

The PIA Ombudsman: a reduction in investor protection?

With the advent of the PIA, investors will lose the right to refer disputes relating to long-term insurance to the Insurance Ombudsman. Peter J Tyldesley explains why this should be a cause for concern

In mid-July 1994, the Personal Investment Authority (PIA) is expected to become the principal self-regulatory organisation for the sale of personal investment products. The membership of both the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) and the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA) will be largely subsumed. In addition, the PIA will regulate a number of firms which currently either are members of the Investment Management Regulatory Organisation (IMRO) or are directly regulated by the Securities and Investments Board (SIB).

Under this new system, complaints that have not been settled by a member of the PIA within two months may be referred to the PIA Ombudsman Bureau. A description of the draft Memorandum and Articles of Association for the Bureau is available from the PIA (*The PIA's Approach to Regulation*, Appendix 19).

These changes will implement many of the recommendations of the 'Report on A Unified Complaints Procedure', submitted to the SIB by Lord Ackner in July 1993.

The PIA has not been without its critics. Wide press coverage has been given to its choice of Chairman, to the decision of one major insurer to seek direct regulation from the SIB, and to the failure of the majority of independent financial advisers to apply for membership before the initial deadline of 5 April 1994. In an interim report on Financial Services Regulation issued on 23 May 1994 the Treasury and Civil Service Committee concluded that the evidence it had taken 'cast serious doubt on the PIA's likely effectiveness as a body for investor protection'.

Cause for concern

One issue should be of particular concern to many investors and their representatives – the removal of the right to refer disputes relating to long-term insurance to the Insurance Ombudsman.

At present, the Insurance Ombudsman Bureau (IOB) acts as the main

complaints-handling body for LAUTRO. Membership of the IOB is voluntary, though most insurers have chosen to join. Complaints against non-members are considered by a sub-committee of LAUTRO. The powers of the Insurance Ombudsman are set out in Terms of Reference, which were published in his Annual Report for 1992. In 1993, the IOB received nearly 3,500 complaints relating to long-term insurance.

Why does it matter that the right to complain to the Insurance Ombudsman will be lost? The answer to this question lies in the very significant differences between the jurisdiction of the Insurance Ombudsman, and that proposed for the PIA Ombudsman. In particular, the protection of the investor will be reduced in six important respects:

1 There will be a fall in the maximum award that can be made. Awards made by the Insurance Ombudsman are (if accepted by the complainant) binding on the insurer to a maximum of £100,000 (Terms of Reference, clause 2(f)). This limit was fixed when the IOB began operating in March 1981, and so an informed observer might feel that an increase is long overdue. In fact, the PIA Ombudsman will be able to make a maximum award of just £50,000 (*The PIA's Approach to Regulation*, p103).

2 More subtly, there will be a change in the basis on which decisions can be made. The Insurance Ombudsman is both empowered and required to make such award as he considers 'fair and reasonable in all the circumstances' (Terms of Reference, clause 2(e)). Regrettably, the PIA Ombudsman will not enjoy this wide discretion. Instead, he or she will be required to consider complaints on the basis of law, and any relevant 'statements of general principles of good insurance, investment or marketing practice, Rules, Codes and Guidance' (*The PIA's Approach to Regulation*, p102).

This serious limitation has led James Haswell OBE (Insurance Ombudsman 1981-1989) to suggest that the office of PIA Ombudsman runs the risk of being a 'whited sepulchre' (letter to *The Times*, 21 May 1994). Significantly, the restriction may disqualify the PIA Ombudsman from membership of the influential British and Irish Ombudsman Association, which regards the ability to make decisions on the basis of 'what is fair in all the circumstances' as a prerequisite for the use of the term Ombudsman.

3 The Insurance Ombudsman is able to consider complaints relating to events that occurred before an insurer became a member of the IOB, provided that an application is received within six months of the matter being considered by the insurer's senior management (Terms of Reference, clause 4(d)). This power might well be regarded as essential – the long-term nature of the products involved inevitably means that it may be many years before an investor discovers that there are grounds for a complaint. Nevertheless, the PIA Ombudsman will not be able to consider complaints arising out of events that occurred before 29 April 1988 or such later date as the 'member firm became an authorised person' (*The PIA's Approach to Regulation*, p103). A further restriction is that the complaint itself must have been received by the member after its admission to the PIA (*The PIA's Approach to Regulation*, p98). Those investors who have complaints which relate to earlier events, or who complained to the member before the date of its admission to PIA, will simply have no means of redress short of the courts.

4 The Insurance Ombudsman is empowered to receive complaints 'made in connection with or arising out of (i) policies of insurance (ii) contracts which constitute investment business' (Terms of Reference, clause 2(a)). For this purpose 'contracts which constitute investment

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Joe Palmer, PIA Chairman

business' are limited to those 'in respect of units in a collective investment scheme' (Terms of Reference, clause 6(a)). Nevertheless, this is a wider remit than that granted to the PIA Ombudsman, who will be unable to consider complaints that 'do not relate to the way in which the member has carried on PIA regulated business' (*The PIA's Approach to Regulation*, p37). Indeed, the Insurance Ombudsman has stated that approximately 50 per cent of the complaints relating to long-term insurance that were received by the IOB in 1993 would have fallen outside the PIA Ombudsman's jurisdiction (*Money Marketing*, 17 March 1994).

This problem has been recognised by the PIA. As an example of a typical dispute that would fall outside the jurisdiction of the PIA Ombudsman, the PIA cites the case of 'a complaint which concerns the way in which a life office has dealt with a maturity claim...'. Such a dispute would, of course, be within the Insurance Ombudsman's jurisdiction.

The PIA's solution is to allow its members to consent to a voluntary extension of the PIA Ombudsman's jurisdiction, so that matters of this nature may be considered. If a member chooses to give its consent, any award under the voluntary jurisdiction is subject to a limit of £100,000. Consent can be withdrawn at 12 months' notice (*The PIA's Approach to Regulation*, p98).

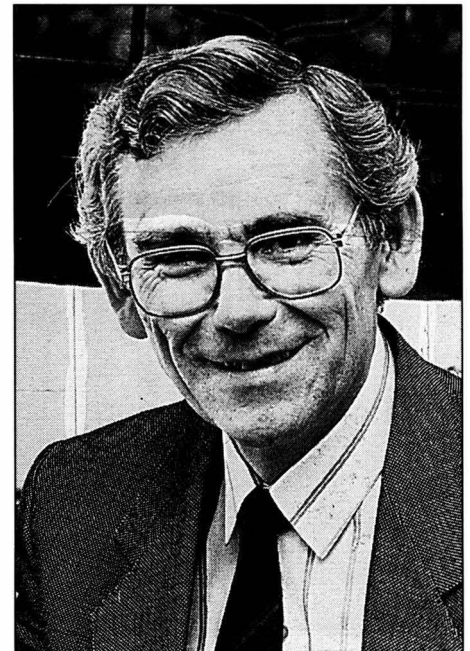
This approach may result in some benefit to some investors, and to that extent it is to be welcomed. However, allowing each member to decide whether it wishes to provide its consent introduces an unfortunate element of uncertainty into the complaints system. Why should the entitlement of an investor to compensa-

tion depend on whether or not the PIA Ombudsman happens to hold a current consent from the member concerned at the time a complaint is made? Equally, why should a member with high standards choose to expose itself to a greater liability when it sees its less virtuous competitors declining to do so? The fact that a member which provides its consent will be expected to pay higher charges to the PIA can only act as a further disincentive (*The PIA's Approach to Regulation*, p37).

5 An associated difficulty arises with complaints relating to mortgages sold alongside policies of insurance. Prior to June 1993 the IOB had believed that in certain circumstances the phrase 'made in connection with or arising out of' entitled the Insurance Ombudsman to look at any part of a complaint that related to such a mortgage. Most commonly this issue arose in Home Income Plan cases, where elderly people were encouraged to take a loan by way of mortgage on their home in order to raise capital to fund investment policies. Almost all Home Income Plan complaints were upheld, and the Insurance Ombudsman invariably included the interest charged under the mortgage in his award. This approach was confirmed in guidelines on compensation prepared in consultation with LAUTRO.

In June 1993, the IOB agreed to arbitration proceedings when a member insurer challenged the interpretation of the phrase as applied in a dispute concerning the terms of an endowment mortgage. The arbitrator indicated that there must be a sufficient level of nexus between the insurance policy and the mortgage for the matter to be within the Insurance Ombudsman's jurisdiction. Following this decision the Insurance Ombudsman took the view that he was not entitled to consider the mortgage element of Home Income Plan cases. However, in August 1993 the Board of the IOB issued a press release stating that the Insurance Ombudsman would continue to deal with Home Income Plans in accordance with the existing guidelines. The result is that it is not uncommon for more than 50 per cent of the award in a Home Income Plan case to represent mortgage interest. As the average total award is £55,000 the sums involved are substantial.

Mortgages will not be PIA regulated business. It will therefore be interesting to see whether the PIA Ombudsman follows the lead set by the IOB's Board, and concludes that he is able to consider the mortgage element of any Home Income Plan complaints.



Julian Farrand, Insurance Ombudsman

6 Within the overall limit on awards of £100,000, there is no restriction on the sum that the Insurance Ombudsman may award for distress. Awards of up to £5,000 have, for example, been made in Home Income Plan cases. In contrast, the PIA Ombudsman will be able to make a maximum distress award of £750 (*The PIA's Approach to Regulation*, p103). The inadequacy of this limit is clear. Can anyone seriously suggest that £750 is adequate compensation for the distress suffered by an elderly investor who has lost his or her home and suffered serious ill-health as a direct result of financial difficulties caused by a Home Income Plan?

Matter of urgency

It is plain, therefore, that investors currently able to complain to the IOB will be afforded a significantly lower level of protection by the PIA Ombudsman Bureau.

Those representing investors should be aware that under present proposals only cases referred to the IOB before 1 July 1994 will be considered by the Insurance Ombudsman. Urgent action may accordingly be required if their clients' interests are to be protected. When submitting cases, representatives should bear in mind that the IOB cannot normally deal with complaints relating to the acts or omissions of independent financial advisers ■

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