Britain: Endowment mortgages showing massive shortfalls

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Just like the great pensions mis-selling scandals that rocked the UK during the last decade and brought misery to millions, another personal finance disgrace involving endowment mortgages could swallow up the savings of hundreds of thousands of people and even leave them homeless. And like the pensions scandals of the 1990s, no one is likely to be held to account.

According to figures recently released by UK insurers, more than half of endowment policies are now showing shortfalls. Across the country more than six million people (one in ten of the population) have endowment mortgages that rely on endowment policies to pay off the original loan to buy their house. In an endowment mortgage, a mortgage loan is combined with a separate savings scheme. Monthly payments to the lender go only towards the interest, not the principal. Lenders invest the endowment policy funds, which frequently do not cover the amount borrowed at the end of the mortgage term.

In the last two years, some 500,000 endowment holders have been sent letters coded “red”—warning that their policies are likely to be worth too little to pay off their mortgages. A further 2.5 million households have received “amber” letters warning them that their policies are in danger of falling short. These figures are set to rise further.

There are now hundreds of thousands of workers facing the predicament of how best to recoup the money that they invested in such policies. The same financial “experts” that advised millions of people to invest in endowment policies 15 years ago are now warning people to avoid either increasing their payments on an existing endowment or buying a new one, saying this would be throwing good money after bad. As a result, many people are now being forced to change their mortgage into a part-repayment loan, which means that in addition to paying off the mortgage interest each month, people have to make extra payments to start paying off the underlying mortgage debt—just as many of them will be approaching retirement age.

Earlier in the year UK insurer Friends Provident heightened anxieties for over 700,000 homeowners with endowment mortgages by warning that payouts from their endowment policies would fall even further, adding years of repayments to their mortgages. The insurer said that payouts on with-profit endowment policies could fall sharply. For example, a payout on a 25-year endowment policy maturing this year would fall to £77,096—compared to £93,145 had it matured last year.

It has now been largely acknowledged that buyers of endowments could never hope to achieve the payouts promised. This is not only because of falling stock markets, but because the amount the companies took in charges was far higher than they told customers at the time.

During the period when millions of endowment policies were sold, at the peak of the late 1980s property boom, insurance companies routinely projected forward the benefits of the endowments, assuming that only 0.3 percent a year would be lost in charges. But the real amounts were often four or five times higher. Remarkably, the persistent underestimation of charges—and overestimation of future returns—came with the blessing of the industry’s regulator at the time, Lautro. But many of these borrowers’ endowment policies are no longer on track to pay off their home loans, and they may have to raid their savings in order to put things right. It was only in 1995 that Lautro capitulated and since then insurance companies have had to reveal their real charges, though

the details of how these charges are calculated are usually in small print and obscured by legal and financial jargon that very few customers can actually understand.

As well as endowments mis-selling, the pensions fiasco from the last decade is still coming back to haunt insurers. In August, insurance giant Royal & Sun Alliance was fined £1.35 million by City watchdog, the Financial Services Authority (FSA), as a result of systemic weaknesses in its internal controls. These caused the company to advise 13,500 people over a six-year period to take out a personal pension when they would have been better off staying in an occupational scheme. The company had previously been fined £225,000 for failings in its conduct of a pensions review following a 1997 visit by the FSA's pensions review monitoring department. In July and August 2000, the FSA visited the company again to review its progress with its pensions review and found limited evidence of effective senior management control.

The FSA has patted itself on the back for handing out the biggest fine to date, but it amounts to little more than a slap on the wrist. The £1.35 million payout equals a £100 fine per person and is one-tenth of a percent of the company's estimated value.