

# Insurers liable for mortgage advice

*Peter Tyldesley considers Martin v Britannia Life*

Since the Financial Services Act 1986 introduced a new regulatory regime in April 1988, there has been a fierce debate as to whether insurers are liable for mortgage advice given by their tied agents in connection with the sale of an investment policy. Insurers have argued that the arrangement of a mortgage does not constitute "investment business" as defined under Sch 1 of the Act, and is outside the scope of their s 44 agreements. Consumer representatives have pointed out that the mortgage and the policy are inter-linked, and that little is done to counter the impression given to prospective policyholders that they are simply parts of a single transaction.

This debate has now been settled by the decision of Parker J in the case of *Martin v Britannia Life Ltd*.

In 1991, Mr and Mrs Michael Martin held a number of life policies, which were in use as collateral security for a residential mortgage with Lloyd's Bank. Mr Martin was concerned that he had not made any recent pension contributions, and that he owed around £40,000 to the Inland Revenue. He sought advice from Mr Ivan Sherman, an Appointed Representative of the Life Association of Scotland (LAS).

Mr Sherman advised the Martins to re-mortgage their home with the Bank of Scotland, to surrender their existing policies, and to effect a new endowment policy with LAS. Switching policies in this way generates commission for the tied agent, but is seldom in the best interests of the policyholder. Unjustified switching, known as "churning", is amongst the more common malpractices within the financial services industry. In this case, the new endowment policy was arranged on a "low-start" basis. Unknown to the Martins, the premiums were set to escalate by 20 per cent per annum over the first five years. The Bank of Scotland mortgage was "stabilised". Its terms allowed for any interest over a certain rate to be added to the capital outstanding. In the right circumstances, low-start policies and stabilised mortgages are legitimate products, but they can mask the true cost of a re-mortgage in its early years.

A further recommendation from Mr Sherman was that Mr Martin should effect a new pension plan with LAS. Mr

Martin believed the gross annual premium would be around £5,000. In fact, the true figure was £14,625, though this was concealed in the first year by the impact of unused tax relief. An additional single net premium of £23,156 was paid from the mortgage advance. In 1992, Mr Sherman sold a second pension plan to Mr Martin. The gross annual premium was £5,625, though regrettably Mr Martin believed this was a single premium contract.

In 1994, Mr Martin discussed his position with an independent financial adviser, and complained to LAS. The long-term business of LAS had been transferred to Britannia Life, which accepted that the sales of the endowment policy and the second pension plan were inappropriate. It paid a refund of premiums with interest for the former, and converted the latter to a single-premium contract. However, it refused to accept liability for any of the mortgage-related elements of the case.

Parker J gave short shrift to this denial of liability:

"In my judgment it is neither appropriate in the context of the 1986 Act, nor for that matter would it be realistic, to seek to limit the concept of 'investment advice' by reference to the extent to which the advice relates to the 'merits' (ie to the advantages or disadvantages) of a particular 'investment' as defined; and if that be accepted, it seems to me that it must follow that the concept of 'investment advice' will comprehend all financial advice given to a prospective client with a view to or in connection with the purchase, sale or surrender of an 'investment', including advice as to any associated or ancillary transaction notwithstanding that such transaction may not fall within the definition of 'investment business' for the purposes of the 1986 Act."

For completeness, Parker J added that if he had not found that Mr Sherman had actual authority from LAS to advise on the mortgage, he would have held that he had ostensible authority to do so.

To assess the significance of this decision, it is necessary to look back to events in 1992. At that time, complaints against most life insurers were dealt with by the Insurance Ombudsman Bureau (IOB), which acted as the primary complaints mechanism for the Life Assurance and

Unit Trust Regulatory Organisation ("LAUTRO"). Under his Terms of Reference, the Insurance Ombudsman, Dr Julian Farrand, was empowered to "receive references in relation to complaints, disputes and claims made in connection with or arising out of: (i) policies of insurance; (ii) contracts which constitute investment business".

In January 1992, Dr Farrand received a complaint from a couple who had been sold an endowment mortgage by an Appointed Representative of Legal and General Assurance Society ("Legal and General"). The loan was arranged with a centralised lender, and the associated endowment policy was provided by Legal and General. The complaint related to the way in which the Appointed Representative had allegedly misrepresented the mortgage terms at the time both the mortgage and the policy had been sold.

Legal and General informed Dr Farrand that it believed the matter was outside his jurisdiction. At that time there was no mechanism for resolving jurisdictional disputes between the Insurance Ombudsman and member insurers. It was therefore agreed by the IOB that the issue would be referred to arbitration. Dr Farrand argued that although the complaint did not arise out of a policy of insurance, it was made "in connection" with such a policy, because it concerned "the process by which a package, including both a mortgage and a policy, was sold to the complainants". However, on June 7, 1993, the arbitrator, the Honourable Michael Beloff QC, issued an award supporting Legal and General. He found that to be within the Insurance Ombudsman's jurisdiction, a complaint "must be made in connection with the policy of insurance; and not merely made in connection with something else that is itself connected with the policy of insurance".

Inevitably, the award led to Dr Farrand instructing his staff to cease considering any mortgage-related element of complaints submitted to the IOB. This restriction proved to be a source of serious embarrassment for insurers. At the time it was introduced, the Home Income Plan scandal was at its height. Thousands of elderly people faced the risk of losing their homes, as a result of being advised to bor-

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row money against them to purchase equity-based investment bonds. The exclusion of the mortgage-related element of such complaints led to a significant drop in the potential level of compensation available. Not surprisingly, the restriction received widespread press coverage and, in July 1993, the matter was raised during a debate in the House of Commons. In August 1993, the Board of the IOB issued a Press Release stating there was to be an immediate change to the Insurance Ombudsman's Terms of Reference to confirm that he could consider "complaints arising from home income plans". However, the arbitration award continued to prevent consideration of mortgage-related elements of other complaints.

In July 1994, the Personal Investment Authority (PIA) replaced LAUTRO as the self-regulating organisation for insurers. The PIA adopted the Personal Investment Authority Ombudsman Bureau Limited (PIAOB) as its complaints mechanism, which led to the IOB losing jurisdiction over complaints regarding long-term insurance. Under their mandatory jurisdiction, the PIA Ombudsmen are entitled to consider complaints "in connection with or arising out of carrying on of investment business". The PIAOB was not bound by the earlier arbitration award, but the PIA Ombudsmen appear to have taken the view, now shown to be erroneous, that it reflected the law in this area. As a result, the approach taken by the PIAOB to mortgage-related complaints has not significantly varied from that imposed on the Insurance Ombudsman. The PIAOB has considered complaints relating to Home Income Plans, but as recently as December 1999 stated in a bulletin item regarding endowment mortgages that "(t)he mortgage itself is not a matter for which the Bureau has jurisdiction to adjudicate upon".

It is inevitable, therefore, that many complainants to the IOB or the PIAOB will not have received the mortgage-related compensation to which they were entitled. Most will have accepted the decision of the Ombudsman and may now be time-barred from pursuing this element of their complaints.

Dr Farrand has always doubted whether the arbitration award was correct. Speaking recently, he said "Beloff described his construction as purposive. That begs the question of whether the purpose of the IOB was to protect consumers or insurers".

Mr Richard Barnett of Barnett Sampson, a firm specialising in financial services litigation, shared those doubts. Where necessary, he has pursued such cases through the courts. As an example, he cites a complaint brought by Mr and Mrs Ian Kirwan against the Marine and General Mutual Life Assurance Society ("MGM Assurance"). In 1989, the Kirwans had an endowment mortgage with Halifax Building Society, and three associated endowment policies underwritten by the Scottish Provident Institution. An Appointed Representative of MGM Assurance, Churstons Financial Services Limited, advised them that there was a scheme whereby they could reduce their monthly outgoings and complete the purchase of their home early.

The scheme involved a re-mortgage with Société Générale Merchant Bank plc, the surrender of one of the Scottish Provident Institution policies, and the purchase of three new policies with MGM Assurance. Those policies comprised a replacement endowment policy, a term assurance policy, and a flexible whole-of-life policy. The Kirwans were informed that surrender value of the flexible whole-of-life policy would be the means of achieving early repayment of the mortgage. In the early years of the new mortgage, part of the interest due was rolled-up and added to the capital outstanding. Hence the repayments required were reduced, but the capital debt was increasing. By 1993, the Kirwans had become alarmed by the rising debt and complained—first to MGM Assurance, and then to the IOB.

In September 1994, one of the Insurance Ombudsman's assistants informed the Kirwans that their complaint relating to the endowment policy and the flexible whole-of-life policy had been upheld. However, she went on to explain that the IOB was unable to consider mortgage-related issues—which formed the greater part of the claim. The remedy available was therefore limited to a refund of the premiums paid under the two policies, plus interest.

Faced with this inadequate remedy, the Kirwans instructed Barnett Sampson to pursue their case through litigation. In April 1998, Mr Barnett successfully applied to the High Court for a preliminary hearing on the issue of whether Churstons Financial Services Limited had authority from MGM Assurance to advise on "the arranging of mortgages and mortgage finance". The hearing was set for February 1999. Earlier that month, the Kirwans accepted an offer from MGM Assurance of a full settlement with costs.

Mr Barnett recently confirmed that the compensation received by Mr and Mrs Kirwan was £50,000, which he described as "more than five times the estimated value of the award of the Insurance Ombudsman". He added "It is disappointing that so many insurers have sought to avoid liability in this area, knowing that many policyholders will not have access to expert advice. We are delighted with the *Martin* decision, which merely reflects the realities of the sales process".

Insurers now face a substantial increase in the cost of complaints. Inevitably, therefore, the issues raised by *Martin v Britannia Life* will be revisited. The Martins' action ultimately failed because it was commenced outside the limitation period—albeit by less than a month. They have leave to appeal, though it is not yet known whether they intend to do so. Insurers have, in any event, the option of asking the PIA Ombudsmen to allow any similar complaint to be dealt with through the courts as a Test Case under para 7 of their Terms of Reference.

In the meantime, the decision in *Martin v Britannia Life* stands. The PIA Ombudsmen (operating as part of the Financial Ombudsman Service since April 1, 2000) are obliged to follow "any relevant judicial authority" except where there is an express provision to the contrary in their Terms of Reference. There is no such provision in respect of mortgage-related issues, and it would clearly damage the credibility of the PIAOB if one were to be introduced.

Speaking recently, the principal PIA Ombudsman, Mr Tony Holland, confirmed that he was reviewing his approach to mortgage-related issues in light of *Martin v Britannia Life*. Any change will, however, only apply to new complaints. With regard to past complaints, Mr Holland indicated that it was unlikely they could be re-opened, since he regards himself as *functus officio*. It appears, therefore, that the affected complainants will need to seek legal advice as to whether they have a viable cause of action to pursue through the courts.

Professional advisers should now urgently check their files, to establish whether they have any clients who may be entitled to further compensation from insurers. o

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