

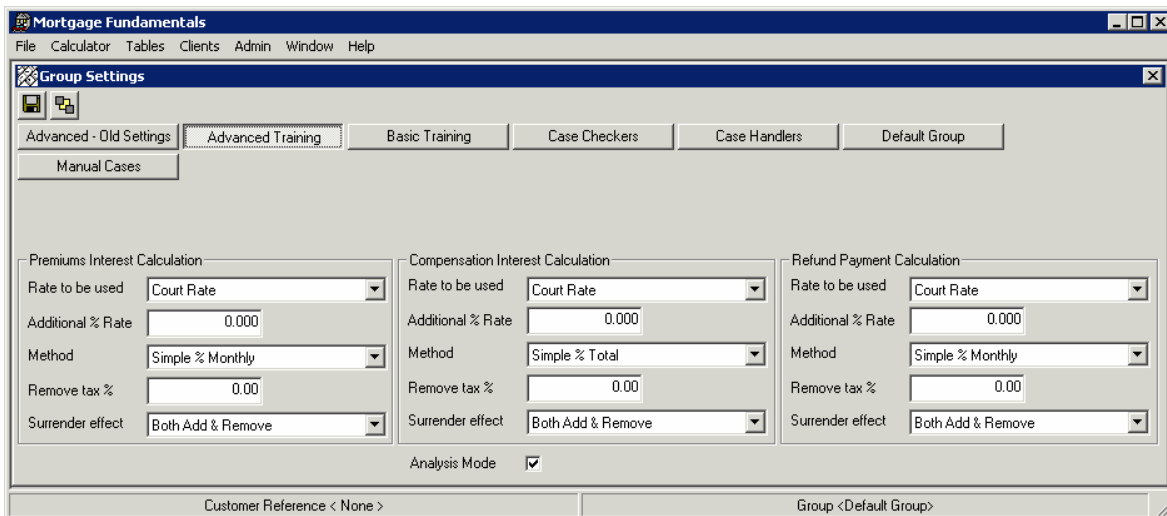
Case Study Summary - FOS Complex cases November 2005 Guidance

Please note, this information is based on our interpretation of the FOS guidelines and how we suggest modelling the cases within Mortgage Fundamentals®. This summary (July 2006) details how some of the enhancements within Mortgage Fundamentals® will enable you to process some of these cases in a more streamlined fashion. It is the responsibility of each company and user to ensure that they are happy that the required results are being produced before compensation is paid out to a client.

Due to the complexity of the following examples we strongly recommend that you ensure all users are competent at using the methods as described before attempting these calculations (full training is available, please contact Exasoft support for details).

The following solutions have been constructed using a particular set of group settings. These are set out below.

- For 'Premiums Interest Calculation' and 'Refund Payment Calculation' we have used the Court Rate with Simple % Monthly (no tax or additional rate but 'Both Add and Remove' for surrender effect).
- For 'Compensation Interest Calculation' we have used the Court Rate with Simple % Total (no tax or additional rate but 'Both Add and Remove' for surrender effect).



The screenshot shows the 'Mortgage Fundamentals' application window with the 'Group Settings' dialog box open. The 'Advanced Training' tab is selected. The settings are as follows:

Calculation Type	Rate to be used	Additional % Rate	Method	Remove tax %	Surrender effect
Premiums Interest Calculation	Court Rate	0.000	Simple % Monthly	0.00	Both Add & Remove
Compensation Interest Calculation	Court Rate	0.000	Simple % Total	0.00	Both Add & Remove
Refund Payment Calculation	Court Rate	0.000	Simple % Monthly	0.00	Both Add & Remove

Additional settings shown in the dialog include 'Analysis Mode' checked, 'Customer Reference' set to '< None >', and 'Group' set to '< Default Group >'.

For ALL calculations we would recommend that your group settings correctly reflect the latest FOS guidelines (interest rates, method and tax rates being applied).

When processing your cases care must be taken with the adjustments, ensuring that they are allocated to the correct calculation.

Our notes must be followed as a sequence of events to ensure the correct results are achieved.

When processing the following cases please enter all relevant mortgage information and adjustments, e.g. fixed/discounted rates in addition to life premiums (DTA) if required. Please do this for all cases being handled. These notes will refer to the additional steps required to help process certain cases.

1. Where the consumer has converted to a repayment mortgage and retained the policy knowing the risk of doing so.

Calculation 1

- **Select the “Mortgage Related” Action and enter the mortgage details.**
 - a) The From date is the start date of the calculation and the To date is the end date which should be the date the consumer converted to a repayment mortgage
 - b) Enter in the endowment premiums using the plan end date or the date the consumer converted to a repayment mortgage, as above (a)
 - c) Enter the surrender value using the end date above (a)

- **Add a 2nd tab and select the “Compensation + Interest” Action and enter the following;**
 - a) The From date should be the conversion date and the To date is the final date for this part of the calculation, here it should be the *Settlement date**
 - b) Allow the term and the balance to carry forward

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

The compensation due is the amount referred to in the calculation summary.

2. Where the consumer has converted to a repayment mortgage and retained the policy initially unaware of the risks of doing so.

The following method enables this calculation to work within Mortgage Fundamentals® but care should be taken to pay, only the compensation amount produced by Calculation 1.

Calculation 1 – Plan 1

- **Select the “Mortgage Related” Action and enter the mortgage details**
 - a) The From date is the calculation start date and the To date is the end date and should be the *Calculation date**
 - b) Enter in the endowment premium but use an end date which reflects the point when the mortgage converted to a capital repayment method
 - c) Enter a “Change Calc Type” adjustment into the Endowment (Source) adjustment set on the date above (b) to reflect when the client converted in full to repayment (conversion date)
 - d) Enter a *nil* surrender value using the date above (a)
- **Add a 2nd tab and select the “Compensation + Interest” Action**
 - a) The From date should be the *Calculation date** and the To date should be 1 day after the Calculation date (Calculation is being performed for 1 day)
 - b) The term can be carried forward
 - c) Enter the actual surrender value using the date of 1 day after the Calculation date (date used in a)
- **Add a 3rd tab and select the “Interest Only” Action**
 - a) The From date should be 1 day after the *Calculation date** and the To date should be the *Settlement date**
 - b) The term can be carried forward

Calculation 2 – Plan 1

- **Select the “Premiums + Interest” Action and enter the following;**
 - a) The From date should be the date the mortgage converted to a repayment method and the To date is the end date which should be the *Calculation date**
 - b) Use the policy sum assured as the balance for this calculation and a term of 1 year minimum (can enter term remaining under the plan if preferred)

- c) Enter the monthly Endowment premiums in the source adjustment set using the following;
 - i. The From date should be the original start date of the policy
 - ii. The To date should be the original start date plus the full term of the policy e.g. 25y
 - iii. Apply the premium to Calc 2
- d) Enter another set of monthly Endowment premiums in the source adjustment set using the following;
 - i. The From date should be the original start date of the policy
 - ii. The To date should be the point when the mortgage was to converted to Repayment
 - iii. The Value should be equal to the premium amount but negative. E.g. premium of £45.65, enter -£45.65
 - iv. Apply the premium to Calc 2

Steps c and d ensure that only premiums paid since conversion are taken into account, whilst also accurately calculating the correct low-start premiums if appropriate. This process also helps to reduce date/duplication errors.

Run calculation 2 to obtain the compensation value and note this down

- e) Add a "Comp Adj Before Int" adjustment to the source (Endowment) adjustment set using the following;
 - i. The From date should be the *Calculation date**
 - ii. The Value should be the compensation from calculation 2
 - iii. The Calc number should be 1

NOTE: The total compensation amount to be paid is provided in Calculation 1. Only this amount should be offered to the client.

**Calculation date* – this may be six months after the consumer became sufficiently aware of the risk of their endowment e.g. six months after they received a red letter. However, this may be later if the consumer thought they needed to keep the policy going during the investigation.

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

3. Where the consumer has repaid his or her mortgage and retained the policy knowing the risks of doing so.

Calculation 1

- **Select the “Mortgage Related” Action and enter the mortgage details.**
 - a) The From date is the calculation start date and the To date is the end date which should reflect the date the consumer repaid his or her mortgage
 - b) Enter the endowment premium using the plan end date or the date the consumer repaid his/her mortgage, along with the surrender value using the (redemption) date above (a)

- **Add a 2nd tab and select the “Compensation + Interest” Action and enter the following;**
 - a) The From date is the date of redemption and the To date is the calculation end date which should be the *Settlement date**

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

4. Where the consumer has repaid his or her mortgage and retained the policy initially unaware of the risks of doing so.

Calculation 1 – Plan 1

- **Select the “Mortgage Related” Action and enter the mortgage details;**
 - a) The From date is the calculation start date and the To date is the end date which should be the date the consumer repaid his or her mortgage
 - b) Enter the endowment premium using the policy end date, along with a *nil* surrender value using the redemption date above (a)
- **Add a 2nd tab and select the “Compensation + Premiums + Interest” Action taking into account the following;**
 - a) The From date is the date the consumer repaid their loan and the To date is the end date which should be to the *Calculation date**
 - b) Enter a surrender value using the calculation date above in a)
- **Add a 3rd tab and select the “Interest Only” Action taking into account the following;**
 - a) The From date should be the *Calculation date**
 - b) The To date should be the *Settlement date**
 - c) The term can be carried forward

**Calculation date* – this may be six months after the consumer became sufficiently aware of the risk of their endowment e.g. six months after they received a red letter. However, this may be later if the consumer thought they needed to keep the policy going during the investigation.

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

5. Where the policy was sold to support a future mortgage (a "forward sale").

(Standard Approach)

In this approach the compensation calculated is one day after the Settlement date*. This ensures that the Surrender value is deducted from the final result within the system.

Calculation 1 – Forward sale element

- **Select the “Premiums + Interest” Action and enter the following;**
 - a) From date is the start date of the plan & To date should reflect the start date of the mortgage
 - b) Enter the plan sum assured as the balance value £ and the term of the plan
 - c) Within the Source adjustment set (Endowment) the endowment premium needs to be entered using the actual plan start date, the premium and the term

- **Add a 2nd tab and select the “Mortgage Related” Action and enter the mortgage details.**
 - a) The From date should be the start date of the mortgage and the To date is the end date which should be the *Settlement date**
 - b) Please note that though the interest only term may be 20 years the comparison mortgage term (repayment side of the mortgage) must be equal to the original term of the policy e.g. 25 years
 - c) Enter a *nil* surrender value using the end date above (a)

- **Add a 3rd tab and select the “Compensation + Interest” Action and enter the following;**
 - a) The From date is the calculation end date (settlement date) as provided in tab 2, the To date is the end date which should be one day after this
 - b) Enter the actual surrender value as obtained at the *Settlement date** and *reflect the end date in a) above (e.g. settlement date + 1 day)*

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

(Other Cases) – Where no mortgage was arranged!

Calculation 1

- Select the “Compensation + Premiums + Interest” Action tab and enter the following;
 - a) From date should be the start date of the policy
 - b) To date is the end date and should be the *Calculation date**
 - c) Enter the endowment premiums and surrender value as at the end date above (b)
- Add an “Interest Only” Action tab and enter the following;
 - a) From date should be the *Calculation date**
 - b) To date is the end date and should be the *Settlement date**
 - c) The term can be carried forward

* *Calculation date* – this may be six months after the consumer became sufficiently aware of the risk of their endowment e.g. six months after they received a red letter. However, this may be later if the consumer thought they needed to keep the policy going during the investigation.

* *Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

6. Where the consumer has made a lump sum payment to the mortgage.

Calculation 1

- Select the “Mortgage Related” Action and enter the mortgage details.
 - a) Enter the lump sum in the common adjustments set using the amount and date supplied

NOTE: If more than one policy is in existence at the date of the lump sum payment see scenario 8.

7. Where the consumer has made a lump sum payment which would have been sufficient to repay a hypothetical repayment mortgage in full.

The following method enables this calculation to work within Mortgage Fundamentals®. When processing such a case, a warning message appears stating that the *“Repayment calculation balance has reached zero on <date>...”*

Action Pre-warning

Calculation 1

- **Create the case as normal, Select the “Mortgage Related” Action and enter the mortgage details, items to be included are as follows;**
 - a) Case end date is to reflect the normal calculation date
 - b) Create a ‘MAIN’ adjustment set and enter in all appropriate rates, Lump Sum payments/additional monthly payments along with any items that you would place into the main set in order to view the final outcome of your case.
 - c) Create an ‘Endowment’ adjustment set and enter the Surrender Value along with the Endowment premium
 - d) Create a ‘Repayment’ adjustment set if appropriate and enter the decreasing term assurance details

Once ALL items have been included to enable you to perform your calculation select the view option to view your compensation results. At this point a warning message will appear if the hypothetical repayment mortgage has been repaid prior to the calculation end date. Should this happen you will need to follow the guidelines set by FOS under scenario 7. The following notes, if followed in sequence, will enable you to produce the required results.

Once the warning has been issued the calculation end date must be altered to reflect the date that the lump sum payment was made.

The following actions then need to be applied

- a) Run a comparison report and note down the outstanding balances for the Interest Only and Repayment mortgages
- b) Amend the lumpsum value to reflect the surplus amount. This is the original lumpsum amount minus the balance highlighted on the warning message (outstanding amount on the Repayment mortgage as noted above in a)
- c) Alter the Mortgage Related tab by selecting (tick) the “Ignore balance” checkbox. This will allow the system to perform a costs comparison between the Interest Only and Hypothetical Repayment mortgages to date
- d) To reflect the revised calculation end date a nil surrender value can be added, this adds clarity as it is not an acceptable practise to enter a historical surrender value at this point

- **Add a 2nd lender (period) tab and select the “Compensation + Premiums + Mortgage Payments + Interest” Action and enter the following;**
 - a) The From date should be the date the repayment loan went to zero (revised end date in first tab) and the To date is the end date and should reflect the *Settlement date**
 - b) A loan balance is required to enable the system to calculate the payments made to the actual interest only mortgage, therefore where the screen indicates Balance, click on the drop down box and select reduce to decrease the balance by the same value as the outstanding Repayment mortgage balance i.e. restoring the mortgage balance to its correct value
 - c) The term, lender and interest table should all be carried forward. The first payment date must be amended to reflect the next logical payment date since the lumpsum was paid. E.g. if the monthly payments are made on the 9th of the month and the lumpsum was paid on 24th April, then the first payment date would be 9th May
 - d) The checkbox “Add uncollected interest” should be un-ticked
 - e) Add a “Comp Adj After Int” adjustment to the source (Endowment) adjustment set with the following details;
 - i. The From date should be the date the lumpsum was paid
 - ii. The Value should be equal to the Endowment balance as noted at the beginning minus the full lumpsum amount

This will add the outstanding balance (without interest) onto the Interest Only side to the compensation amount.

Steps a to d above calculate the payments made to the Interest Only mortgage and the premiums paid on the Endowment policy since the lump sum payment was made, adding appropriate interest to these two figures. The steps also add interest to the costs comparison. All interest calculations are done to the date of settlement.

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement

8. Where the consumer has made a lump sum payment, but has more than one policy.

- Select the “Mortgage Related” Action and enter the mortgage details;
 - a) Enter the lump sum into the common adjustment set using the following rules;
 - i. In the absence of any evidence to the contrary, proportion the lump sum based on the total value (sum assured amounts) of the endowment policies that the consumer had at the time the lump sum payment was made.

When proportioning the lump sum the formula is;

- L = Lump sum
- T = Total value of endowment policies in force
- V = Value of this policy
- P = Portion of lump sum

$$P = \frac{L \times V}{T}$$

Example

Customer has two endowment policies, the first for £20,000 and the other for £10,000. The customer makes a £9,000 lump sum reduction and in this example we are dealing with the £10,000 endowment policy (i.e. the second policy).

$$\begin{aligned}
 L &= 9,000 \\
 T &= 20,000 + 10,000 \\
 V &= 10,000 \\
 P &= \frac{9,000 \times 10,000}{30,000} = \text{£}3,000
 \end{aligned}$$

The portion of lump sum required is £3,000.

- ii. Where evidence suggests the lump sum was paid to a specific part of the mortgage account, it may be applied in full to this part.

Our understanding is that all additional payments whether lump sum or monthly payments should all be apportioned following the guidelines as highlighted above.

Mortgage payments must also be apportioned over all policies in force at the time. Apportion the payment amount and enter using mortgage payment adjustments for each policy. The System Generator can then be used to calculate the appropriate over/underpayments.

9. Where the consumer now has an offset mortgage.

- Run as a standard Mortgage Related calculation ignoring the effects of offsetting such as saving levels, credit card and/or loan balance etc.
- Where possible select the lender and interest tab relating to the lender (e.g. IF), on some occasions you may need to use your standard default lender.

10. Where the firm churned an existing policy *and* recommended an unsuitable policy.

This would be carried out by way of 2 separate calculations:

Calculation 1 – Plan 1

The Churned (surrendered) policy

- **Select the “Compensation + Premiums + Interest” Action and enter the 1st endowment details along with the following;**
 - a) From date should be the start date of the policy and the To date is the end date and should be the date the policy was surrendered
 - b) Use the policy sum assured as the balance for this calculation and the plan term e.g. 25 years
 - c) Create an Endowment adjustment set and enter the premium start date, the premium value and the date the policy was surrendered.
 - d) Enter the date and the surrender value (proceeds) the consumer received at the time the policy was churned.
- **Add a 2nd tab, selecting the “Interest Only” Action and enter the following;**
 - a) From date should be date the policy was surrendered
 - b) To date should be the *Settlement date**
 - c) The term can be carried forward

Calculation 2 – Plan 2

The replacement policy

- **Select the “Mortgage Related” Action and enter the mortgage and the new endowment plan details, premium, surrender value and apply to calculation 2.**
 - a) From date should be the commencement date of the replacement policy and new mortgage (should be same date) and the To date is the end date and should reflect the *Settlement date**

NOTE: The total compensation amount to be paid is the sum provided in Calculations 1 & 2.

**Settlement date* – date of decision if the case goes to FOS or the date of the agreed settlement.