House of Commons

Treasury Committee

Restoring confidence in long–term savings: Endowment mortgages

Fifth Report of Session 2003–04

HC 394

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Low-cost endowment mortgages became popular in the 1980s and 1990s, taking over 80% of the mortgage market at their peak. There are still around 8.5 million policies in force. These mortgages carry with them the risk that the endowment policy might not repay the mortgage. As inflation and interest rates collapsed through the 1990s it became clear that actual investment returns were likely to be much lower than those originally assumed, implying that many policies would indeed fail to pay off the associated mortgage. The industry nevertheless responded slowly to the changing investment climate until regulators stepped in. This slow response raises questions about the role of appointed actuaries within insurance companies. It is important that the FSA's proposed reforms of the actuarial process within insurance companies succeed in delivering more proactive and independently minded actuarial advice.

Endowment mortgage mis-selling

The industry was also slow to respond to intense regulatory pressure to improve the marketing of low-cost endowment mortgages. The regulator initially warned in late 1999 that the standard of endowment mortgage marketing was inadequate. Continued problems surfaced in summer 2000 and the FSA had to take further action in the autumn of 2000. So far, five firms have been fined £5.2 million and over £670 million has been paid out in compensation to endowment policyholders.

The available evidence suggests that between 50% and 60% of all policyholders believe their policies were mis-sold, which if correct would be a significantly high figure. The scale and persistence of mis-selling in the financial services industry suggests a need to reinforce the current regulatory approach. To break the cycle of mis-selling which currently dogs the industry action is also needed to align consumer and product provider interests more closely. The current commission structure rewards potentially inappropriate and short-term sales practices and pays no heed to the investment performance of the product.

Shortfalls

The insurance industry has a poor track record for asset allocation and generally failed to cut back its equity exposure as the equity bubble inflated. The industry has thus been caught out by the recent fall in equity markets, forcing many companies to switch into low risk, low growth portfolios dominated by bonds. The result is that around 80% of endowment policies are now unlikely meet their target of repaying the original mortgage, with an average shortfall across policies of £5,500. The shortfall on policies is likely to grow over time, but the current figures nevertheless suggest a collective shortfall across the endowment mortgage market that is already approaching £40 billion.

The industry initially failed to give policyholders adequate information about the shortfalls emerging across the endowment mortgages market, a failure that has added considerably to the difficulties many people now face. The FSA has now instigated a system of warning

letters to policyholders, although these letters could be made clearer in many cases.

Advice to consumers

Consumers need reliable advice on what to do about their shortfalls. Given the track record of the industry in selling endowment mortgages in the first place, the industry is not widely trusted as a source of advice and many policyholders are now being left in an advice vacuum. Mechanisms need to be developed for delivering low cost, trusted financial advice.

Complaints and compensation

If policyholders received unsuitable advice when buying their endowment policy and are worse off than they would have been taking out a repayment mortgage they are entitled to compensation. Fewer than 6% of policyholders have so far claimed compensation, suggesting that urgent action is needed to ensure that the complaints process is better understood and more accessible to policyholders. The FSA should ensure that clear information on how to make a complaint is enclosed with the letters warning policyholders about shortfalls. There are also currently strict time limits on policyholders' rights to claim for compensation, but theses limits have not been clearly explained to many policyholders. The time limits should be extended while the rules are spelt out explicitly to all policyholders.

Many companies have not handled complaints fairly and the FSA has intervened repeatedly on this issue. Even so, for some companies the Financial Ombudsman Service, the appeals body for consumer complaints, is finding in favour of the consumer in over 50% of cases. This suggests that much of the industry is still locked into an unacceptable culture that focuses upon short term sales rather than long term customer care.

While there are some concerns within the industry, the evidence we received suggests that the Financial Ombudsman Service process is working acceptably as an appeals body for endowment mortgage complaints. There are significant problems, however, in relation to endowment policies sold via IFAs prior to 1988. Consideration should be given to means of helping such consumers establish fair redress.

Lessons for the future

Endowment mortgages have damaged public trust in the financial services industry. Many large retailers now have a higher level of public trust than some of the UK's largest financial institutions and there is an overriding need to rebuild public trust and confidence in the long term savings industry. Reforming the way the long term savings industry conducts its business should also help defend the UK's position as a major financial services centre.

Central to rebuilding trust is reforming the business model used by much of the industry. The debate on the Sandler price cap illustrates a continued focus on commission and sales that is unlikely to benefit the consumer. The challenge for both the industry and Government is to develop a fee structure that rewards good investment returns and client retention rather then simply paying out high rewards for client acquisition.

1 Introduction

1. There are around 8.5 million endowment mortgages. These were generally taken out in the 1980s and 1990s. Endowment mortgage holders have a mortgage which does not reduce over a period of years but which has to be paid off in one go at the end of its term, using the proceeds of a separate low-cost 'endowment' with-profits insurance policy intended to cover *at least* the amount of the mortgage. But 80% of endowment mortgage policies are now unlikely to pay enough to cover the amount of the mortgage they were originally linked to. The average shortfall on such policies is currently around £5,500, implying that endowment mortgages are already a near £40 billion problem, but the shortfalls are likely to grow and the problems could intensify until 2013, the peak year for endowment policies reaching maturity.

2. Some policyholders will have other funds with which to repay the mortgage or will have made plans to cope with the shortfall in other ways. 4.5 million policyholders, with between them 6.8 million separate policies, are nevertheless still relying on their endowment policies to repay their mortgage. A large number of these policyholders—and many have written to the Committee and to other members of the House—face the possibility of serious financial difficulty. In extreme cases, they may even have to sell their home.

3. This situation has to some extent been brought about by the recent poor investment climate, in particular the stock market falls of 2000–2003, which have depressed the investment performance of endowment policies. But in many ways this masks underlying problems for which the life insurance industry must take the blame. These problems include:

- questions about the basic design of endowment mortgages
- asset allocation policy
- issues over mis-selling of policies
- inadequate communication with customers (policyholders)
- inadequate handling of complaints.

4. This Report has arisen as part of our wider inquiry into *Restoring confidence in long-term savings*. This wider inquiry was announced in November 2003 and we stated at the time the inquiry would include an examination of the problems relating to endowment mortgages. Although questioning touching on endowment mortgages was included in our early evidence sessions in the wider inquiry, we decided to devote three early evidence sessions specifically to this issue. These were with:—

- a range of consumer groups (Consumers' Association, Citizens Advice,[1] Financial Services Consumer Panel) (2 December 2003)

1 National Association of Citizens Advice Bureaux

- the Financial Services Authority and the Financial Ombudsman Service (2 December 2003), and
- Chief Executives of five leading endowment mortgage provider companies (Aviva,[2] Legal and General, Prudential, Royal & Sun Alliance, and Standard Life) (27 January 2004).

Following these sessions, we decided that it would be appropriate to produce a separate Report on the endowment mortgage issue alone, ahead of the main Report on long-term savings.[3] Not only do we feel that the issue is both important and urgent, we feel that there are important lessons from this issue which help to inform the wider Inquiry.

5. In this Report we look first at the concept of endowment mortgages and some of the problems associated with them. We then follow through the issues as they have developed, covering the mis-selling of endowment mortgages and then the current state of play on the shortfalls being faced by policy holders and the advice being given to them. We also look at the complaints and compensation process for those who may have been mis-sold policies and who are facing a shortfall as a result. Finally, we draw some broad conclusions as to possible lessons for the future.

2 Aviva's life insurance business trades in the UK as Norwich Union.

3 The oral and written evidence received on endowment mortgages is not readily separable from the evidence received for the wider long-term savings inquiry as a whole. The *oral evidence* taken so far is available in one volume as HC (2003–04) 71: this incorporates HC (2002–03) 1274–i (evidence of 11 November 2003) and HC (2003–04) 71–i,–ii,–iii (evidence of 2 December 2003, 22 January 2004 and 27 January 2004). The written evidence taken so far is published in one volume as HC (2003–04) 275

2 Endowment mortgages

The product

6. The finance needed to purchase a home has traditionally been provided via one of two main long-term financial products. The simplest is a repayment mortgage, where the home buyer receives a loan secured against the property from a bank or a building society and repays the loan via monthly instalments that pay off a combination of both the capital sum borrowed and the interest costs of the loan. The second product is an endowment mortgage, in which the home buyer receives a loan as with a repayment mortgage, but only repays interest on the loan. Rather than repay any of the capital sum borrowed, the home buyer instead makes monthly payments into an endowment policy, typically a with-profits policy investing in a mixture of bonds, equities and property, purchased from an insurance company. The consumer hopes that when the endowment policy matures the investment return will be sufficient to repay the whole of the bank or building society loan and possibly leave something left over as a capital windfall.

7. Endowment mortgages grew rapidly in popularity through the 1970s and 1980s, particularly 'low-cost' endowment mortgages which carried a guaranteed maturity value for the endowment policy below the outstanding mortgage debt, but anticipated the addition of 'with-profits' bonuses sufficient to repay the debt. Such policies enabled premiums to be set at levels which made them appear competitive with repayment mortgage, but carried the risk for the policyholder that the maturity value of the endowment policy would be insufficient to pay off the mortgage. Figures provided to us by the Association of British Insurers (ABI)[4], shown in the Table overleaf, suggest that the share (in terms of the number of mortgages issued) of the mortgage market accounted for by endowment mortgages rose from 7% in 1970 to a peak of 83% in 1988. Data presented to us by Cazalet Consulting suggests that over 1.7 million endowment mortgages were sold in 1988[5] and that sales of endowment policies consistently topped one million a year between 1986 and 1991. Since the early 1990s, however, endowment mortgages have taken a steadily falling share of the overall market, with a particularly abrupt decline over the past four or five years. The latest figures we have available suggest that endowments accounted for just 5% of the new mortgages taken out in 2002.

4 Ev 3, Table 1 (HC 275)

5 *How Many Endowments Fall Short?* Cazalet Consulting 27 January 2004

Table: % Share of UK Mortgage Market

	% Share of UK Mortgage Market		
Year	**Repayment**	**Endowment**	**Other**
1969	88	9	3
1970	88	7	5
1971	86	8	6
1972	80	12	8
1973	72	17	11
1974	73	16	11
1975	74	16	10
1976	72	18	10
1977	71	21	8
1978	67	25	8
1979	64	27	10
1980	69	23	9
1981	74	20	6
1982	73	20	7
1983	41	54	5
1984	38	61	1
1985	42	57	1
1986	28	70	2
1987	18	80	2
1988	14	83	3
1989	18	79	3
1990	20	76	4
1991	18	77	5
1992	21	68	12
1993	26	59	15
1994	30	56	14
1995	35	46	16
1996	38	32	24
1997	41	34	26
1998	43	34	25
1999	47	28	25
2000	60	17	23
2001	72	9	19
2002	82	5	13

Source: Association of British Insurers

8. As the Personal Investment Authority (PIA), a predecessor organisation of the FSA, warned some years ago, "compared with an ordinary repayment mortgage, endowment–related mortgages are complex products. They have features with which many borrowers will be unfamiliar—especially the nature and extent of their exposure to market risks."[6] This view was reinforced by evidence the Committee heard from independent experts, such as Professor Davis of Brunel University, who argued that in reality there was a "fundamental problem"[7] with endowment mortgages. The consumer is assuming a liability which is both fixed in nominal terms and often very large relative to his available assets. To pay off this liability the consumer is investing in an endowment policy which is often largely invested in equities, an asset class that is both volatile and exposed to lower nominal

6 PIA Regulatory Update Number 72, December 1999

7 Q 109

returns as inflation falls. As Mr O'Brien of Nottingham University Business School told us, "the problem with endowment mortgages is you have this nominal liability and it isn't going to be covered when you get disinflation."[8] Set against these drawbacks were certain tax advantages in the 1970s and 1980s (discussed in paragraphs 13 and 14 below). While the balance of risks and possible rewards offered by endowment mortgages may have appealed to some individuals, the lack of certainty that an endowment policy would be worth enough at maturity to pay off the mortgage means that such mortgages were probably unsuitable for many homebuyers.

9. **Buying a home is the largest single financial transaction most people undertake in their lives and the financial services industry owes a particular duty of care to its customers in the marketing and subsequent management of relatively complex financial products such as endowment mortgages. Unfortunately, the reality is that in selling low-cost endowment mortgages the industry often failed to provide homeowners with a suitable product for their individual circumstances or a product that was fit for the purpose it was being used for. The performance of the financial services industry in providing reliable and effective products to those looking to fund a house purchase is likely to be crucial in shaping consumers' views of the industry. The failures in respect of endowment mortgage policies are a contributory factor towards the low consumer confidence in the industry.**

With-profits policies

10. The endowment policy written as part of the endowment mortgage product was typically a 'with-profits' policy. With-profits policies are legally a form of life insurance, although most people buy them as a savings product rather than as an insurance product. The key characteristic of with-profits policies is that investment returns are smoothed. The smoothing process is often very complicated and is at the product provider's discretion. Such policies have therefore attracted widespread criticism for their inherent lack of transparency. Mr Sandler, author of a major review of the long-term savings market for HM Treasury[9], told us that "there are very few insurance companies or with-profits providers who actually provide the policyholder with any indication of what the investment performance has been. The policyholder receives, at the end of a period of time, a bonus, which is delivered on the basis of all sorts of factors: amounts coming from inherited estates; amounts due to other profits which arise within the activity set of the provider."[10]

11. Some companies told us that with-profits policies had a valuable role to play. Standard Life said that "we remain committed to the with-profits concept because of its potential to provide better performance than deposits without full exposure to the volatility associated with longer term, equity-type investments."[11] Independent experts and consumer groups have nevertheless typically told us that there is a strong case for reform. The National Consumer Council, for example, said that "Despite the well-documented weaknesses of the

8 ibid

9 *Medium and Long-Terms Retail Savings in the UK, A Review*, HM Treasury, July 2002

10 Q 319

11 Ev 186 paragraph 29 (HC 275)

with-profits model, we do consider that some consumers might welcome a good value smoothed investment product offering some long-term stock market exposure alongside limits on volatility. But this requires greater transparency regarding the basic product proposition, and a fairer deal in terms of charges."[12] Mr Sandler told us that "I think a large part of the answer for the insurance industry lies in the reform of with-profits, which are in a sense the flagship product of the insurance industry—less so today than was the case even as recently as a few years ago but, nonetheless, historically, the core savings product of the insurance industry. That is a product which represents the extremes of opacity, which has the extremes of complexity built into it, and a very substantive process of reform in my judgment has to be mandated on with-profits if we are going to get the sort of functioning of the industry that we all, I believe, would wish to see."[13]

12. The FSA has proposed reforms for with-profits products in its consultation paper CP 207, commonly referred to as "Principles and Practices of Financial Management". The view of several experts we asked was nevertheless that the FSA's proposals were unlikely to significantly improve the position of the consumer. Mr O'Brien of Nottingham University Business School told us that "the principles of financial management that companies will be issuing earlier next year will help, but even so my view is that with-profits will still be an act of faith and that you are not going to be able to understand exactly what has gone on."[14] Several witnesses suggested that more fundamental reform might well be appropriate. Mr O'Brien told us "the benefits of with-profits can now be met by different means to avoid the situation where we have lots of discretion and lack of transparency, so I think there are now products in the financial markets that firms can invest in that can actually deliver smoothing on a more mechanical basis than we currently have with with-profits."[15] This view was endorsed by Mr Sandler, who told us that "I think, generally speaking, there are few investment needs which are addressed by a with-profits policy which cannot better, more cheaply and with greater flexibility be addressed by a combination of other investment products."[16] **Many of the basic problems identified in endowment mortgages are shared by other with-profits products sold by the life insurance industry. The Committee is concerned by evidence that even after the FSA's proposed reforms, buying any with-profits policy will still be little more than an "act of faith" for the consumer. Developing cheaper, more transparent products offering the same smoothing benefits to the saver as the traditional with-profits product is now a key challenge for the long-term savings industry.**

The role of the tax system

13. Two issues, tax and changes in the estimates of likely investment returns, played a key role in the rise and subsequent fall of the share of the mortgage market taken by endowment mortgages. Looking at tax issues first, in the very early 1980s anyone taking out an endowment mortgage enjoyed two major tax advantages relative to someone in a similar position taking out a repayment mortgage. The most important benefit related to

12 Ev 162 paragraph 42 (HC 275)

13 Q 299

14 Q 27

15 Q 36

16 Q 273

the tax relief available on life assurance premiums, which most endowment policies qualified for. Life assurance premium relief was abolished in 1984. Endowment mortgages also enjoyed some benefit relative to repayment mortgages from mortgage interest relief because the interest-only mortgage underlying the endowment product implied a higher outstanding capital sum and hence higher interest payments over the lifetime of the mortgage. This advantage was progressively scaled back through the 1990s, as the level of mortgage interest relief was limited, initially to the basic rate of tax, and then to progressively lower tax rates before the relief was finally abolished in April 2000.

14. Legal & General have described the endowment mortgage product as "the child of generous tax breaks"[17] and, as Mr O'Brien, one of our expert witnesses, noted, the on-going growth of endowment mortgages after the product's tax advantages began to be withdrawn in 1984 appears to have been simply a "bandwagon that continued [rolling]."[18] It seems likely that the tax system played a key role in encouraging the growth of endowment mortgages relative to repayment mortgages. The Sandler Review noted that tax complexity can "weaken competitive forces by distracting attention away from the real economic costs and benefits of different products—charges and performance—and by making comparison between different products more difficult."[19] This view is shared by some of the major players in the financial services industry. Mr Bloomer, Chief Executive of Prudential plc, told us "I would much prefer a simpler [tax] system which makes it much more transparent and easier for customers to see where they are saving."[20] **It seems clear that it was undesirable for the tax system to be so slanted as to entice consumers into one relatively complicated financial product rather than a broadly comparable, but much simpler, product such as a repayment mortgage. The Committee believes that this is an important lesson for the future and strongly endorses Mr Sandler's call that "the overriding policy goal in this area… should be one of reducing complexity and distortions in the taxation of savings products".**[21]

Projected investment returns and the role of actuaries

15. While the share of the mortgage market taken by endowments declined through much of the 1990s as tax relief was progressively withdrawn, the Table above indicates a particularly abrupt fall in just five years from 34% in 1998 to just 5% in 2002. Many major companies ceased selling endowment policies over this period. A variety of factors seem to have conspired to undermine endowment mortgage sales, but one major problem was that a slide in likely investment returns exposed the risks for all to see that were always inherent in endowment mortgages. Major insurance companies told us that they, alongside the Institute of Actuaries, began to review the likely returns on endowment policies in the late 1990s in the face of the changing economic environment, with the Institute of Actuaries panel reporting on the issue in 1999.[22] Thus when asked what was the first point at which the appointed actuary raised the issue, Prudential plc told us "that it was late 1999, [as] part

17 Ev 154 paragraph 7.2 (HC 275)

18 Q 103

19 *Medium and Long-Terms Retail Savings in the UK, A Review*, HM Treasury, July 2002, page 16, paragraph 90

20 Q 556

21 *Medium and Long-Terms Retail Savings in the UK, A Review*, HM Treasury, July 2002, page 16, paragraph 92

22 Q 526

of the discussion we were having about asset allocation, which was also linked with future expected yields on investments, which is really the key part of it, together with changes on the interest side that led to consideration of the balance between an endowment mortgage and a repayment mortgage and the economic effects of them."[23] In the wake of those discussions the company stopped selling endowment mortgages from 2000.[24]

16. The period in which endowment mortgage sales collapsed also coincided with intense regulatory activity on a variety of fronts. Looking at potential investment returns, the investment landscape had changed fundamentally through the 1990s. Base rates fell from 14% in late 1990 to levels that were less than half that through most of the mid-1990s. The risk free rate of return expressed by long-bond yields, widely used as a benchmark in gauging likely returns across a range of financial assets, had also fallen from 11.8% at the end of 1990 to just over 7% at the end of 1997, before falling below 6% in 1998. It was against this background that the PIA embarked in October 1998 on a formal consultation exercise on the need to reduce the illustrative investment returns used in marketing material. They were subsequently reduced from 5%, 7.5% and 10% to 4%, 6% and 8% in July 1999.[25]

17. The industry's slow switch to a more realistic internal assessment of the likely investment returns underpinning endowment products as the investment environment changed through the 1990s may have reflected a desire to maintain the apparent competitiveness of endowment mortgages relative to repayment mortgages. The industry's failure to respond quickly to the sharp fall in bond yields and inflation rates nevertheless raises significant questions about the effectiveness with which the appointed actuaries within insurance companies fulfilled their roles. Legal & General, for example, told us that throughout this period the appointed actuary had not issued a warning about likely investment returns—"not formally, informally or in any other way"[26] and the evidence the Committee heard from other major insurance companies[27] confirmed that the appointed actuaries had generally failed to provide the warnings that might have been expected about the changing investment climate. As well as providing an earlier alert to everyone of the potential problems building on endowment mortgages, if the actuaries had raised such warnings on investment returns in a more timely fashion the industry may have entered the bear market in equities from 2000 onwards with rather more robust investment portfolios.

18. The FSA has launched a major reform of the actuarial function within life insurance companies, prompted partly by the events surrounding Equitable Life. The evidence the Committee has heard about the role the actuarial profession played, or failed to play, in advising companies and their customers on the unfolding problems in endowment mortgages confirms the urgent need for change. The FSA's proposals, contained in consultation paper CP167 "include discontinuing the role currently fulfilled by the appointed actuary. Responsibility for actuarial aspects of the insurance business would

23 Q 539

24 Q 537

25 *Progress Report on Mortgage Endowments* FSA, October 2000, page 8

26 Q 536

27 Q 534

then clearly rest with the board and senior management, rather than the appointed actuary."[28] A new actuarial role is also being introduced for with-profits business, in the shape of a with-profits actuary who will be barred from sitting on the board and "will play an important continuous role in protecting consumers."[29] In addition the FSA is also requiring auditors to seek independent actuarial advice, but the issue of the appropriate role for actuarial advice is an important one which the Committee intends to return to later in the course of our broad inquiry into restoring confidence in long-term savings. **The events surrounding Equitable Life raised questions about the effectiveness of the pre-existing actuarial regime, but the insurance industry's approach to endowment mortgages through the late 1990s also demonstrates an inadequate approach to investment issues by appointed actuaries. The Committee considers it important that the FSA's proposed reforms of the actuarial process within insurance companies are effective in providing warnings and a more proactive and independently minded actuarial advice.**

Conclusions

19. The evidence the Committee has received has shown that there are a range of issues surrounding the basic nature of the endowment mortgage as a product. First and foremost, despite their great popularity in the 1980s and 1990s (in part because they sometimes enabled the borrower to take out a larger mortgage), there must be a question as to whether it was ever appropriate for consumers to be sold a complex savings product with potentially volatile returns as a means of paying off a fixed debt without a clear explanation of the risks they were taking. There are, however, wider issues which raise concerns about long-term savings generally. These include the 'with-profits' model, the role of actuaries and the part played by the tax system. These are issues which will form an important part of our wider long-term savings inquiry, but **it seems clear to the Committee from its review of endowment mortgages that generally more needs to be done to ensure that financial products and the tax system surrounding them are simplified as much as possible, that officials whose role is in part to protect and re-assure the consumer actually discharge that function effectively and, above all, that when complex financial products are sold to consumers they accurately fit the purpose for which they are bought.**

28 FSA Press release on CP167, 23 January 2003

29 *With-profits governance and the role of actuaries in life insurers*, FSA, June 2003, page 6

3 Endowment Mortgage Mis-selling

20. The FSA has noted that "arguably, mis-selling is not a regulatory concept at all. It does not feature in our Handbook. But the term is commonly used to refer to an advised sale which does not meet the Handbook requirements for suitability….Consumers rightly expect those who advise and sell financial services products to behave with honesty and integrity and apply their skills, experience and judgement to give them a fair deal….Our Handbook, including the Principles, makes clear to firms that this is what we expect of them."[30] Using this as a guide to what constitutes mis-selling, it is clear that the problems of complexity and opaqueness discussed in Section 2 lie at the root of what may have been wide mis-selling of endowment mortgages. In many cases consumers purchasing an endowment mortgage were left with the impression that the endowment policy was guaranteed to pay off the mortgage. In fact in most cases the product carried no such guarantee.

Regulatory action on mis-selling

21. As well as industry regulators lowering the illustrative projected investment returns the industry could use, the late 1990s also saw the regulation of the selling process being tightened considerably. The Financial Services Consumer Panel told us that "in September 1999 we informed the FSA and Personal Investment Authority (PIA) Boards of our view that regulatory attention in this area was long overdue. We also stressed the importance and urgency of publicly feeding back the findings of the PIA's supervisory visits on endowment mortgage sales to the industry as a preventative measure."[31] In December 1999 the PIA issued a Regulatory Update which warned that a recent round of company supervision visits had revealed that "the general standards of selling practices and record-keeping revealed by the themed supervision visits were inadequate. Such poor practices are unacceptable and consideration is being given as to whether firms should be referred for further investigation and possible discipline."[32] As the FSA subsequently noted "At the time of the FSA's December 1999 announcement there were 44 providers active in the mortgage market. Following the FSA's requirement that insurance companies justify their marketing strategies, and the continuing public spotlight on the market, the number had fallen to 20 by September 2000. Volumes of endowment mortgage sales have halved over the year to 30 June 2000."[33] It is disappointing to note, however, that an FSA investigation over the summer of 2000 showed that "some firms are still failing to match the risk of an endowment to the needs and personal circumstances of the consumer."[34] The FSA promised a still wider programme of supervisory visits "to examine the quality of advice given on endowment sales."[35] In the aftermath of these regulatory checks, the FSA told us[36] that it had taken the following action against specific firms:

30 *Clarifying 'mis-selling'*: a note by the FSA, 17 July 2003

31 Ev 114 paragraph 19 (HC 275)

32 PIA Regulatory Update Number 72, December 1999

33 *Progress Report on Mortgage Endowments* FSA, October 2000, page 4

34 ibid page 5

35 ibid

- *Royal & Sun Alliance* - fined £950,000 in March 2003 for endowment mis-selling and related deficiencies in its sales systems and control functions;
- *Scottish Amicable* - fined £750,000 in March 2003 for endowment mis-selling and related deficiencies in its sales systems and control functions;
- *Abbey Life* - fined £1 million in December 2002 for endowment mis-selling and deficiencies in compliance procedures and controls;
- *Wintherthur Life* - fined £500,000 in September 2001 for endowment mis-selling;
- *Royal Scottish Assurance plc* - fined £2 million in November 2000 for serious deficiencies in their endowment mortgage product.

22. As well as facing fines totalling £5.2 million, the five companies disciplined by the FSA have been forced to pay out £227 million of compensation to 183,000 customers. The FSA also told us that another 19 firms had agreed to pay approximately £446.5 million compensation to 253,500 customers on a non-disciplinary basis.[37] In many cases, the key problem was that companies failed to keep adequate records and in such cases there is a presumption that policies were mis-sold. **The insurance industry was lamentably slow to respond adequately to regulatory pressure to improve its sales process for endowment mortgages. This forced the regulator to intervene repeatedly to toughen its supervision of the industry. While the FSA can take the credit for the sustained attack it has made on malpractice within the industry from late 1999 onwards, effectively the mis-selling of endowments only disappeared once much of the industry stopped selling the product at all.**

The scale of mis-selling

23. While sales of endowment mortgages wound down sharply through 1999 and 2000, a very large outstanding book of endowment policies remained in force and do so to this day. At the start of 2000 the FSA told us that its first major mailing exercise to consumers on endowment policies went to 6 million policyholders with, between them, 11 million policies.[38] The evidence suggests strongly that a large percentage of these 11 million policies may have been mis-sold. The Financial Services Consumer Panel told us that they had conducted a survey in 2000 in which 50% of respondents replied that they "recalled being told at the point of sale that their endowment policy 'would definitely' or 'was guaranteed to' pay off their mortgage—which suggests a mis-sale."[39] The Consumers' Association told us that they too had conducted a survey in 2002 which suggested that 61% of those with endowment policies said that they were "told their endowment 'would definitely' or 'was guaranteed' to pay off their mortgage."[40] While John Tiner, Chief Executive of the FSA, has stated that "we have not observed systemic mis-selling of endowment mortgages"[41] he

36 Ev 97 paragraph 15 (HC 275)

37 ibid paragraph 17 (HC 275)

38 Ev 95 paragraph 5 (HC 275)

39 Ev 114 paragraph 17 (HC 275)

40 Ev 78 paragraph 2 (HC 275)

41 Speech to SOFA Update Conference 27 November 2003, paragraph 7

agreed with the Committee that "the reality is that there has been widespread mis-selling of endowment mortgages."[42] **The available evidence suggests that between 50% and 60% of holders of endowment policies believe their policies were mis-sold. If correct, this would be a significantly high figure.**

24. Many may feel that the distinction the FSA draws between 'systemic mis-selling' and 'widespread mis-selling' is a fine one. The FSA did indicate in a 2001 press briefing that its own survey evidence indicated that 60% of policyholders "say they were told the policy was guaranteed or would definitely pay off the mortgage"[43]. But when the Committee asked for an updated estimate we were told that "in order to answer this question, it would be necessary for the FSA to have mandated an industry-wide review, requiring all firms to review the specific circumstances of each case. We decided that this would not be a proportionate approach and could not be justified on cost-benefit analysis grounds."[44]

25. The Financial Services Consumer Panel told us that they originally concurred with the FSA's judgement that a formal industry-wide review of endowment mortgage mis-selling would be disproportionately expensive, but they were concerned that "there was, and is still, an absence of information to help consider the costs and benefits of different redress mechanisms in various situations."[45] The Consumers' Association expressed similar views, telling us that "the fundamental problem is that if you do not estimate the size of the problem, then how do you measure the effectiveness of the strategy you put in place to tackle it?"[46] Many of the consumer bodies told us that they, like the Committee, had pressed the FSA for clearer figures, so far without success. The Financial Services Consumer Panel, for example, told us that "it is a very confusing picture and one of the things that the Panel has called for is for the FSA to do their level best to get a much more accurate calculation of the number of policies that were sold to the number of households, and what proportion of these are likely to have been mis-sold… Until we get the best effort at a clear factual calculation it is impossible even to judge whether the mis-selling compensation exercise has been anywhere near successful or not."[47]

26. We asked the FSA if it felt our provisional conclusion that, based on survey evidence, between 50%–60% of endowment policies may have been mis-sold was reasonable. We also asked the FSA if it had any plans to commission further research on the subject. The FSA told us that while the surveys we cited in paragraphs 23 and 24 were "generally helpful and informative….we know that consumers' perceptions of events perhaps ten, fifteen or more years ago do not always provide a reliable indication of the extent of past mis-selling… We do not believe it is safe to conclude from this evidence that, in [the Committee's] words, 'between 50% and 60% of all mortgage endowment policies were very possibly mis-sold'." [48] The FSA went on to reiterate, however, that "we do not intend to commission research focused particularly on mis-selling". **We recognise that estimates of**

42 Q 208

43 *Mortgage Endowment Communication Research—Summary of BMRB omnibus findings for the Financial Services Authority*, June 2001

44 Ev 110 paragraph 22 (HC 275)

45 Ev 115 paragraph 23 (HC 275)

46 Q 131

47 Q 128

48 Ev 192 (HC 275)

past mis-selling, which depend on the memory of what was said 10 to 15 years ago, must involve a wide margin of uncertainty.

Changes needed in the regulatory environment

27. The track record of the industry raises questions about a business model used in much of the financial services industry that seems to have the effect, however unintended, of encouraging mis-selling. The FSA has itself expressed its frustration at the level and persistence of mis-selling. As he left the FSA, Sir Howard Davis told the FSA annual meeting that "The biggest disappointment of my time at the FSA has been the failure of firms, and particularly their senior managements, to learn the lessons of past mis-selling."[49] Some expert witnesses have suggested therefore that it might be useful to extend the current regulatory approach, which focuses on punishing firms for breaking the rules, so as to also punish the managements of firms breaking the rules. Mr Watts of the Financial Services Consumer Panel, argued that while the FSA has imposed fines on firms for endowment mis-selling "what about the individuals who were responsible for that? What has happened to them? Should not individuals be targeted as well as firms."[50] Mr Myners, author of a major report on institutional investment for HM Treasury, [51] expressed similar sentiments and drew an analogy with health and safety legislation, telling us there "must be merit"[52] in moving to a system that holds corporate officers responsible for ensuring that firms conduct their affairs in accordance with the regulations.

28. While it may be possible to reinforce the regulatory environment surrounding the financial services industry, the Committee has heard evidence that the repeated regulatory interventions needed over policies such as endowment mortgages are adding considerably to the industry's costs and that ultimately this has consequences for the consumer. Mr Sandler, for example, told us "the more the system is tightened up—which is in many respects a desirable thing—the more cost is added to the process and the more saving is made uneconomic for the smaller saver."[53] **The need to place increasingly tight regulatory constraints on the financial services industry to ensure satisfactory behaviour on the part of companies is imposing significant costs that risk pricing the less affluent out of the long term savings market.**

Tackling the underlying issues that encourage mis-selling

29. Many witnesses suggested to the Committee that the fundamental problem exposed by the history of endowment mortgage mis-selling is a sales-led culture within the industry. Mr Watts, of the Financial Services Consumer Panel, told us that the "industry is sales-based, and that is what it makes its money from, and that is a huge, fundamental problem. The FSA, I think, needs to address the problem of how to achieve cultural change within the industry to stop mis-selling."[54] Several witnesses went on to suggest that the only

49 FSA annual meeting, 17 July 2003

50 Q 181

51 *Institutional Investment in the UK*, HM Treasury, March 2001

52 Q 281

53 Q 281

54 Q 181

effective way to deliver the needed cultural change is to wean the industry off its current commission-driven approach to business. Mr Sandler, for example, told us that "a commission-based system where the front-line is effectively rewarded on the basis of how much product it delivers to the market—and that is true irrespective of whether we are talking about a tied sales force or an independent financial adviser—such a system is always going to be prone to the more enthusiastic or perhaps the less ethical choosing to circumvent the process and deliver a product which may, with the fullness of time, not be suitable for the recipient."[55] Mr Myners noted that while the current sales process is entirely rational "for the people who are paying for it, who are the product providers… it may not be in the best interests of the product purchaser, who is not paying for it."[56]

30. Professor Davis of Brunel University told us that "a question for the industry and financial services generally is, why does the commission have to come up-front and therefore make it so attractive to sell certain products and not others? Could not the commission somehow go over the life of the product and be related to its performance? Then there would be in a sense sharing of the pain and much more care in terms of the sales."[57] Mr Sandler endorsed Professor Davis's views, telling us "I think that anything that reduces the up-front cost is to be welcomed and anything that has a performance-related dimension is further to be welcomed because it aligns the adviser more closely to the consumer, which is the state of affairs that we are seeking to create" although he went on to warn that "it is classically the area where the FSA is not going to take any steps, and the industry left to its own devices has no incentive to take steps."[58] **Action is needed to better align consumer and product provider interests in the area of financial services. The current commission structure within the industry rewards potentially inappropriate and short-term sales practices. Sometimes this is at the expense of the saver's long term interests. It is unacceptable that the industry's current commission structures rewards the industry irrespective of the investment performance of the products it sells.**

55 Q 278

56 Q 276

57 Q 104

58 Q 326

4 Shortfalls

Asset allocation and poor investment returns

31. Unfortunately it has become plain in recent years that many endowment policies are unlikely to generate enough to pay off their target, the sum borrowed as a mortgage. In large part these shortfalls reflect problems in the asset allocation policies pursued by insurance companies. Section 2 highlighted the inherently risky nature of endowment mortgages. Whether they were aware of it or not, anyone taking out an endowment mortgage was essentially gambling that when it matured, their endowment policy—invested in relatively volatile assets such as equities—would generate enough funds to pay off the fixed liability represented by the mortgage. That gamble was a particularly large one because UK insurers have a much higher exposure to equities than their counterparts overseas. ONS data suggests that for much of the 1980s and 1990s life company portfolios typically had a 65%–70% weighting in equities. Witnesses told us that US life companies were not allowed to take equity weightings above 15%.[59]

32. UK life companies as a whole failed to take any action to trim their equity exposure as the equity bubble inflated through the latter half of the 1990s. Mr Bloomer of Prudential told us that his company began to respond towards the end of 1999, but that "we have a £55 billion/£60 billion fund so it does take us some time to rebalance the portfolio without causing real concern in equity markets. Over the period from late 1999 through to early 2001 we moved 40% of the fund out of equities."[60] Other major companies, however, seem to take a very different attitude to asset allocation. Mr Crombie of Standard Life, told us that "the Standard Life Group financial strategy for a very long time has been to hold the maximum amount of equity consistent with its financial strength and that policy has been held throughout. Clearly at times that will look to be the wrong policy and at other times it will look to be the right policy." [61]

33. It is clear that poor asset allocation policies have played a major role in creating many of the problems that have hit endowment policyholders. Both Mr Sandler and Mr Myners told us that this reflected a herd-like mentality towards asset allocation, an issue which received far too little attention, yet "there is no question that the ultimate outcome for consumers in their savings process is governed in the overwhelming majority by the asset allocation decision…. That is one of the reasons why the investment process in this country is not a very effective deliverer to consumers of the best possible result."[62] Mr Sandler went on to suggest that the failure to devote enough time and resource to the asset allocation decision owed much to the opaqueness with which the industry operates, with "no effective scrutiny of what the asset allocation should be. Most people do not know it; it is not publicised. It does not contribute in any way to the evaluation of the performance of the product provider, so, if it is out of kilter, it is certainly not because it has been driven that way by consumer pressure or advisory pressure."[63] **Given the central role of asset**

59 Q 46

60 Q 497

61 ibid

62 Q 317

63 Q 319

allocation in determining investment returns, the FSA should make it a basic principle that all investors in long-term savings products are given regular information on the asset allocation policies of the product provider and how this has added to, or detracted from, the performance of the investment fund.

34. Mr Myners told us that the "long-term record of the industry in asset allocation is not terribly good. National economic statistics have shown that on the whole the industry tries to buy more equities at the peak of the [equity] market than it does at the bottom and buys more bonds at the peak of the bond market than it does at the bottom of the bear market [in bonds]."[64] That thesis is borne out by the recent track record of the insurance industry, which went into the peak of the equity market with relatively high weightings in equities, but then cut back equity weightings and bought bonds near the bottom of the equity market. Indeed it seems clear that across the industry a mix of changing investment views and prudential regulatory requirements have produced a shift from equities to bonds. Thus, Mr Cazalet told us that "broadly, across the with-profit sector, going back two years ago, the typical weighting in equities was 65%; it is now about 30%."[65]

35. **The net result is that the shortfalls policyholders are now suffering only partially reflect the fall in the equity market between early 2000 and spring 2003. In many cases the major problem is rather that as the economy has settled into an era of low inflation and low nominal interest rates, it has become increasingly improbable that the underlying investments underpinning endowment policies will deliver the nominal returns assumed when the policies were written in the late 1980s and 1990s. This is particularly so given that many with-profits funds have now switched from risky, but potentially higher growth, equities into safer, but lower growth, bonds. Recent signs of an equity market revival thus do not herald the end of the problems for policyholders.**

36. In several cases the recent switch in asset allocation reflects funds closing to new business. Mr Haste, Chief Executive of Royal & Sun Alliance, which has itself closed its with-profits fund to new business, told us he thought that therewere "over 20 closed funds in the industry."[66] We return to the issues posed by closed funds in greater detail later, but such funds typically now have very limited exposure to equities and are extremely unlikely to rebuild their equity weightings.

Actions taken to keep customers informed

37. To reflect the shifts in likely investment returns the FSA told us that they had sought to ensure "that policyholders are well informed about any potential shortfalls on their investments and the options available to them."[67] With this objective in mind, "at the instigation of the FSA, the Association of British Insurers (ABI) adopted a code of practice in September 1999 under which its member firms carried out regular forecasts of the final value of mortgage endowment policies and communicated this information to all their policyholders. The resulting 'reprojection' letters told individual policyholders whether or

64 Q 317

65 Q 39

66 Q 481

67 Ev 95 paragraph 3 (HC 275)

not the policy was still on track to repay the mortgage. These are now sent out every two years. Individual reprojection letters began going out to consumers in April 2000. The letters outlined the need to take action if the policyholder faced a potential shortfall and also enclosed factsheets from the FSA."[68]

38. Within the industry the reprojection letters are referred to by colour codes, although we understand that in most cases the letter actually sent to clients has no colour printing on it to reflect the coding level. As a standard, policies needing annualised investment growth of over 8% during their remaining lifetime to meet the sum needed for repayment of the original mortgage receive what is known as a red letter, indicating a high probability that the endowment will not meet its target sum. 8% is in line with the upper boundary for illustrative projections set by the PIA in July 1999, but any policy bought prior to July 1999 will probably have had a higher upper boundary for potential returns in the marketing literature. Amber letters are sent to holders of policies which require an annualised return of 6% to 8%, with the view being that "the endowment is unlikely, on the balance of probabilities, to reach the target sum."[69] Green letters go to remaining policyholders. **To help the process of alerting as many policyholders as possible to the shortfall problem, the Committee recommends that "red" reprojection letters, warning policyholders of a high probability that their endowment policy will fall short of its target, should always have the key section printed in red, analogous to the format used in overdue bills from utilities and others.**

39. The FSA has complained that the industry generally failed to do anything on its own initiative to keep policyholders informed of the problems developing in endowment mortgages and it sees the problem as symptomatic of the industry often failing to pay due regard to customers' interests after the point of sale. As far back as 2001, the FSA stated that "even when it became clear that many customers' endowment polices might fail to pay off their mortgages, it still required intervention by the FSA before firms agreed to tell customers about the risk. Customers deserve better. If the financial services industry is to enjoy their trust it must treat customers fairly throughout the term of the commercial relationship and not just when making the sale."[70] There seems now, with a few exceptions, to be a widespread acceptance in the industry that initial consumer communications on the subject of possible shortfalls were deficient, a deficiency which has played a crucial role in worsening the problem. Standard Life told us that "the crux of the matter is that over a lengthy period interest rates fell, but providers and advisers failed to warn policyholders of the desirability of saving some of the reduction in their mortgage interest payments against the risk that policy returns would also fall."[71] Aviva plc also told us that "had early consumer awareness of any emerging shortfall been better managed, more policyholders may have exercised the option of using some or all of the savings they were realising through lower interest rates to offset the projected shortfall."[72] In essence, the first warning many consumers received of the problem was a red letter telling them the policy was already highly likely to show a shortfall. Prior to 2000 holders of "with-profits policies

68 Ev 95 paragraphs 6 & 7 (HC 275)

69 Ev 108 paragraph 7 (HC 275)

70 *DP7: Treating customers fairly after the point of sale*, FSA press release, 27 June 2001

71 Ev 185 paragraph 27 (HC 275)

72 Ev 65 paragraph 4.1.1.7 (HC 275)

would normally have received annual bonus notices, but these usually focused only on the bonus for the year not the likely return over the lifetime of the policy."[73] The ABI told us that "post-sale communications to customers in the 1980s and 1990s could clearly have been better—a lesson the industry has now learned for all product ranges, not just endowments."[74]

40. The main voice dissenting from this view came from Mr Prosser, Chief Executive of Legal & General, who told us that the endowment mortgage issue was a "basic piece of maths"[75] which "consumers did grasp"[76] and that the company had done everything it could to advise its customers of what was happening.[77] Legal & General pointed out that their main endowment product "contained from the outset a five yearly review of premiums. This feature gave policy holders information at regular intervals on which to decide what action, if any, to take to ensure their mortgages would be paid off at maturity."[78] It is notable, however, that prior to the FSA's requirement to send out regular reprojection letters, the best policyholders could expect across the industry was to be told how their policies were doing every five years. **The industry's track record ahead of FSA intervention in failing to keep the customer informed about the deepening problems surrounding endowment policies is a matter of serious concern. It is, to use the term employed by Standard Life in its submission to the Committee, the "crux" of the endowment mortgages issue, both because of the problems it subsequently caused as the shortfalls confronting policyholders spiralled, but also because of what it reveals about the industry's attitude to the post-sale care of its customers.**

41. While the current reprojection exercises are standardised around the 4%, 6% and 8% target ranges laid down by the PIA in June 1999, Mr Tiner told us that "with the three years of bear markets and, more particularly, the changing asset allocation within portfolios away from equities and towards the bond markets" he had asked "firms now to review whether their projection rates of 4%, 6% and 8% were proper ones in the light of that change and to adjust them where appropriate. We have found that since our letter in June on that, a very large number of companies have reduced the projections, which will themselves increase the number of red letters."[79] At least one independent industry expert, Mr Cazalet, has argued that "the use of a 6% after tax projection rate by life companies looks highly unrealistic given that, in the case of with-profits contracts, the average underlying asset mix is dominated by bonds, which means that life offices may struggle to generate annual returns of 4% to 5% after tax."[80] Mr Tiner agreed there may be a problem, telling us that the FSA was "reviewing the whole concept of reprojection rates at the moment because I am not sure that the FSA should be responsible for setting the reprojections rates. I think that we might want to give it over to perhaps an academic body that can then, perhaps, look at

73 Ev 5 paragraph 11 (HC 275)

74 ibid paragraph 12

75 Ev 155 paragraph 7.12 (HC 275)

76 Q 389

77 Qq 396, 397

78 Ev 157 (HC 275)

79 Q 216

80 *Caught Short—Mortgage Endowment Shortfalls*, Cazalet Consulting, September 2003, page 3

them in a more dynamic way."[81] **The assumed rates of returns being used in reprojection letters are central to the FSA strategy for warning policyholders about potential shortfalls. It is essential that the FSA closely monitors the assumptions used and ensures that they are realistic. While it may be useful to call in outside bodies in an advisory capacity in this process, the responsibility of setting the rates used and ensuring that they are realistic should rest ultimately with the relevant insurance company, which knows the nature of its own portfolio.**

The current scale of the shortfall problem

42. The Committee was anxious to ascertain the scale of the endowment mortgage shortfall problem. The Association of British Insurers, for example, had told us that it estimated "that around 1.5 million people currently face a projected shortfall against their mortgage loan."[82] John Tiner, Chief Executive of the FSA, told us that he found that estimate "incredibly surprising; I thought that would be a bigger number, quite frankly"[83], but was unable initially to provide firm data on either the number of policies or the number of policyholders currently facing a projected shortfall. Mr Tiner did tell us that "the estimate of the number of red letters for this year's round of reprojection letters is going to be much higher than last time; the last time round it was quite high, about 50 per cent. I should think it will go to 70 per cent or so this year"[84] but the FSA was initially unable to give the Committee any estimate of the average projected shortfall for policies receiving red letters. The Committee put it to Mr Tiner that without hard figures on such issues the FSA would be unable to implement its product risk framework approach to regulation, which relies on matching the regulatory resources devoted to a problem to its likely size. Mr Tiner agreed.[85]

43. Given the sketchy nature of the initial information available from the FSA on endowment mortgage shortfalls, the Committee decided to approach five major insurance companies both to give general evidence on endowment mortgages but also to give us detailed data on the shortfalls issue. The companies approached were Aviva (whose UK life business trades as Norwich Union), Legal & General, Prudential (with endowment policies issued by both Prudential and Scottish Amicable), Royal & Sun Alliance and Standard Life. Between them these companies have 4,680,000 endowment policies still in force, 55% of the 8,500,000 policies estimates by the FSA to be still in force across the market. The percentage of policies attracting red letters in the last available reprojection exercise, indicating a high probability that the endowment will not meet its target sum, ranged from 39% in the case of Aviva to 81% in the case of Royal & Sun Alliance. Across the 4.68 million policies in force with our sample of five companies, 83%, or 3.88 million policies, attracted red or amber letters, indicating that, on balance, the policies were unlikely to generate enough funds to pay off the endowment mortgage. This compares with a 78% estimate[86] for the industry as a whole that the FSA was able to provide to the Committee. The FSA also estimated that the average shortfall per policy was £5,500, in line with the

81 Q 218

82 Ev 8 (HC 275)

83 Q 193

84 Q 220

85 Q 195

86 Ev 111 paragraph 27 (HC 275)

range of estimates we received from our sample of companies.[87] This suggests that at the time of the last reprojection mailing the total shortfall confronting policyholders was of the order of £37 billion, although the figure quoted to us by the FSA for the total shortfall was 'only' £30 billion because the FSA based its calculations simply on the 6.8 million policies in place it believes are still being relied upon to repay a mortgage, rather the 8.5 million total number of policies.[88]

44. The FSA pointed out to us that its estimate of a £30 billion aggregate shortfall is subject to "major uncertainties relating to future investment performance. It also fails to take into account the 'time-value' of money—that is, £1 in ten years' time is worth less than £1 today. So we would caution against placing too much reliance on any estimate."[89] At the same time however, the FSA, told us that the "current projection data suggests that the larger shortfalls will arise on policies with a maturity date more than five years hence (i.e. after 2008) as the fall in returns in more recent years works through."[90] In addition the FSA noted that "a recovery in equity markets and higher investment returns more generally would help to reduce the proportion of policies likely to see a shortfall at maturity. However, this 'upside potential' will be constrained by the fact that in recent years most funds have substantially reduced their exposure to equities. Many funds have also maintained payments above asset share as part of the 'smoothing' of returns provided by with-profits funds, but this implies some 'catching up' will be required in the coming years to restore an equilibrium. As a result, our analysis suggests that the balance of risks is weighted towards a further increase in the numbers of policies falling short."[91]

45. Independent experts are similarly gloomy. Mr Cazalet, of Cazalet Consulting, expects the mortgage endowment failure rate "to increase over the next few years to the point where practically all mortgage endowments maturing will fall short."[92] In the absence of remedial action, it is also likely that the absolute number of endowment policies maturing and failing to produce enough to pay off the mortgage to which they are linked is likely to grow steadily between now and 2013, 25 years after the share of the mortgage market taken by endowments peaked at 83% in 1988.[93] Mr Cazalet has also argued that the generally assumed rate of return on investments of 6% may be too high. If a more cautious, but still plausible, assumption of future post-tax investment returns of 4% is employed he suggested that this could boost the aggregate shortfall confronting policyholders to £95 billion. This view was dismissed as too gloomy by both major insurance companies and the FSA[94]. Mr Harvey of Aviva told us that he thought "Mr Cazalet's numbers exaggerate the problem by a factor of more than two."[95] The FSA has nevertheless acknowledged the sensitivity of the size of projected shortfalls to the future projections rates used, noting that on its own analysis assuming net returns of 4% would produce an average shortfall per

87 Qq 361–366

88 Ev 111 paragraph 27 (HC 275)

89 ibid

90 Ev 109 paragraph 18 (HC 275)

91 ibid paragraph 19

92 *Caught Short—Mortgage Endowment Shortfalls*, Cazalet Consulting, September 2003, page 3

93 ibid page 12

94 Q 250

95 Q 562

policy of £9,600. This would an imply an aggregate shortfall across all endowment policies of over £65 billion. The situation is therefore uncertain, but on all available estimates endowment mortgage shortfalls are a major problem that is likely to grow over time.

46. **The Committee concludes that the best available evidence suggests that mortgage endowment policies are currently showing a collective shortfall of around £40 billion. Looking just at policies still being relied upon to repay a mortgage, the collective shortfall is at least £30 billion. Around 80% of policies are currently unlikely to generate enough funds to pay off the mortgage they were originally sold to meet and the average shortfall is currently around £5,500. The balance of probabilities is that both the percentage of policies showing a shortfall and the average size of the shortfall per policy will worsen over the coming years. Without remedial action endowment policies maturing but failing to meet their targets are likely to be an increasingly common problem until 2013, 25 years after the peak in endowment policy sales in 1988**.

47. Members of the insurance industry have at times seemed to suggest that the shortfall picture was being portrayed in an overly dramatic fashion. The Association of British Insurers (ABI), for example, suggested that one mitigating factor is that many policyholders "will have accumulated substantial housing equity as a result of rising house prices."[96] It is apparent, however, that releasing any equity would involve policyholders selling their home and moving to a smaller property, not always a palatable or realistic option. The ABI also pointed out that "those with repayment mortgages have seen their total mortgage payments fall as interest rates have come down. Those with endowment mortgages have benefited more from lower interest rates since (in contrast to repayment mortgages) they pay interest on the full loan throughout, not on a declining sum." This observation would carry more weight if policyholders had been better informed at an early stage and advised of the need to use the benefit of lower interest rates to bolster their mortgage repayments. The ABI acknowledges that "for many endowment holders, the lower actual and predicted investment returns mean they need to save or invest more each month to avoid a shortfall at the end of their mortgage term."[97]

48. While there are indeed various offsets to the mortgage endowment shortfall problem, it is equally clear that there are some households for which it could prove a major difficulty. Citizens Advice, for example, told us that "because many of our clients are poor they do not have the resources to repay projected endowment shortfalls. This is a particularly acute problem for people who are approaching retirement or who have already retired."[98] Citizens Advice also told us "that particularly acute financial difficulties are experienced by homeowners who are notified of an endowment shortfall towards the end of their mortgage term."[99] Ms Foster of the Financial Services Consumer Panel agreed that "there is a real problem about people approaching retirement age facing a shortfall, and [the Financial Services Consumer Panel] did recommend that the FSA should ask the whole industry, not just the problem firms but the whole industry, to look at that particular category of policyholder right across the industry, and they did not see it as necessary to do

96 ibid paragraph 21

97 Ev 6 (HC 275)

98 Ev 75 paragraph 2.2 (HC 275)

99 ibid paragraph 2.4

so."[100] Indeed Mr Tiner told us that the FSA had no information on particular parts of the community that may be more than usually vulnerable to problems with endowment shortfalls and that if it was anyone's responsibility to explore this issue it was "probably the [insurance] companies."[101]

49. The Committee has expressed concern in the past that there are no clear lines of responsibility in monitoring potentially destabilising financial issues. In our Report on the Chancellor's recent Pre-Budget Report, for example, we highlighted the potential dangers surrounding high levels of consumer credit and recommended that "A greater degree of coordination is needed between the Treasury and the Bank in assessing how policies should address the potential risks to both the economy and individual households flowing from high levels of household debt."[102] There seem to be similar gaps in the lines of responsibility between the FSA, the industry and Government in terms off who takes the lead in monitoring the risks to the economy and individual sections of society flowing from endowment mortgages. **Mortgage endowment shortfalls are a multi-billion pound problem. The shortfalls are a problem that could have a particularly serious impact on the elderly and some of the more vulnerable sections of society. It is particularly important that these individuals get timely and accurate advice on how to tackle this problem.**

The position of policyholders in closed funds

50. We noted earlier (Section 2) that the position of with-profits policyholders generally seemed unsatisfactory but the treatment of with-profits policyholders who have taken out endowment or other policies through insurance companies that have closed to new business seems to be particularly unfair. We have been told that there are now over 20 closed funds in the industry.[103] An insurance company can close a with-profits fund to new business, but the rest of the company will continue to trade as normal. Thus, for example, Royal & Sun Alliance told us that it had closed its with-profits funds to new business, but that it remained "one of the UK's leading general insurance groups, employing around 12,000 people in the UK."[104] On closing to new business, a with-profits fund will typically switch a substantial proportion of the investment portfolio out of equities into bonds in an attempt to reduce the volatility of the fund and minimise the capital the insurance company may need to support the fund. Thus Royal & Sun Alliance, which closed its funds to new business in 2002, told us that the equity weighting of its two main life funds had fallen in one case from 59% in 1998 to 21% in 2003 and in the other case from 41% to 10%.[105] The result is that an investor who bought a policy offering strong exposure to equities and therefore potentially high growth prospects suddenly finds that their policy is now invested in a low growth, bond dominated fund.

100 Q 134

101 Q 249

102 Third Report of Session 2003–04, *The 2003 Pre-Budget Report*, HC 136, paragraph 13

103 Q 481

104 Ev 175 paragraph 1.2 (HC 275)

105 Ev 177 paragraph 3.3.3 (HC 275)

51. The switch in asset allocation can have a significant impact on likely returns. The Committee, for example, has been told that on standard actuarial assumptions someone with a £50,000 with-profits pension policy and 10 years to retirement is likely to find their fund reduced by £6000 on retirement if their insurer closes to new business.[106] A similar reduction in returns is likely to apply to endowment policy holders in closed funds and Royal & Sun Alliance told us that it had considered it prudent to reduce its projected returns to endowment policyholders to "reflect the lower proportion of equities held in the investment portfolio."[107] For its traditional with-profits funds it now used reprojection rates of 4%, 4.75% and 5.5% and this had "inevitably placed more policies in the red category."[108] 81% of Royal & Sun Alliance endowment policyholders are currently receiving red reprojection letters, the highest figure among the major insurers we asked for data. While Royal & Sun Alliance told us that they had written to their clients on the closure of the fund and explained the implications, policyholders were given no particular opportunity to leave the fund and if they chose to do so normal exit penalties would apply.[109] We have asked several experts[110] and the FSA[111] if they can think of any other industry that sells its customers one product, such as an equity based with-profits endowment policy and then unilaterally switches the customer into another product, such as a bond-oriented closed fund. No one has yet been able to name another industry which treats its customers in an equivalent fashion. **The treatment of policyholders in closed funds is unfair. The insurance industry seems to be unique in preserving to itself the right to sell a customer one product and then substitute it with another product which is inferior in key respects. The FSA should examine the case for a regulatory requirement that solvent companies[112] closing the with-profits elements of their operations to new business should, on request, transfer their customers without penalty to another supplier offering a product broadly similar to the one the customer originally bought.**

Aligning company and consumer interests

52. Many consumers are currently suffering large losses from the shortfalls surfacing on endowment policies. The insurance companies that sold them the policies are suffering no direct losses or costs at all from the shortfalls. Indeed the companies are still able to levy their full fees on the underlying funds, regardless of the performance of the fund. This suggests a fundamental mismatch between the companies' interests and the interests of policyholders. Most of the endowment mortgages sold were "low cost" endowments, with no guaranteed maturity value and industry executives confirmed to us that all of the shortfall fell on the policyholder.[113] Because of this, some witnesses have suggested that companies had an incentive to sell the product cheaply by setting premiums below those

106 Q 58

107 Ev 177 paragraph 4.2.3 (HC 275)

108 ibid paragraph 4.2.4

109 Q 493

110 Q 61

111 Q 142 [HC (2002–03) 1211–i]

112 i.e. excluding mutuals

113 Q 350

which gave the policy a reasonable chance of hitting its target. Companies also had an incentive to employ a high risk, but possibly high return, asset allocation strategy to try and make the potential returns for the policy look more attractive at the time of the sale.[114]

53. Industry executives denied these accusations. Mr Harvey, Group Chief Executive of Aviva plc, told us that "the company has no interest in selling too small a policy. In general we illustrated mortgage endowments at three rates of interest and it was normal for the central rate of interest to be that which the customer chose as being their target."[115] Mr Crombie of Standard Life also told the Committee that "In the specific case of mortgage endowments in the year 2000, we issued an endowment promise to make up some of the gap that existed at that time on forward projections. It was a move made voluntarily to try to reduce the level of discomfort that our policyholders who were using this product for the original purpose were experiencing. I think we have tried hard."[116] **There is an urgent need to align the interests of savers and product providers more closely, not just in areas such as endowment mortgages but in other areas such as the forthcoming Sandler suite of products. From the consumer's perspective, it is perverse that most companies are still charging their full fees on endowment policies when 80% of policies will fail to meet the product's original objective of paying off the mortgage. A structure in which the fees charged by product providers were tied to the product meeting set investment targets would serve the consumer better, and we recommend that the FSA together with the industry investigate this issue, with a view to developing proposals for reform.**

114 Q 183

115 Q 358

116 Q 356

5 Advice to consumers

Advice on dealing with a shortfall

54. The FSA told us that in large part its strategy for tackling the problem of endowment mortgage shortfalls rests on ensuring that policyholders are "being warned of a potential shortfall on their investments… we have taken considerable steps to ensure that policyholders know the options available to them and understand the importance of taking appropriate action."[117] Consumers thus receive warnings of possible shortfalls via the reprojection letters the FSA requires companies to send out regularly. Each reprojection mailing has also included a fact sheet produced by the FSA urging consumers to take action over any projected shortfalls. In addition, since October 2003 the FSA has launched its own media campaign to alert consumers to the need to take action to correct endowment policy shortfalls.

55. The FSA told us that its research had "indicated that 99% of consumers were aware of concerns about mortgage endowments"[118] and that its information suggested "that a fifth of policyholders are very seriously worried about the impact on their financial position."[119] Equally, however, the FSA acknowledges that "there is a worry that not sufficient numbers of consumers are taking steps to address the shortfall, for example, by converting a part of their mortgage to a repayment mortgage"[120] and the ABI told us that its "figures suggest that the number of people who face a projected shortfall and have not yet made specific provision to deal with it could be around 700,000."[121]

56. In addition to worries about the number of consumers not taking any action at all to correct endowment mortgage shortfalls, consumer groups have expressed worries that the reprojection letters are implicitly encouraging consumers to take actions which are often inappropriate. The Financial Services Consumer Panel told us that one of its "concerns about the reprojection exercise was that policyholders may think their insurance company was suggesting an increase in premiums as the best option open to them and our research revealed some evidence of this. Increasing contributions to their policy was the most spontaneously mentioned course of action (46%), and seeking advice from an IFA was second (17%). However, we were somewhat reassured that, despite this, respondents in our survey were as likely to take other forms of action such as changing part of their mortgage to a repayment mortgage as they were to increase contributions to their existing policy."[122] The Consumers' Association raised similar concerns, telling us that "many [reprojection] letters contained additional wording that would have had the effect of encouraging consumers to increase the premiums being paid into their endowment policies, even

117 Ev 95 paragraph 2 (HC 275)

118 Ev 96 paragraph 13 (HC 275)

119 Q 197

120 Q 196

121 Ev 8 (HC 275)

122 Ev 113 paragraph 13 (HC 275)

providing a contact number and in some cases an application form with the reprojection letter."[123]

57. Perhaps the sharpest criticism of the communication process for consumers with endowment shortfalls nevertheless centres on the failure of anyone to take responsibility for providing simple, common-sense independent advice. The FSA's strategy of ensuring that all policyholders receive information on shortfalls has been a success but, as the Financial Services Consumer Panel told us, "consumers need help, as well as information."[124] Citizens Advice raised similar concerns, noting that "there are particular difficulties for those on low income in accessing suitable financial advice at a low cost. Distrust of financial advisers, not knowing how to find a suitable adviser and the cost of financial advice are significant factors for many consumers to put off seeking professional independent financial advice."[125] In addition, the problem for many low income policyholders is compounded by the fact that "most independent financial advice seems to be targeted at people with substantial incomes, and financial advisers are unlikely to have experience of relevant issues for those on low incomes, such as how the benefits system treats savings products."[126] Consumer groups also told us that the advice vacuum for many policyholders is compounded by the current regulatory restrictions on well trusted advice bodies such as Citizens Advice Bureaux giving financial advice to individuals.[127]

58. Companies within the financial services industry are clearly failing to fill the advice vacuum surrounding endowment mortgages. As well as the widespread perception of consumer mistrust of companies noted by several consumer bodies, an FSA survey noted that 29 % of those customers contacting their insurance company for further information about their mortgage endowment shortfalls were unhappy with the service they received, with dissatisfaction centred on "poor explanations and responses to questions."[128] Mr Harvey, Group Chief Executive of Aviva plc, told us that he thought the explanation of this was that "we have been the bearer of some very disappointing tidings to our customers and it is entirely understandable that they should be disappointed (and the bridge between disappointment and dissatisfaction is a fairly narrow one)."[129] **Advice on endowment policy shortfalls from insurance companies is both widely distrusted and frequently found to be unsatisfactory by consumers. Some 'red' letters imply that increased premiums will be sufficient to restore the product to its previous promises. Letters should refer to the possibility of contacting the mortgage lender to discuss ways of addressing the shortfall and to give advice on the rights of policyholders to make a complaint. Policyholders without access to an IFA are being left in an advice vacuum, with no access to any effective advice on what to do about the situation**.

123 Ev 80 paragraph 21 (HC 275)

124 Ev 118 paragraph 48 (HC 275)

125 Ev 76 paragraph 4.2 (HC 275)

126 Ev 77 paragraph 4.3 (HC 275)

127 ibid paragraph 4.4

128 *Mortgage Endowments: the consumers' view*, FSA, December 2002, page 6

129 Q 413

Advice on financial services generally

59. One witness told us, "there are leaflets galore telling people not to do things without financial advice, but there is no investment in appropriate financial advice for the people who need most help and have least experience in using financial advisers and probably have the least assets to throw at this problem when it hits them."[130] Citizens Advice told us that it "sees a significant need for the Financial Services Authority and Government to develop a strategy for meeting consumers' needs for ready access to high quality independent, affordable financial advice. In this context 'affordable' must include free advice and information for consumers on low incomes who would be unable to afford the costs of advice provided by the market."[131] The Financial Services Consumer Panel agreed, but noted that they "and other consumer groups, have long been calling for the wider provision of generic advice…. It is clear that non-sales advice is needed by consumers. Whilst the FSA and the Government have seemed positive about the idea, there has been little progress."[132]

60. While the provision of a dedicated network for the provision of basic, generic financial advice to consumers would be both a lengthy and expensive project, the Committee notes that there are precedents elsewhere across the public sector, particularly in the health sector, for authoritative figures such as the Chief Medical Officer to give clear basic advice to the public. **The issue of endowment mortgage shortfalls has exposed significant gaps in the advice framework available to consumers that require urgent corrective action. The Committee endorses the call of many consumer groups for a mechanism to deliver low cost or free generic advice to consumers. We welcome the establishment by the FSA of the Financial Capability Steering Group[133] and look forward to its findings on the promotion of financial education. The FSA should play a more active role in encouraging companies to ensure basic financial advice is available to consumers on key issues such as how to respond to endowment mortgage shortfalls.**

130 Q 149

131 Ev 77 paragraph 4.7 (HC 275)

132 Ev 118 paragraph 50 (HC 275)

133 *Towards a national strategy for financial capability* FSA November 2003

6 Complaints and compensation

The complaint and compensation process

61. To have a valid complaint about a mortgage endowment policy policyholders need to show that they were both given unsuitable advice when purchasing the policy and that they have lost out financially as a result. In calculating any compensation due, the aim is normally to return the policyholder to the position they would have been in had they taken out a repayment mortgage. The calculation of any compensation thus involves comparing the mortgage interest and premiums actually paid on the endowment mortgage, and the current surrender value of the mortgage endowment policy, with the mortgage interest and capital repayments paid on an equivalent repayment mortgage, and how much capital would have been paid off the mortgage.[134]

62. In the first instance policyholders must complain to the seller of the policy. Insurance companies are thus only responsible for policies sold directly to the customer, not those sold by intermediaries. If a policyholder feels they have not been treated fairly by the company, they can then appeal to the Financial Ombudsman Service (FOS), although the FOS has no power in cases involving sales via IFAs pre-1988.[135] In addition to the normal complaint process for individuals, however, the FSA has intervened and agreed a proactive review programme with some companies.

Level of complaints and compensation

63. The FSA told us that so far its interventions had produced "£5.2 million in fines and involves approximately £227 million in compensation to around 183,000 consumers. In addition, through our intervention on a non-disciplinary basis, 19 other firms have delivered approximately £446.5 million in compensation for a further 253,500 consumers."[136] In addition, the FSA told us that a "further £200 million has been paid by firms as a result of individual complaints made by consumers. We expect this figure to rise significantly in the forthcoming period."[137] The FSA added that in the past year 216,000 complaints were made to companies about endowment mortgages. In total the FSA's figures suggest that the number of complaints relative to the number of policies remains well below 10%. This conclusion was reinforced when we asked the five major insurance companies that gave us evidence what percentage of the endowment policies on their books had so far lodged complaints. The figures ranged from 10% in the case of Standard Life to 2.0% in the case of Scottish Amicable,[138] but across the five companies 5.7% of the 4.68 million policies had prompted complaints. This figure needs to be compared with the evidence we noted earlier (Section 3) that between 50% and 60% of endowment policies were mis-sold. Mr Harvey, Chief Executive of Aviva, told us that he did "not agree with the view that [the percentage of complaints] is a tiny proportion of those who have a potential

134 www.financial-ombudsman.org.uk/faq/mortgage.htm

135 Q 225

136 Ev 97 paragraphs 16 & 17 (HC 275)

137 ibid paragraph 18 (HC 275)

138 Qq 417, 418

claim."[139] While not all mis-sold policies will give rise to a compensatable loss, with around 80% of endowment policies showing a shortfall it nevertheless seems fair to expect many more policyholders to be complaining if they were fully aware of their rights and the complaints process. **The available evidence suggests that 80% of endowment mortgage policies are now showing a shortfall and that 50%–60% of holders of such policies believe they were probably mis-sold. However, we note that in many cases there is a lack of any contemporaneous record of what the sales person said to the client and vice versa; this will make it difficult to determine reliably what a client's attitude to risk was at the time the contract was entered into. Against this background, under 6% of policyholders have so far complained. Urgent action is needed to ensure that the complaints process is better understood and more accessible to policyholders.**

64. Consumer groups told us that they had made requests to the FSA to improve the information available to policyholders about making a complaint. Ms Foster of the Financial Services Consumer Panel told us that "our main concern about the communications with consumers was the fact that FSA did not require the firms to send out with the reprojection letters the leaflet about endowment mortgage complaints. They did send out the fact sheet about endowment mortgages and we agree that was helpful, but actually consumers really needed help to understand whether they might have a claim for compensation arising from mis-selling, and it is not easy to work that out and they needed this leaflet to enable them to do that. We asked the FSA if they could ask the industry to send this leaflet out with every reprojection letter, and that has not been done."[140] The Consumers' Association told us that they had made a similar request to the FSA because, while the FSA had produced a fact sheet on how to make a complaint, Consumers' Association research showed that "only 13% of people who had endowments knew that this fact sheet existed."[141] The FSA has told us that its research showed that "that 85% of consumers knew how to make a complaint if they needed to".[142] However, **the FSA should include a fact sheet explaining in what circumstances policyholders have a valid complaint, and how to make a complaint, with all reprojection letters.**

Time limits

65. It may well be that many policyholders do know of the complaints process but have opted not to act because "something might turn up". What policyholders might well not realise is that there are time limits on making a valid complaint. If the policyholder ultimately has to appeal to the Financial Ombudsman Service, complaints will only be considered if made within three years of receiving the first red letter warning of a likely shortfall or six months of receiving a second red letter.[143] While the latest FSA leaflet "Your endowment mortgage—have you acted yet?" does mention that a time limit for complaints exists, it is not explained in detail and Mr Harvey of Aviva told us that this will not be sent out until its phase three mailing, planned for July 2004.[144] This could well be too late for

139 Q 419

140 Q 139

141 Q 135

142 Ev 96 paragraph 13 (HC 275)

143 Q 227

144 Q 457

anyone who received a red letter in the first wave of mailings in 2000 and 2001. Mr Tiner of the FSA told us that information on the time limits is currently "not set out in the red letter, it is set out in the document that people can request as a consequence of the red letter that deals with 'How do you make a complaint?'"[145] The issue of time limits is likely to become increasingly pressing given that the first wave of projection letters went out in 2000, although Mr Prosser of Legal & General assured the Committee "We would not be looking to timeliness as a reason for not dealing with a complaint."[146] **The Committee welcomes Legal & General's statement that it would not use time limits to rule out complaints, but across the industry urgent action is required to ensure that substantial numbers of policyholders do not lose their rights to compensation. It would be unfair to apply time limit rules which early mailings made little or no mention of. These rules, which have still not been spelt out explicitly to most policyholders, should be reviewed and the time limits extended.**

Companies' complaints handling processes

66. The way companies have been handling complaints received from policyholders has been the subject of intense regulatory activity. As the flow of complaints began to grow it soon became evident that many companies were incapable of dealing effectively with the problem. Sir Howard Davis, then head of the FSA, said that "some firms complaints systems are currently snowed under by indiscriminate claims for compensation by endowment mortgage policyholders. Many have little prospect of success, and merely delay the resolution of other, worthy claims." [147]

67. The industry has had difficulties in simply handling the number of complaints received. Several companies told us that the number of staff handing complaints had risen dramatically over the past year or so. The FSA had originally imposed an eight week deadline for companies to respond to complaints, but then found it necessary to extend this deadline for several companies as they have struggled to cope with the surging number of complaints. The regulator has nevertheless informed the Committee that "all firms are expected to be back on track with complaints by the end of April 2004. Enforcement action will be pursued against any firms that continue to fail to deal with complaints fairly, consistently and promptly or fail to identify and remedy any recurring or systemic problems."[148]

68. As well as failing to process complaints in a timely fashion, the industry also seems to have initially adopted an unduly restrictive view of what constitutes reasonable grounds for a complaint. The FSA told us "we issued guidance, agreed with the Financial Ombudsman Service, in May 2001 on how firms, found to be responsible for mis-selling, should deal with complaints and calculate redress due"[149] and that "to further emphasise the importance of this, in April 2002 John Tiner wrote to the chief executives of the largest firms. He set out best practice for the way in which firms should handle complaints and

145 Q 232

146 Q 459

147 FSA annual meeting, 17 July 2003

148 Ev 97 paragraph 24 (HC 275)

149 ibid paragraph 21

asked CEOs to review their firms' procedures and experience in the light of the letter."[150] The practical effect of what the industry now terms the "Tiner letter" has been a significant increase in the number of complaints that companies are upholding, from 52% in Q3 2002 to 63% in Q3 2003,[151] although the improvement also reflects a series of targeted reviews following "an analysis of mortgage endowment complaints procedures for a sample of twelve large retail groups between 2001 and 2003."[152] The FSA has also told us that it intends to conduct "an analysis in early 2004 of standards of complaints handling in a sample of smaller IFAs, to assess whether there is action we should take to improve complaints handling in that sector."[153] The FSA has been persistent in its attempts to ensure that the companies handle complaints fairly and seems to have insisted on a general strategy of the customer being given the benefit of the doubt in cases where there is no clear evidence of whether the endowment policy was mis-sold or not due to inadequate documentation. **It is very disappointing that it has required sustained pressure from the FSA to ensure that companies handle complaints satisfactorily. As with mis-selling, the need for repeated action to ensure fair treatment for customers seems to confirm that the insurance industry is locked into an unacceptable culture that focuses upon short term sales rather than long term customer care.**

69. The Financial Services Consumer Panel has argued that one lesson to draw from recent events is that "the FSA must approach its dealings with firms with a healthy dose of cynicism. It is disturbing, but unsurprising, that it was not until the FSA put pressure on firms to raise the standards in firms' complaint handling that they did so." The Committee agrees with this assessment. **The industry's track record, both in terms of mis-selling and in terms of handling complaints, has not been conducive to an atmosphere of trust either between the industry and its customers or between the industry and its regulator. Events have demonstrated that in the future the FSA needs to be much more rigorous in ensuring that its policies and strategies are being effectively implemented by the financial services industry.**

Complaints to the Financial Ombudsman Service

70. If a company rejects a policyholder's complaint the policyholder has a right of appeal to the Financial Ombudsman Service (FOS). As the endowment mortgage problem has grown, the number of mortgage endowment complaints going to the Financial Ombudsman has soared from under 3,000 in 1998–99 to almost 14,000 in 2002–03 and an anticipated 50,000 in 2003–04.[154] In 2003–04 mortgage endowment complaints are likely to comprise around half of the Ombudsman's total work load. In spite of this explosive growth, the Committee was pleased to hear from the FOS that "our published timeliness targets are to resolve 45% of complaints within three months, 80% of complaints within six

150 ibid paragraph 22

151 Ev 110 paragraph 21

152 Ev 97 paragraph 24

153 ibid

154 Ev 94 paragraph 12 (HC 275)

months and 90% within nine months. Our current closure rate for mortgage endowment complaints is in line with these targets."[155]

71. The FOS stated that "of the 13,570 complaints the Financial Ombudsman Service resolved in 2002–03, 39% were upheld, either substantially, or in part, in the favour of the consumer."[156] Consumer groups have highlighted the view that the percentage of appeals the Ombudsman is upholding reflects poorly on the ability of companies to adjudicate complaints fairly.[157] The FOS has further noted, however, that "in the case of some firms we are upholding 60% of complaints while in others we are upholding only 15%."[158] **It is unacceptable that some companies' complaints handling processes are so flawed that the Ombudsman is upholding over 50% of consumer appeals against the companies' decisions. The FSA should take swift action to ensure that these companies begin treating their customers more fairly.**

72. Consumer groups have highlighted two outstanding problem areas in the Ombudsman process. One is the issue of unnecessary delays in the paying of compensation by the company after the Ombudsman has found in favour of the policyholder[159]. The other area of concern relates to policyholders who received advice from IFAs. Many IFAs have now gone out of business and claims against them must be made via the Financial Services Compensation Scheme. Neither the Financial Services Compensation Scheme nor the FOS have a remit to look at cases relating to IFAs prior to 1988.[160] Broadly, however, consumer groups have expressed satisfaction at the way the Ombudsman is coping in difficult circumstances. The Consumers' Association told us that "we are very satisfied with the way the Ombudsman is taking forward what must be a huge increase in the complaints that are coming [through]",[161] a view broadly endorsed by the Financial Services Consumer Panel.[162] **There remain concerns in the industry about the statutory framework within which the FOS works (for example in respect of the lack of symmetry between companies and complainants over rights of appeal from its decisions) and concerns about some of its decisions. In other respects, the Financial Ombudsman Service process appears to be working acceptably as an appeals body for the consumer on endowment mortgages and providing an efficient and accessible service.**

73. The full complaints process can be lengthy and complex and there are some consumers who are not covered by the complaints process at all. We have heard from people who, when faced with a prospective shortfall, have complained to the endowment provider. The provider has, quite properly, indicated that in the particular case the complaint lies with the IFA who sold the policy. On making a complaint to the Ombudsman about the adviser, the policyholder has been informed that where the policy was taken out before 1988 the Ombudsman has no role. Additionally, if the adviser has gone out of business, and the

155 Ev 94 paragraph 20 (HC 275)

156 ibid paragraph 13

157 Q 155

158 Walter Merricks, Chief Ombudsman, speech to the Council of Mortgage Lenders, 2 December 2003

159 Q 156

160 Q 225

161 Q 156

162 ibid

policyholder has quite properly tried to claim from the Financial Services Compensation Scheme, the policyholder will again have been informed that where the policy was taken out before 1988 it is not covered by the Scheme. **Consumers may need more help in establishing fair redress in some cases, with the main problem areas relating to policies sold via IFAs prior to 1988.**

7 Conclusions

74. **The evidence presented to the Committee in the course of this inquiry suggests that the financial services industry has shown significant failings in the endowment mortgages story**.

- There were failings in the way the product was sold.
- The way assets were managed did not generate the level of returns for investors which might reasonably have been expected.
- The industry failed to inform customers about what was happening to their savings as investment returns tumbled and failed to give them adequate advice on what to do about the problem.
- There were inadequacies in the way the issue of policyholder compensation was addressed, after the industry's other failings had been exposed.

75. **Our inquiry has also identified a range of issues which the FSA has had to address and which it needs to continue to address. However, as the table at paragraph 7 above indicates, the vast majority of endowment mortgage mis-selling occurred before the FSA came into being.**

- It has to ensure that measures are in hand to identify those affected by shortfalls. This has included requiring companies to send red, amber, green letters from companies to their customers indicating the extent to which their mortgages would not be covered, as an essential start to addressing the situation. The assessment by individual companies of the number of red and amber letters they need to send out provides as good an estimate of the scale of the number of policies subject to shortfall as is likely to be available. The figures will need to be monitored regularly by the FSA to see how the problem develops in coming years. Any alternative survey would not only have to look at the specifics of hundreds of thousands of cases but would have to forecast the likely state of equities when particular policies mature. For both reasons it would involve a wide range of uncertainty.
- It has to oversee the process by which individuals are advised on what they should do if faced with a shortfall on their policy. For many, a repayment mortgage may be the appropriate option but alternative solutions may be available to others. It is not the FSA's role to give this advice itself, but to ensure that the companies which sold the products are doing so.
- It has to ensure that remedies are provided by the companies responsible for mis-selling. The time limits that apply to endowment mortgage complaints have been poorly communicated to policyholders and require urgent review as growing numbers of policyholders pass the third anniversary of receiving their first warning that there was a probable shortfall on their policy.

76. **Overall, it is important for the industry, the regulators and the Government all to recognise the size of the problem which has arisen. The problem is likely to worsen as**

increasing numbers of low-cost endowment mortgage policies mature in the coming decade. There needs to be a constructive engagement by the industry with the problem if difficulties—in some cases serious distress—for a large number of people are to be avoided.

Lessons for the future

77. Given that many of the insurance companies involved in the endowment mortgages problem are among the UK's most significant financial institutions, it is a matter of grave concern to the Committee when a leading independent expert such as Mr Sandler tells us that "a far higher degree of trust is attached to the brands of the large supermarkets than attaches to the large life insurers."[163] **There is an overriding need to rebuild public trust and confidence in many of the companies that currently dominate the long-term savings industry.**

78. There are some signs of progress. Most in the industry do now at least accept that things have gone badly wrong and the reputation of companies has been damaged. The Association of British Insurers, for example, told us that "the industry recognises that it has many disappointed customers and the [endowment mortgages] episode has tarnished its reputation. Wherever insurers and/or distributors are found to have acted wrongly, policyholders should be compensated for any loss. More generally, there is a need to rebuild trust with customers."[164] Mr Sandler told us that he too detected the first "glimmers of hope that the industry is beginning to acknowledge that it has a reputational problem and is now taking steps to rectify that"[165] but that, like the Committee, he believed there was still a long way to go. In particular, it is far from clear to the Committee that the basic business model that has historically dominated the industry, a focus on commission driven sales rather than longer-term product performance, has changed in a way that will encourage the industry to behave more responsibly toward the consumer in the future. **The picture that emerges from our inquiry into endowment mortgages is one of a long-term savings industry wedded to an inappropriate sales and commission led business model which is damaging the reputation of the industry and undermining consumer confidence in long-term savings. In this context, the current regulatory framework is left struggling to tackle the symptoms of that inappropriate business model.**

79. Improving the business model and culture that currently dominates the long-term savings industry would deliver benefits that extend well beyond restoring domestic consumer confidence in the UK's savings institutions. Such reforms should deliver world class financial institutions and confirm the UK as a venue of choice for both savers and fund mangers, but Mr Myners warned the Committee that this would only happen "if we are able to show the world that the UK sets best standards in terms of sales process, commissions, charges, reasonableness, equity between the product provider and the customer, full and open disclosure [and] the absence of kick-backs."[166] **Many of our witnesses have argued the case for fundamental reform of the way the long-term**

163 Q 315

164 Ev 9 (HC 275)

165 Q 325

166 Q 330

savings industry conducts its business. Such reform would not just serve to restore domestic consumer confidence, it would deliver world class financial institutions and help the UK claim the position of international venue of choice for savers and fund managers alike.

80. It is important to align the interest of the consumer and the industry more closely. One of the most striking features to emerge from the evidence we have heard on endowment mortgages is that the industry can sell a financial product which, in 80% of cases, fails to meet its clear target in terms of returns. Yet the industry suffers no direct financial loss itself from the endowment shortfalls and can charge the same fees whether the product delivers a satisfactory return or not. This inevitably raises questions about the industry's fees structure. Retail financial services companies have traditionally charged a simple percentage of the funds invested, plus any commission payable. It is notable that the debate surrounding the appropriate charging regime for Sandler products has concentrated on a similar fee structure, based on a percentage of the funds invested, to that underpinning most endowment products. **Whatever level the price cap on Sandler products is set at, the fee structure proposed will simply continue to bias the industry towards the aggressive pursuit of sales, since that is what it will be rewarded for. It would be preferable for the fee structure in the long-term savings industry to reward the delivery of superior investment returns and the provision by the industry of the sort of after-sales care for the saver that was spectacularly missing in the case of endowment mortgages.**

81. Mr Sandler identified what the Committee believes is the core of the problem, when he told us that "the industry—and I am thinking of the life companies in particular—have clearly defined obligations to their shareholders. Their obligations in terms of duties of care to policyholders are much less well defined, and I think, historically, the industry has operated much more on the basis of how do I secure distribution rather than how do I ensure that my customers are being best served."[167] This view was endorsed by Mr Myners[168] and several other expert witnesses. **Urgent action is needed from the Government, the FSA and the industry to alter a culture that has led to the multiple failures seen in the case of endowment mortgages. Central to delivering the needed cultural change is a shift from the current fee structure that rewards an often inappropriate sales process. It is disappointing that a similar fee structure has dominated the industry's thinking on the proposed Sandler suite of products. The challenge, for both the industry and Government, is to develop a fee structure for long-terms savings products that reinforces the industry's duty of care to the saver by directly rewarding good investment returns and client retention rather than simply paying out high rewards for client acquisition.**

167 Q 333

168 ibid

Conclusions and recommendations

Endowment mortgages as a savings product

1. Buying a home is the largest single financial transaction most people undertake in their lives and the financial services industry owes a particular duty of care to its customers in the marketing and subsequent management of relatively complex financial products such as endowment mortgages. Unfortunately, the reality is that in selling low-cost endowment mortgages the industry often failed to provide homeowners with a suitable product for their individual circumstances or a product that was fit for the purpose it was being used for. The performance of the financial services industry in providing reliable and effective products to those looking to fund a house purchase is likely to be crucial in shaping consumers' views of the industry. The failures in respect of endowment mortgage policies are a contributory factor towards the low consumer confidence in the industry. (Paragraph 9)

2. Many of the basic problems identified in endowment mortgages are shared by other with-profits products sold by the life insurance industry. The Committee is concerned by evidence that even after the FSA's proposed reforms, buying any with-profits policy will still be little more than an "act of faith" for the consumer. Developing cheaper, more transparent products offering the same smoothing benefits to the saver as the traditional with-profits product is now a key challenge for the long-term savings industry. (Paragraph 12)

3. It seems clear that it was undesirable for the tax system to be so slanted as to entice consumers into one relatively complicated financial product rather than a broadly comparable, but much simpler, product such as a repayment mortgage. The Committee believes that this is an important lesson for the future and strongly endorses Mr Sandler's call that "the overriding policy goal in this area… should be one of reducing complexity and distortions in the taxation of savings products". (Paragraph 14)

4. The events surrounding Equitable Life raised questions about the effectiveness of the pre-existing actuarial regime, but the insurance industry's approach to endowment mortgages through the late 1990s also demonstrates an inadequate approach to investment issues by appointed actuaries. The Committee considers it important that the FSA's proposed reforms of the actuarial process within insurance companies are effective in providing warnings and a more proactive and independently minded actuarial advice. (Paragraph 18)

5. It seems clear to the Committee from its review of endowment mortgages that generally more needs to be done to ensure that financial products and the tax system surrounding them are simplified as much as possible, that officials whose role is in part to protect and re-assure the consumer actually discharge that function effectively and, above all, that when complex financial products are sold to consumers they accurately fit the purpose for which they are bought. (Paragraph 19)

Mis-selling of endowment mortgages

6. The insurance industry was lamentably slow to respond adequately to regulatory pressure to improve its sales process for endowment mortgages. This forced the regulator to intervene repeatedly to toughen its supervision of the industry. While the FSA can take the credit for the sustained attack it has made on malpractice within the industry from late 1999 onwards, effectively the mis-selling of endowments only disappeared once much of the industry stopped selling the product at all. (Paragraph 22)

7. The available evidence suggests that between 50% and 60% of holders of endowment policies believe their policies were mis-sold. If correct, this would be a significantly high figure. (Paragraph 23)

8. We recognise that estimates of past mis-selling, which depend on the memory of what was said 10 to 15 years ago, must involve a wide margin of uncertainty. (Paragraph 26)

Future action to address mis-selling

9. The need to place increasingly tight regulatory constraints on the financial services industry to ensure satisfactory behaviour on the part of companies is imposing significant costs that risk pricing the less affluent out of the long term savings market. (Paragraph 28)

10. Action is needed to better align consumer and product provider interests in the area of financial services. The current commission structure within the industry rewards potentially inappropriate and short-term sales practices. Sometimes this is at the expense of the saver's long term interests. It is unacceptable that the industry's current commission structures rewards the industry irrespective of the investment performance of the products it sells. (Paragraph 30)

Development of shortfalls in endowment policies and communication with policyholders

11. Given the central role of asset allocation in determining investment returns, the FSA should make it a basic principle that all investors in long-term savings products are given regular information on the asset allocation policies of the product provider and how this has added to, or detracted from, the performance of the investment fund (Paragraph 33)

12. The net result is that the shortfalls policyholders are now suffering only partially reflect the fall in the equity market between early 2000 and spring 2003. In many cases the major problem is rather that as the economy has settled into an era of low inflation and low nominal interest rates, it has become increasingly improbable that the underlying investments underpinning endowment policies will deliver the nominal returns assumed when the policies were written in the late 1980s and 1990s. This is particularly so given that many with-profits funds have now switched from risky, but potentially higher growth, equities into safer, but lower growth, bonds.

Recent signs of an equity market revival thus do not herald the end of the problems for policyholders. (Paragraph 35)

13. To help the process of alerting as many policyholders as possible to the shortfall problem, the Committee recommends that "red" reprojection letters, warning policyholders of a high probability that their endowment policy will fall short of its target, should always have the key section printed in red, analogous to the format used in overdue bills from utilities and others. (Paragraph 38)

14. The industry's track record ahead of FSA intervention in failing to keep the customer informed about the deepening problems surrounding endowment policies is a matter of serious concern. It is, to use the term employed by Standard Life in its submission to the Committee, the "crux" of the endowment mortgages issue, both because of the problems it subsequently caused as the shortfalls confronting policyholders spiralled, but also because of what it reveals about the industry's attitude to the post-sale care of its customers. (Paragraph 40)

15. The assumed rates of returns being used in reprojection letters are central to the FSA strategy for warning policyholders about potential shortfalls. It is essential that the FSA closely monitors the assumptions used and ensures that they are realistic. While it may be useful to call in outside bodies in an advisory capacity in this process, the responsibility of setting the rates used and ensuring that they are realistic should rest ultimately with the relevant insurance company, which knows the nature of its own portfolio. (Paragraph 41)

Levels of shortfalls

16. The Committee concludes that the best available evidence suggests that mortgage endowment policies are currently showing a collective shortfall of around £40 billion. Looking just at policies still being relied upon to repay a mortgage, the collective shortfall is at least £30 billion. Around 80% of policies are currently unlikely to generate enough funds to pay off the mortgage they were originally sold to meet and the average shortfall is currently around £5,500. The balance of probabilities is that both the percentage of policies showing a shortfall and the average size of the shortfall per policy will worsen over the coming years. Without remedial action endowment policies maturing but failing to meet their targets are likely to be an increasingly common problem until 2013, 25 years after the peak in endowment policy sales in 1988. (Paragraph 46)

17. Mortgage endowment shortfalls are a multi-billion pound problem. The shortfalls are a problem that could have a particularly serious impact on the elderly and some of the more vulnerable sections of society. It is particularly important that these individuals get timely and accurate advice on how to tackle this problem. (Paragraph 49)

Policyholders in closed funds

18. The treatment of policyholders in closed funds is unfair. The insurance industry seems to be unique in preserving to itself the right to sell a customer one product and then substitute it with another product which is inferior in key respects. The FSA should examine the case for a regulatory requirement that solvent companies closing the with-profits elements of their operations to new business should, on request, transfer their customers without penalty to another supplier offering a product broadly similar to the one the customer originally bought. (Paragraph 51)

Aligning the interests of savers and product providers

19. There is an urgent need to align the interests of savers and product providers more closely, not just in areas such as endowment mortgages but in other areas such as the forthcoming Sandler suite of products. From the consumer's perspective, it is perverse that most companies are still charging their full fees on endowment policies when 80% of policies will fail to meet the product's original objective of paying off the mortgage. A structure in which the fees charged by product providers were tied to the product meeting set investment targets would serve the consumer better, and we recommend that the FSA together with the industry investigate this issue, with a view to developing proposals for reform. (Paragraph 53)

Advice on dealing with shortfalls and on financial services generally

20. Advice on endowment policy shortfalls from insurance companies is both widely distrusted and frequently found to be unsatisfactory by consumers. Some 'red' letters imply that increased premiums will be sufficient to restore the product to its previous promises. Letters should refer to the possibility of contacting the mortgage lender to discuss ways of addressing the shortfall and to give advice on the rights of policyholders to make a complaint. Policyholders without access to an IFA are being left in an advice vacuum, with no access to any effective advice on what to do about the situation. (Paragraph 58)

21. The issue of endowment mortgage shortfalls has exposed significant gaps in the advice framework available to consumers that require urgent corrective action. The Committee endorses the call of many consumer groups for a mechanism to deliver low cost or free generic advice to consumers. We welcome the establishment by the FSA of the Financial Capability Steering Group and look forward to its findings on the promotion of financial education. The FSA should play a more active role in encouraging companies to ensure basic financial advice is available to consumers on key issues such as how to respond to endowment mortgage shortfalls. (Paragraph 60)

Levels of complaints

22. The available evidence suggests that 80% of endowment mortgage policies are now showing a shortfall and that 50%–60% of holders of such policies believe they were probably mis-sold. However, we note that in many cases there is a lack of any contemporaneous record of what the sales person said to the client and vice versa; this will make it difficult to determine reliably what a client's attitude to risk was at the time the contract was entered into. Against this background, under 6% of policyholders have so far complained. Urgent action is needed to ensure that the complaints process is better understood and more accessible to policyholders. (Paragraph 63)

23. The FSA should include a fact sheet explaining in what circumstances policyholders have a valid complaint, and how to make a complaint, with all reprojection letters. (Paragraph 64)

24. The Committee welcomes Legal & General's statement that it would not use time limits to rule out complaints, but across the industry urgent action is required to ensure that substantial numbers of policyholders do not lose their rights to compensation. It would be unfair to apply time limit rules which early mailings made little or no mention of. These rules, which have still not been spelt out explicitly to most policyholders, should be reviewed and the time limits extended. (Paragraph 65)

Companies' handling of complaints

25. It is very disappointing that it has required sustained pressure from the FSA to ensure that companies handle complaints satisfactorily. As with mis-selling, the need for repeated action to ensure fair treatment for customers seems to confirm that the insurance industry is locked into an unacceptable culture that focuses upon short term sales rather than long term customer care. (Paragraph 68)

26. The industry's track record, both in terms of mis-selling and in terms of handling complaints, has not been conducive to an atmosphere of trust either between the industry and its customers or between the industry and its regulator. Events have demonstrated that in the future the FSA needs to be much more rigorous in ensuring that its policies and strategies are being effectively implemented by the financial services industry. (Paragraph 69)

27. It is unacceptable that some companies' complaints handling processes are so flawed that the Ombudsman is upholding over 50% of consumer appeals against the companies' decisions. The FSA should take swift action to ensure that these companies begin treating their customers more fairly. (Paragraph 71)

Complaints and the Financial Ombudsman Service

28. There remain concerns in the industry about the statutory framework within which the FOS works (for example in respect of the lack of symmetry between companies and complainants over rights of appeal from its decisions) and concerns about some of its decisions. In other respects, the Financial Ombudsman Service process appears to be working acceptably as an appeals body for the consumer on endowment mortgages and providing an efficient and accessible service. (Paragraph 72)

29. Consumers may need more help in establishing fair redress in some cases, with the main problem areas relating to policies sold via IFAs prior to 1988. (Paragraph 73)

General conclusions on endowment mortgages

30. The evidence presented to the Committee in the course of this inquiry suggests that the financial services industry has shown significant failings in the endowment mortgages story. (Paragraph 74)

31. Our inquiry has also identified a range of issues which the FSA has had to address and which it needs to continue to address. However, as the table at paragraph 7 above indicates, the vast majority of endowment mortgage mis-selling occurred before the FSA came into being. (Paragraph 75)

32. Overall, it is important for the industry, the regulators and the Government all to recognise the size of the problem which has arisen. The problem is likely to worsen as increasing numbers of low-cost endowment mortgage policies mature in the coming decade. There needs to be a constructive engagement by the industry with the problem if difficulties—in some cases serious distress—for a large number of people are to be avoided. (Paragraph 76)

Lessons for the future

33. There is an overriding need to rebuild public trust and confidence in many of the companies that currently dominate the long-term savings industry. (Paragraph 77)

34. The picture that emerges from our inquiry into endowment mortgages is one of a long-term savings industry wedded to an inappropriate sales and commission led business model which is damaging the reputation of the industry and undermining consumer confidence in long-term savings. In this context, the current regulatory framework is left struggling to tackle the symptoms of that inappropriate business model. (Paragraph 78)

35. Many of our witnesses have argued the case for fundamental reform of the way the long-term savings industry conducts its business. Such reform would not just serve to restore domestic consumer confidence, it would deliver world class financial institutions and help the UK claim the position of international venue of choice for savers and fund managers alike. (Paragraph 79)

36. Whatever level the price cap on Sandler products is set at, the fee structure proposed will simply continue to bias the industry towards the aggressive pursuit of sales, since that is what it will be rewarded for. It would be preferable for the fee structure in the long-term savings industry to reward the delivery of superior investment returns and the provision by the industry of the sort of after-sales care for the saver that was spectacularly missing in the case of endowment mortgages. (Paragraph 80)

37. Urgent action is needed from the Government, the FSA and the industry to alter a culture that has led to the multiple failures seen in the case of endowment mortgages. Central to delivering the needed cultural change is a shift from the current fee structure that rewards an often inappropriate sales process. It is disappointing that a similar fee structure has dominated the industry's thinking on the proposed Sandler suite of products. The challenge, for both the industry and Government, is to develop a fee structure for long-terms savings products that reinforces the industry's duty of care to the saver by directly rewarding good investment returns and client retention rather than simply paying out high rewards for client acquisition. (Paragraph 81)

Formal minutes

Wednesday 25 February 2004

Members present:

Mr John McFall, in the Chair

Mr Nigel Beard
Angela Eagle
Mr Michael Fallon
Norman Lamb
Mr James Plaskitt
Mr David Ruffley
Mr Robert Walter

Draft Report (Restoring confidence in long-term savings: Endowment mortgages), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraph 1 read, amended and agreed to.

Paragraphs 2 to 6 read and agreed to.

Paragraph 7 read, amended and agreed to.

Paragraphs 8 to 24 read and agreed to.

Paragraph 25 read, amended and agreed to.

Paragraphs 26 to 31 read and agreed to.

Paragraph 32 read, amended and agreed to.

Paragraphs 33 to 52 read and agreed to.

Paragraph 53 read, amended and agreed to.

Paragraphs 54 to 59 read and agreed to.

Paragraph 60 read, amended and agreed to.

Paragraphs 61 to 74 read and agreed to.

Paragraph 75 read, amended and agreed to.

Paragraphs 76 and 77 read and disagreed to.

Paragraphs 78 to 83 read and agreed to (now paragraphs 76 to 81).

Summary read, amended and agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

[Adjourned till Wednesday 10 March at 2.00 pm

Evidence

Note on the publication of the oral and written evidence:
The oral and written evidence received on endowment mortgages is not readily separable from the evidence received for the Committee's wider long-term savings inquiry as a whole. The oral evidence taken so far is available in one volume as HC (2003–04) 71: this incorporates HC (2002–03) 1274–i (evidence of 11 November 2003) and HC (2003–04) 71–i,–ii,–iii (evidence of 2 December 2003, 22 January 2004 and 27 January 2004). The written evidence taken so far is published in one volume as HC (2003–04) 275.

Witnesses

List of written evidence

(See HC 275)

List of Reports from the Treasury Committee since 2001

Session 2003–04

		Report	*Govt Response**
First Report	The Transparency of Credit Card Charges	HC 125	
Second Report	Child Trust Funds	HC 86	*HC 387*
Third Report	The 2003 Pre-Budget Report	HC 136	
Fourth Report	Annual Report for 2003	HC 386	
Fifth Report	Restoring confidence in long-term savings: Endowment mortgages	HC 394	

Session 2002–03

First Report	National Statistics: The Classification of Network Rail	HC 154	*HC 550*
Second Report	The 2002 Pre-Budget Report	HC 159	*HC 528*
Third Report	Split Capital Investment Trusts	HC 418	*HC 651*
Fourth Report	The Handling of the Joint Inland Revenue/ Customs and Excise PFI Project	HC 184	*HC 706*
Fifth Report	Annual Report for 2002	HC 491	
Sixth Report	The UK and the Euro	HC 187	*HC 1004*
Seventh Report	The 2003 Budget	HC 652	*HC 1028*
Eighth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Richard Lambert	HC 811	
Ninth Report	Appointment of Ms Rachel Lomax as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC 1011	
Tenth Report	Inland Revenue Matters	HC 834	*HC 1181*

Session 2001–02

First Report	The 2001 Census in England and Wales	HC 310	*HC 852*
Second Report	Budget 2002	HC 780	*HC 1075*
Third Report	The Office of Government Commerce	HC 851	*HC 1217*
Fourth Report	Appointment to the Monetary Policy Committee of the Bank of England of Mr Paul Tucker and Ms Marian Bell	HC 880	
Fifth Report	Banking, the Consumer and Small Businesses	HC 818	*HC 1218*
Sixth Report	The Financial Regulation of Public Limited Companies	HC 758	*HC 1219*
Seventh Report	Parliamentary Accountability of Departments	HC 340	*HC (2002–03) 149*
Eighth Report	Inland Revenue: Self Assessment Systems	HC 681	*HC 1220*
Ninth Report	Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee	HC 1189	

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