AUTORITÉ DES MARCHÉS FINANCIERS

The Ombudsman's Case of the Month
September 2016

Be aware of financial packages that are ill-suited to customer needs

This dispute illustrates the checks that a credit institution needs to carry out with respect to its customer before recommending a financial package, to ensure that the advice provided suits the customer's requirements.

The facts

In 2006, Mr and Mrs P. signed a preliminary sale agreement with a view to acquiring a rental apartment for their daughter to live in. Mr and Mrs P. were not concerned about obtaining financing for the apartment since they already had the requisite funds.

In late May 2006, they went to their bank to obtain a banker's draft with a view to completing the purchase.

At that time, one of the branch advisers recommended that instead of the draft they should take out a bullet loan as part of a bespoke financial package. The package consisted of a bullet-type eight-year property loan, with principal and interest to be repaid at maturity. The couple were advised to place their savings in diversified financial products (two-thirds in an equity savings plan and the remainder in a unit-linked insurance policy[1]) so that they could make their money work for them, repay the loan at maturity and, according to the adviser, probably generate a capital gain. The adviser also touted the tax benefits of the package, which allowed the couple to deduct the loan interest from the rental payments made by their daughter.

Won over by the arguments, Mr and Mrs P. bought the apartment by taking out a €140,000 bullet loan, with principal and interest repayable at maturity. Their savings, which came to the same amount and which had been invested in risk-free products until then, were invested in a life insurance policy and an equity savings plan.

In June 2014, when the loan matured, the borrowed amount and interest became payable. But the financial investments made through the savings plan and insurance policy on the bank's advice were not enough to fully repay the loan principal and interest: there was a shortfall of €37,000.

Mr and Mrs P. felt that they had suffered a loss in this amount, since the financial package proposed to them had been supposed to enable them to repay the entire loan and enjoy significant tax benefits.

They asked the institution in question to share liability and accept half of the loss sustained. The bank rejected their complaint, arguing that it was not guilty of providing poor advice.

For this reason, the couple contacted me.

The analysis

I contacted the bank in question. At that time, I reminded it of its obligations under Article L. 533-4 of the Monetary and Financial Code as applicable at the time of the events, namely:

(i) to enquire about its customers' financial position, investment experience and goals for the services being requested;

(ii) to provide, in an appropriate way, relevant information during negotiations with customers.

[1] The AMF Ombudsman has no jurisdiction over life insurance. However, in this instance, to enable the whole dispute to be dealt with and promote effective resolution, the Ombudsman looked at this issue with the agreement of the institution in question, insofar as the life insurance investment was modestly sized relative to the investment in the equity savings plan.

After this, I had numerous discussions during which I pointed out that the package proposed to Mr and Mrs P. was completely unsuited to their needs and profile: the couple was liable for just €53 in tax when they took out their investment and in following years. This point demonstrated the patent lack of the tax advantage as described by the adviser, which the bank failed to verify. Moreover, these customers, who were obviously not experts, had never invested in financial products and had only had two popular savings passbooks until that time. Last but not least, by liquidating their passbooks and other risk-free investments, they already had the funds needed to acquire the apartment.

The recommendation

For these reasons, I made a recommendation, which was accepted by the bank's senior management, that the institution should bear half the amount that Mr and Mrs P. needed to provide to repay the loan, over and above the amount obtained from liquidating the equity savings plan and life insurance contract.

The lesson to be learned

Before recommending complex financial packages emphasising substantial tax benefits, banks should make sure that the advantages are applicable to the customers in question. By taking the risk of offering products that are unsuited to their customers' needs and goals, institutions are exposing themselves to potential liability.

Read more

The AMF Ombudsman