

The logo for Griffiths & Armour, featuring the company name in a blue sans-serif font with an orange ampersand. The background of the entire cover is a high-angle, black and white photograph of a modern office interior with large glass windows. Silhouettes of business professionals are visible: two men shaking hands on the left, and a man and a woman walking on the right. The floor is highly reflective, mirroring the figures. A large, semi-transparent blue banner with a white border cuts across the middle of the image, containing the title text. A large, faint, stylized 'G' logo is also visible in the background on the left side.

Griffiths &
Armour

RISK MANAGEMENT

LESSONS TO BE LEARNED



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01 INTRODUCTION

RECENT YEARS HAVE SEEN A SIGNIFICANT CHANGE IN THE PROFESSIONAL INDEMNITY (PI) MARKET FOR THE UK'S FINANCIAL ADVISER COMMUNITY WITH A CONTRACTION IN THE NUMBER OF UNDERWRITERS HAVING ANY APPETITE AT ALL TO WRITE BUSINESS IN THIS SECTOR .



A business that is focused on robust risk management supported by effective compliance advice from a sector specialist is key to ensuring the availability and affordability of insurer's terms. ”

Financial Advisers have experienced a hardening of PI rates, increased levels of self insurance and restriction of policy cover as insurers seek to return their business to profitable levels.

There are a number of underlying factors influencing market conditions including the economic downturn, an increasingly litigious society and a number of high profile mis-selling 'scandals' by players operating in the Financial Services Market. Add that to a succession of failed or suspended investment funds and/or investment houses such as Lehman Brothers, Arch Cru, and Keydata all producing a sizable flow of expensive PI claims adding to insurer losses.

You could argue that all Financial Advisers have been affected as insurers significantly increase premiums across the board in an effort to repair their balance sheets.

On a more positive note the impact of the Retail Distribution Review (RDR) should drive higher levels of technical qualifications of Financial Advisers and in turn produce better advice for their clients. Understanding a client's attitude to risk and providing relevant professional advice matching the client's needs will always fundamentally underpin a well governed Financial Adviser business and reduce their exposure to claims from unsatisfied clients.

The role of the specialist PI broker is to assist and support the Financial Adviser in the placement of their PI safety net in satisfactory, long-term, secure markets with terms that accurately reflect the risk they bring to the underwriter. A business that is focused on robust risk management supported by effective compliance advice from a sector specialist is key to ensuring the availability and affordability of insurer's terms.

This publication may not make any significant difference to collective or individual risk profiles, nor does it offer any 'one size fits all' solutions - that would be an impossible task given the breadth of its intended readership, and the varied niche fields of practice across a diverse client base. Nevertheless, we believe that its content provides food for thought regardless of individual circumstances.

Where possible we have tried to illustrate the risks with relevant case law although it should be noted that a case cited in this publication may well be appealed. However, even where appeals are successful and the legal outcome changes the factual circumstances may still be instructive to the reader.

02 THE FINANCIAL OMBUDSMAN SERVICE

IF AN IFA IS UNABLE TO RESOLVE A COMPLAINT INTERNALLY THEN THE MAJORITY OF COMPLAINTS BY PRIVATE INVESTORS CAN BE ESCALATED TO THE FINANCIAL OMBUDSMAN SERVICE (FOS). THIS CAN BE BOTH AN ADVANTAGE AND A DISADVANTAGE TO AN IFA; WHILST THE COMPLAINT WILL (USUALLY) BE RESOLVED MORE QUICKLY AND MORE CHEAPLY THAN A COMPLAINT BROUGHT VIA TRADITIONAL LEGAL PROCEEDINGS, THERE ARE A NUMBER OF DISADVANTAGES.



If the Ombudsman considered what is fair and reasonable differs from English law, he is free to make an award in accordance with that view assuming it to be fair and reasonable in all the circumstances of the case.

Firstly, the FOS is a free service to consumers. There is therefore no risk to a complainant in referring the matter to the FOS if they are unhappy with the IFA's final response. Unlike formal court proceedings where an unsuccessful claimant will face a significant exposure to the defendant's legal costs, there is no such cost risk in cases that are referred to the FOS, which has led to complaints that the FOS is too 'claimant friendly'. This significantly reduces the scope for seeking a commercial settlement since a complainant has little to lose by referring their case to the FOS.

Secondly, the FOS has a wide inquisitorial remit and will investigate the wider background to determine whether there are grounds for complaint, rather than continuing its investigation and the scope of the complaint presented by the consumer. In extreme examples, this can lead to a finding against the IFA for issues which fall outwith the scope of the initial complaint, or monetary awards for sums higher than originally sought, as highlighted in the following example.

A client sought advice from an IFA regarding investing the proceeds from the sale of her home when she moved into a nursing home. The client required the funds to supplement her modest pension income and to pay the fees due to the nursing home. The IFA recommended an investment in a number of actively managed funds, including a substantial exposure to commodities and overseas property markets.

The investment did not perform well and, with the help of her son, the client complained to the IFA regarding the advice given. Essentially it was alleged that the funds recommended were too risky and the IFA should have advised that she invest in a fixed rate bond. Had they done so, then the value of the investment at the date of the complaint would have been around £10,000 more than the value of the funds in which the client had invested.

The IFA rejected the complaint on two grounds:

- 1) that the funds they had recommended were appropriate and the associated risks had been clearly explained;
- 2) that the client had made a simple error in her calculations – her assessment of the value of the bond in which it was alleged she should have invested took no account of the fact that she had drawn money from the funds invested. Once the sums drawn down were taken into account, the recommended funds had actually performed marginally better than the bond which it was alleged that the IFA should have recommended. However, the client disagreed with the IFA's assessment and referred the matter to the FOS.

The FOS concluded that the investments had been inappropriate for the client. It ordered the IFA to pay compensation based not on the difference between the current value of the funds recommended by the IFA and the bond referred to by the client (a value which the IFA argued would have been nil), but on the difference between the current value of the investment and the value that the investment would have achieved had it performed in line with the APCIMS Stock Market Income Total Return Index. That produced a difference of around £22,000 which was paid by the IFA.

This particular case is unusual in that the FOS found against the IFA for a claim that had not even been made by the client, and also for a larger amount of compensation than originally sought. By contrast, had the claim progressed through the courts, the scope of the court's jurisdiction would have been limited to the case as pleaded by the claimant. It could be argued that in the absence of the FOS, the client would have been forced to seek advice from a solicitor who would have advised her to amend her claim and the outcome may have been the same (but with legal costs in addition). However it's a good example of the potentially wide-ranging remit of the FOS when dealing with complaints.

Thirdly, the FOS makes its decision based on what is "fair and reasonable in all the circumstances of the case". The FOS does not need to adhere to the relevant case law if, in its opinion, that would not result in a "fair and reasonable decision". This can result in the FOS finding against an IFA in circumstances where a court might have dismissed the complaint. The consequences can be seen in the following case of IFG Financial Services v FOS:

Two clients of IFG referred complaints to the FOS arguing that IFG had invested their money in a high-risk investment instead of a medium-risk investment as they had requested. Both clients had suffered large losses, not as a consequence of the investment performance but by a fraud committed by one of the investment fund managers. IFG argued that they should not be held liable because English law prevents the recovery of losses flowing from the unforeseen consequences of fraud. The FOS accepted the argument in principle, but awarded compensation nevertheless, otherwise the result would not have been "fair and reasonable".

IFG sought a judicial review, arguing that the FOS had failed to adhere to relevant case law. However, the court upheld the Ombudsman's decision and stated:

"If the Ombudsman considered what is fair and reasonable differs from English law, he is free to make an award in accordance with that view assuming it to be fair and reasonable in all the circumstances of the case."

Provided therefore that the FOS takes into account the relevant law, regulations, regulators' rules and guidance and what the FOS considers to be accepted industry practice at the time, the FOS is not strictly obliged to follow English law.

The very fact that an FOS decision can only be appealed by seeking a Judicial Review is a significant deterrent in itself given the costs involved with that process. Even if successful, the court will simply ask the FOS to consider the position again and there is no guarantee that a new Ombudsman would reach a different view from his predecessor.

Fourthly, due to the fact that the FOS is under no obligation to follow case law and is free to base its decision on what it thinks is fair and reasonable in all the circumstances, it is very difficult to predict the outcome of an investigation as highlighted in the following two cases, both relating to investments in Arch Cru funds recommended by different IFAs.

An IFA was approached by its client to provide advice regarding the investment of £100,000 which had been recently inherited. The client had only a modest income and was close to retirement and was correctly assessed by the IFA to adopt a low-risk approach. The IFA advised its client to invest the full £100,000 in a variety of low-risk investments including index-linked savings certificates, a savings account, a capital guaranteed structured product and £15,000 in the Keydata Secure Income Bond. It was the investment in the Keydata bond which formed the basis of the claim against the IFA.



THE NEXT STEP

At Griffiths & Armour, we know all too well the need for our clients to protect their assets against claims; maintaining professional indemnity cover that is suitable, reliable and at the right level for your business needs is key when claims arise.

Our primary aim is to protect your interests; our focused risk management services provide timely and proactive guidance on the best ways to safeguard your business from the adverse effects of risk and our long-term placement strategy serves to minimise the financial impact when claims arise.

For more information on our bespoke professional indemnity insurance proposition for insurance brokers, please visit griffithsandarmour.com or email us at piinsurance@griffithsandarmour.com.

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