HINDSIGHT

Collegiate
UNDERWRITING

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Welcome to the latest edition of our Hindsight publication.

Understanding the FCA complaint handling rules and how they work with your professional indemnity policy is an issue that is close to our hearts but also one that is important to any IFA in an increasingly litigious world. We have summarised the rules and our thoughts on what an IFA should do to ensure he complies with FCA requirements and his professional indemnity policy.

Sometimes IFA's get involved in drafting legal documents even though they advise customers to seek legal advice. We do see examples where this is done badly and correcting what has happened can be difficult and expensive.

We are seeing an increase in the use of Discretionary Fund Managers by IFA's and we have produced some thoughts on risks that need to be dealt with.

Finally we have produced a summary of recent Ombudsman decisions together with some thoughts from the Ombudsman service about what they regard as good and bad advice with our thoughts.

These articles have been produced in collaboration with Mark Gibbon, Managing Director and Martin Archer, Legal Director.

We hope that you will find these articles informative and useful.

If you have any comments on the content, or suggestions for future issues, please write to us or e-mail us at newsletter@collegiate.co.uk

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Complaint handling rules and your professional indemnity policy

FCA Complaint definition:-

'any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a *person* about the provision of, or failure to provide, a financial service or a *redress determination*, which:

(a) alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience; and

(b) relates to an activity of that *respondent*, or of any other *respondent* with whom that *respondent* has some connection in marketing or providing financial services or products, which comes under the jurisdiction of the *Financial Ombudsman Service*.'

If you receive an expression of dissatisfaction then you must ask yourself does that fall within the above definition.

Once a *complaint* has been received by a *respondent*, it must:

(1) investigate the *complaint* competently, diligently and impartially, obtaining additional information as necessary;

(2) assess fairly, consistently and promptly:

(a) the subject matter of the *complaint*;

(b) whether the *complaint* should be upheld;

(c) what remedial action or redress (or both) may be appropriate;

(d) if appropriate, whether it has reasonable grounds to be satisfied that another *respondent* may be solely or jointly responsible for the matter alleged in the *complaint*;

taking into account all relevant factors;

(3) offer redress or remedial action when it decides this is appropriate;

(4) explain to the complainant promptly and, in a way that is fair, clear and not misleading, its assessment of the *complaint*, its decision on it, and any offer of remedial action or redress; and

(5) comply promptly with any offer of remedial action or redress accepted by the complainant

On receipt of a *complaint*, a *respondent* must:

(1) send the complainant a prompt written acknowledgement providing early reassurance that it has received the *complaint* and is dealing with it; and

(2) ensure the complainant is kept informed thereafter of the progress of the measures being taken for the *complaint's* resolution.

The *respondent* must, by the end of eight weeks after its receipt of the *complaint*, send the complainant:

(1) a 'final response', being a written response from the *respondent* which:

(a) accepts the *complaint* and, where appropriate, offers redress or remedial action; or

(b) offers redress or remedial action without accepting the *complaint*; or

(c) rejects the *complaint* and gives reasons for doing so;

and which:

(d) encloses a copy of the *Financial Ombudsman Service's* standard explanatory leaflet; and

(e) informs the complainant that if he remains dissatisfied with the *respondent's* response, he may now refer his *complaint* to the *Financial Ombudsman Service* and must do so within six months; or

(2) a written response which:

(a) explains why it is not in a position to make a *final response* and indicates when it expects to be able to provide one;

(b) informs the complainant that he may now refer the *complaint* to the *Financial Ombudsman Service*; and

(c) encloses a copy of the *Financial Ombudsman Service* standard explanatory leaflet.

Is the complaint notifiable under your professional indemnity policy?

Yes it is!

Notify your current Insurer immediately the complaint is received, unless a prior notification has already been made, and liase with them in the conduct of the defence of the claim including the issuing of any Final Response Letter ('FRL'). Professional indemnity insurance is written on a 'claims made basis' which means the policy covers advice given by the Insured during the dates covered by the policy where a 'notifiable' event falls within the policy period and that event is notified in the policy period. This will include any complaint that falls within the definition of a complaint by the FCA unless there are circumstances where it should have been notified in a prior insurance period. Each annual insurance policy is a separate policy and notifying a claim late in the wrong policy could have serious consequences for any Insured. The claim would not fall under the current insurance policy as it is a pre existing claim and it would not fall under the previous policy as that only covers claims notified in that policy period. There is also the issue of non-disclosure of the claim when the current policy was incepted as one of the questions on the renewal proposal form specifically asks about claims in prior periods.

Every year we see a number of notifications where the complaint has been made in a prior insurance period but there has been no notification to Insurer. Sometimes a final response letter has been issued and the complaint is notified when the complaint is referred to the Ombudsman service. Sometimes no 'FRL' issued but later the complainant raises concerns again or refers the case to the Ombudsman service. One of the dangers here is that when the complaint was first raised there was an opportunity to follow up any discussions/correspondence with a final response letter and include Ombudsman rights. This allows the complainant only 6 months to refer from the date of the FRL, after that they are out of date and the complaint will not be considered by the Ombudsman service unless there are exceptional circumstances. This effectively puts a time limit on the complaint through the Ombudsman service. Where this has not been done the time limits are the standard six years from the date of advice or 3 years from when the complainant knew or ought to have known they had grounds for complaint.

Legal Advice?

Independent Financial Advisers are not lawyers so they need to be careful that they do not get caught acting as one. A suitability letter that contains a statement that 'we do not give legal advice, you need to consult your legal advisers' is no good if in fact the adviser does give legal advice. We had a recent example where the adviser made that statement but then got involved in drafting a trust document using the standard wording provided by the life company. No legal advice was ever obtained and the adviser knew that when he submitted the documentation to the provider. When the trust document failed to deliver what it was supposed to, the customer complained against the adviser who was unable to rely on the statement made in the suitability letter. Unwinding this has proved very expensive.

A similar situation arises where an adviser asks a representative of a life company for advice and mistakenly misinterprets what is being said. The life company invariably disclaims responsibility for any advice they have given stating that it is the Adviser's responsibility to ensure that the advice they give the customer is correct. To compound the problem advisers regularly do not provide all the relevant background information, ask a too narrow question so they get the right answer to the wrong question and often do not get the answer in writing.

A good example of this is partial encashment of investment bonds which we still see occasionally giving rise to large tax liabilities caused by amounts in excess of the 5% allowance.

Discretionary Fund Managers

In 2012 the FSA carried out a thematic review of Centralised Investment Propositions, which included the use of Discretionary Fund Managers ('DFM'). They had identified that many firms were choosing this model to add additional value to their service and to justify ongoing adviser charging given the ban on commission as part of RDR. In the review they listed a number of key findings including:-

- Failure to consider suitability of additional charges on replacement business
- No evidence to support switches based on improved investment performance
- Risk of systemic mis-selling from any mis-alignment of portfolio risk and client profile risk using risk based portfolios
- Risk of portfolio drift where asset allocation approach used to create portfolio

They identified that the DFM could be accessed by:-

- Direct contractual relationship with client
- IFA holding the relevant permission and delegating investment management to the DFM
- DFM treats IFA as client who acts as agent for client

These relationships can create a number of problems:-

- Lack of clarity as far as the end client is concerned
- Confusion over areas of responsibility

We think there are some key areas that need to be addressed and confirmed in writing:-

- Who is responsible for risk profiling the client?
- Who is responsible for risk rating the portfolios?
- Who is responsible for selecting the portfolio and ensuring it is aligned with the client's interests?
- Who is responsible for monitoring the portfolio to ensure it continues to be aligned with the client's interests?

Where an IFA is being paid ongoing remuneration then it should be clear what the IFA is doing for this. We would recommend that every client receives full disclosure of what duties the IFA is carrying out and what the relationship is with the DMF and what duties they are being asked to do.

We are currently seeing claims where the DMF portfolio is unsuitable for the client and this has led to a complaint against the IFA.

Case studies

How much cash to hold?

Following advice the customer had 10% cash whereas prior had 65%. The FOS found that the customer had been exposed to too high equity content although there was agreement that the customer was 'medium' risk. One of the issues was how much cash the customer should have. The FOS thought this should not be based on a % but should reflect a monetary amount. The FOS made the point that this was often regarded as 'rainy day' money and therefore should not be based on a % of the portfolio as small portfolios would not contain enough cash.

In another case the complainant had £50K cash deposits after the new investment which increased the exposure on equity based investments to 25% of the available capital assets. FOS agreed that the advice was suitable commenting it would not be unwise to undertake some investment for capital growth. The customer had been assessed as having a 'balanced' attitude to investment risk.

In another case deposit based accounts were used to fund ISA's which did not perform as expected. However substantial funds were still left on deposit. The FOS stated it was unable to uphold a complaint on the basis that it has not achieved expected investment returns. The FOS looked at the suitability of the investments and commented that the size of the investments did not place too much capital within risk based investments. The complaint was rejected.

The customer had inherited money and placed it in a deposit account. They were advised to invest the majority of it into one fund which fell in value. The customer was categorised as a medium risk investor who had no experience of equity investment. The FOS determined that this had exposed the customer to a greater risk than they had been used to and there was no recorded rationale for the sudden increase in capacity for risk. The complaint was upheld.

Generally the FOS do not like to see sudden changes in risk without a good explanation. A customer with large cash balances needs to have some experience of equity markets if that money is to be invested, otherwise a drip feed approach should be used if you don't want to have your advice questioned at a later date.

Extracting tax free cash

The customer was advised to take tax free cash from pension benefits to clear a business overdraft. Maximum income was taken from the fund and reinvested as pension contributions. The customer complained about death benefits and annuity loss. The FOS found there was nothing to support the contention that the customer was looking to retire immediately. Net incomings exceeded outgoings so there was no immediate need for any income. The FOS was not persuaded there was anything unsuitable about withdrawing pension to reinvest. Although there was no requirement for any further tax free cash there was a benefit to the customer from such an arrangement. The complaint was rejected. In another claim the customer was advised to take tax free cash and reinvest part into their pension plan. They breached the recycling rules contained in s159 Finance Act 2006 and the whole of the tax free cash was dealt with as an unauthorised payment. Adviser Beware!

Guaranteed Annuity Rates ('GAR')

The customer was advised to sacrifice the 'GAR' in favour of taking pension benefits early with spouse provision. The 'GAR' was only available on a single life basis with no guaranteed period. The FOS view was the customer could have made financial provision for the spouse by saving a proportion of the annuity or by starting a life policy. The IFA had told the customer that there were 'GAR' on the policy but had not set out what this meant in figures. Without this the FOS was not satisfied that the customer could appreciate the significant difference the 'GAR' would make. Although the spouse was several years younger the FOS considered there were affordable alternatives to financially provide for the spouse without giving up the 'GAR'. The complaint was upheld.

In another case the 'GAR' was quoted in a report but the FOS was not persuaded that the customer would have appreciated the impact of giving up the 'GAR' from just the rates. Again the guaranteed rate was on a single life basis but the FOS was not convinced that this was not unacceptable as the spouse was not dependant on this fund alone.

It is clear that the FOS expect the actual amounts payable under a 'GAR' to be set out for the customer so they can appreciate the impact of giving them up. The lack of spouse provision in the 'GAR' is unlikely to be a reason for giving them up unless all other possible avenues of providing for the spouse have been explored

Failure to switch to cash

This complaint arose from a fall in stock market values whilst the transfer of funds to an annuity provider under the Open Market Option was being arranged. The IFA had failed to advise the customer about the choice of switching to a cash fund. The IFA had given no advice on the choice of funds but was merely advising on taking pension benefits. The IFA had included a warning that funds would remain invested until the transfer was made and could increase or decrease in value. The planning report did comment that the customer did not want there to be any risk of pension income falling. The FOS considered this comment related to immediate and future pension values. The FOS was of the view that the customer should have been advised to switch to a more cautious fund such as cash and upheld the complaint.

Dealing with Executors

The customer was advised to take out investment bonds but died during the cooling off period. There were two executors, who held power of attorney for the customer, but only one was involved in the advice process. The other executor complained that the bonds should have been cancelled and the IFA should have advised both of the executors jointly. The IFA wrote to one of the executors informing them that the cooling off period was due to expire. The FOS considered that it was reasonable for the IFA to believe this information would have been relayed and discussed with the other executor and was not persuaded there was any legal obligation on the IFA to write to all the executors. It was for the executors to decide how to proceed with

the investments and issue instructions. The complaint was dismissed.

Despite this we would advise it is better to involve all executors.

Discounted Gift Trust ('DGT')

The customer was advised to invest money into a discounted gift trust and a loan trust. They opted to take maximum income. The policy was arranged on a non-underwritten basis. The customer's objectives were to increase income and reduce Inheritance Tax ('IHT'). The customer died within seven years of setting up the 'DGT'. The beneficiaries complained. The FOS did not consider the 'DGT' to be an inappropriate recommendation. It allowed the customer to draw an income for life whilst placing money in trust for her children. An immediate portion would be outside of her estate as well as any future growth and if she survived seven years the whole of the gift to the 'DGT' would be outside the estate for 'IHT' purposes. The 'DGT' offered many fund choices which were suitable to the customer's attitude to risk. The suitability letter informed the customer about the two underwriting options, one of which required a medical assessment and made it clear this was the better option. The customer opted not to undertake the medical assessment required. There were no medical issues which would mean it was likely that the customer would live for another seven years. The complaint was rejected.

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