* with such *customers* (and any other interested parties);

that they have excluded windfall augmentation benefits from values used or to be used for loss and redress. *Firms* should provide this information to the *Financial Services Compensation Scheme* when providing them with a value to be used for loss or redress. Should their own relevant *customers*, other *firms* with such *customers* (and any other interested parties) and the *Financial Services Compensation Scheme* request it, the *firm* should provide the value of these benefits and a description of the method used to exclude them.