Redress – Case Studies

Session 2B/3B

speakers	Philip Field	general manager corporate & legal counsel	Banking and Financial Services Ombudsman, Australia
	Sue Wrigley	ombudsman	Financial Ombudsman Service, UK
	Brian Martin	ombudsman	Ombudsman for Short-Term Insurance, South Africa
session leader	Peter Hinchliffe	lead ombudsman – insurance	Financial Ombudsman Service, UK
note taker	Doug Hill	adjudicator	Financial Ombudsman Service, UK

Introduction/Scope

The nature and aims of redress awarded by different schemes, in two parts

- the mechanics of assessing financial loss
- the philosophy of awards for non-financial loss

Australian approach

- Australian consumers receive unsolicited invitations from their banks to increase the level of their borrowing. These invitations are often accepted and the money is spent before the borrowing proves to be unaffordable for the consumer.
- There is a requirement in Australia for banks to have a reasonable basis for thinking that any lending is affordable. The banks attempt to demonstrate that they have fulfilled this by considering past payment history. But there is no consideration of where the payments have come from or how circumstances may have changed.
- Borrowers typically say they want a complete debt write off as the banks have not complied with requirements. The banks' typical response is that a consumer should not borrow money they cannot repay.
- The ombudsman's office takes a balanced approach:
  - It assesses the level of lending that would have been appropriate if the necessary checks had been conducted.
  - Any sum in excess of this has to be repaid by the borrower, over a reasonable period (usually 3 – 5 years) but with no addition of interest.
  - Any payments already made are treated as having first paid off the interest bearing element of the restructured borrowing.
  - In many cases this restructuring results in the interest bearing element of the borrowing having been fully redeemed prior to the complaint.
- Any non-financial results of the excessive lending, such as adverse credit reports, are ordered to be reversed.
- Consumers are often disappointed by this approach but the banks have generally adopted it and it is now rare for this type of complaint to reach the ombudsman.

UK approach

Ombudsman schemes represent an informal way of putting things right as an alternative to the courts. All parties want fairness and consistency. Simple, understandable methods most easily meet these requirements.

- UK rules provide a 'fair and reasonable' remit. Legal precedent is taken into account but is not binding.
- Awards of up to £100,000 can be made that are binding on the firm.
- Awards for loss aim to place the complainants in the position they would have been in but for the firm's error.
- If calculating loss becomes too precise the effectiveness of the scheme as a quick, informal dispute resolution service can be lost. The award is often different to the outcome the complainant is seeking. Investment cases are particularly complex. It is often impossible to know with any certainty what alternative action an investor might have taken. The complainant will often use hindsight to say they would have done something particularly advantageous. If the investor's likely action is uncertain, a 'standard approach' based on a notional capital return of Bank of England base rates plus 1% compounded yearly is used.
- Formulaic awards are also useful when large groups of consumers are affected and many firms are involved; eg the mis-selling of mortgage endowments.
- The FOS and the Financial Services Authority (FSA) work closely to give firms and consumers guidance and certainly about the calculation of compensation in these cases.
- The FSA issued guidance about endowment cases which included a formula for putting consumers back in the position they would have been in if they had taken out a repayment mortgage rather than an endowment mortgage - by comparing the capital and costs position.
- The formula is complex but everyone, consumers included, has broadly accepted that this (as a methodology) provides appropriate redress.
- In practice the formula worked well as a starting point but could not take into account every variation in individual circumstances. Assessing loss has become more and more complex and more difficult for consumers to assess whether they are getting fair redress.
- The use of formulaic awards raises a few questions
    - Is there a trade off between complexity and certainty?
    - How do formulaic awards affect the proportionality of the investigation against the amount of the award?
    - Awarding redress based on a formula means that an individual ombudsman is often making a binding award without knowing precisely what the amount of that award is – which can feel uncomfortable.

South African approach

- The insurance industry is largely contract based but fairness dictates that any breach of contract terms must be material to be relevant to any claim.
- Generally, in the context of insurance, the method of valuing a claimant's losses is set out in the contract and does not give rise to dispute. But problems do arise.
- Disputes may relate to market values of items such as collectables and insurers are increasingly tending to work on agreed values determined in advance.
- Assessment of damages has not been considered in detail by the courts, perhaps as a result of the relatively small sums involved.
- Using collision damage to a motor vehicle as an example of a difficult area, the accepted method of valuing losses is based on the cost of repairs. However this is subject to criticism on the basis that a repaired car may not have the same market value as it had prior to the accident.
- A challenging situation also arises where a vehicle is stolen and later recovered or written off and later repaired. Fraud is common in both instances with the former frequently being disguised as the latter.
- In order to combat this problem the police have started to register the fact that a car is written off or stolen and require re-registration on rebuilding or recovery. However this results in difficulty in identifying the difference between the two. An increasing

number of complaints are about the loss in value when a vehicle is stolen and recovered. Repair costs are met by the insurer, but the market value is significantly reduced by the fact the car is now effectively registered as rebuilt from write off.
- The South African office has generally taken the view that the insurer is meeting its obligations in indemnifying the repair costs. But it accepts this may not be entirely satisfactory.
- The aim is to place complainants in the position they would have been in had the loss or damage not occurred. Assessing losses based on market value, rather than replacement costs, does not seem to fully meet this aim.

Non-Financial Loss
- The specific approach to non-financial loss was slightly different for each of the delegates but the principles applied were fairly consistent.
- Awards for non-financial losses normally reflect personal inconvenience and anxiety or stress. They might also reflect loss of utility or enjoyment if, for example, a holiday is disrupted.
- Each of the schemes expect a complainant to be 'moderately robust' and able to bear reasonable levels of inconvenience. Awards are only made in limited circumstances and are normally relatively low.
- A complainant does not need to ask for this type of award for a scheme to exercise its discretion and make an award.
- Generally, whilst schemes tend to have powers to make non-monetary awards (such as apologies, flowers etc) most preferred the simplicity and clarity of making a monetary award.

Discussion
- There are wide implications when a large number of complaints are dealt with in a similar way. Virtually all of the schemes are required to consider each case on its own merits, but by adopting standard approaches there is a danger of 'backdoor regulation'. However this danger was not considered too significant outside of the UK.
- Many schemes' approaches to redress are linked to contract or tort law in their respective countries. The idea that the UK is not bound to follow the law, but instead to be fair and reasonable, raises the question, *is the law not fair and reasonable*? Whilst the FOS does take account of the law it was suggested there is more certainty for all involved when the law is applied directly.
- All agreed that the aim of compensation should be to redress losses and not to be punitive. But some schemes did indicate a willingness to 'show disapproval' in the size and nature of their awards.
- When considering complainants' losses it may be fair to offset any benefit they gained from the firm's error.
- There were significant differences between schemes in dealing with insurance policies that never had any realistic chance of a successful claim being made.
  - Some suggested that the contract never had any value and should therefore be treated as never existing (ie a refund of premiums plus, possibly, interest should be awarded).
  - Alternatively some considered that, if complainants had a realistic expectation that a claim might be met, insurers were obliged to meet that claim.
- Many schemes were happy to consider two equally fair methods of redress and award the most advantageous for the complainant, or the most expeditious for both parties.
- Most schemes were content to make an award for two inseparable losses even if a complainant only complained about one of them. Complainants should not necessarily be expected to know the cause of loss. In addition the schemes operate

as informal, and free, alternative to the courts and their inquisitorial role must avoid the need for consumers to have expert representation.

- In terms of assessing investment losses some schemes are more willing than others to specify the level of risk for a product and to make an award based on a comparison with a notional product with an appropriate level or risk for the complainant. The UK has, historically, been unwilling to take this approach but a recent Judicial Review regarding the 'standard approach' of Bank of England base rates plus 1% has suggested it might be more appropriate.