DRN-3117956

The complaint

Mr and Mrs M complain about advice they received from Coutts & Company to invest £300,000 in a collective investment called the Orbita Capital Return Strategy. They say that advice was unsuitable because the investment represented more risk than they had been willing to take.

What happened

Mr and Mrs M were existing clients of Coutts. In November 2006 they approached Coutts for advice on what to do with £300,000. Their financial circumstances at the time were that they had significant other investments and cash on deposit, as well as a number of properties.

The suitability letter they received said that Mr and Mrs M wanted to 'invest in hedge funds as an asset class, with a bias towards capital preservation'. The letter said they wanted to invest 'for capital appreciation' and were not looking for an income. And it said they had a 'cautious attitude to risk for this element' of their wealth. The letter said that they also wanted to provide diversification to their existing portfolio.

The adviser recommended Mr and Mrs M invest £300,000 in the Orbita Capital Return Strategy – an unregulated collective investment scheme (UCIS). He said that this investment provided access to a diversified portfolio of leading hedge funds, with a spread of different strategies which would provide them with diversification. He explained that the fund's strategy was 'diversified across a range of external managers who are employing arbitrage and other investment strategies in a variety of bond and equity markets'. And he said that the fund was designed to offer a return that is attractive relative to cash and bonds, with a low risk profile when compared to equities. It said that in a downturn in the equity market, the strategy 'should continue to produce a stable stream of positive returns' while in a strongly rising equity market, it wouldn't expect it to match equity returns.

The adviser explained that Coutts designated this investment as a 'cautious risk investment'. He pointed out that there were specific instructions in relation to redemptions, including that holdings could only be redeemed on a quarterly basis and there may therefore be a delay in settling any redemption requests.

In 2020 the fund was suspended and Coutts notified Mr and Mrs M of this, so they complained.

One of our investigators looked into the complaint. He concluded that it should be upheld. He said that the financial report from November 2006 showed that Mr and Mrs M were looking for advice to do with this specific sum of money – they were not looking for a broader review of their overall investments. For this sum, Mr and Mrs M had a cautious attitude to risk – and they were prepared to invest for a minimum of 5 years. He said that in the report the Orbita Capital Return Strategy was described as a cautious investment and there was insufficient information about the specific risks associated with an unregulated collective investment of this nature. As a result, he thought that the advice Mr and Mrs M had received was unsuitable, and concluded that the complaint should be upheld.

Mr and Mrs M agreed with the investigator, but Coutts didn't. It said that given the characteristics of the fund 'it was entirely proper for the adviser at the time to recommend it as he did'. It provided a fact sheet that it said compared the performance of the Orbita Capital Return Strategy versus 'two frequently used diversified equity and fixed income indices'. It said that this factsheet showed that the fund demonstrated lower volatility than both indices. It said that in 'other periods of high market stress the fund delivered consistent returns with limited drawdowns'. It said that this was 'attributable to the cautious investment policy by its investment manager, using diversified strategies to reduce volatility while achieving consistent returns'. Coutts said that the 'risk/return profile of the fund and its behaviour during the majority of financial stress events is conform to the initial investment objectives'.

It acknowledged that unregulated collective investments could be 'volatile, illiquid or speculative' – but it said that this depended on the underlying assets and investment strategy. It said that regulated investments could also show these characteristics.

It said that the issue which triggered Mr and Mrs M's complaint was to do with the suspension of the fund in March 2020. It said that this was an exceptional event not linked to any investment concerns such as volatility or illiquidity. It explained that this was driven by the fund's directors in order to protect the interests of investor's as a whole, and this could've happened to any type of fund – low risk or high risk, regulated or unregulated. It said that this event, which occurred many years after the original recommendation was not enough to 'affect the classification of the Orbita fund, or the suitability of the original advice'.

Coutts reiterated Mr and Mrs M's objectives for the fund, and emphasised that Mr and Mrs M were looking for diversification, which this investment gave them.

Coutts also acknowledged that there wasn't anything 'specific' in the suitability letter about the risks which this fund represented – however it said that the complaint was based on the suspension of the fund in March 2020. It said that given 'the remoteness of the suspension happening [it considered] a general reference in the letter to the client not receiving their investment back [was] reasonable'.

Coutts emphasised Mr and Mrs M's experience in investing and said that a meeting in June 2014, they both confirmed that they were happy with the investments they held and that these were in line with their risk profile. Coutts said that Mr and Mrs M confirmed that they 'were prepared to hold investments where the risk category could be higher or lower than their agreed risk category providing their overarching risk profile was achieved'. Their overarching risk profile was 'moderately risk averse'. Coutts concluded by explaining that the recommendation to invest in the Orbita fund was considered as part of a bank-wide review of historical investment advice – this was overseen by a third party and reported to the Financial Conduct Authority (FCA). It said that the outcome of this review was that the advice given to Mr and Mrs M was suitable for them – and a letter explaining this was sent to them in March 2015.

As agreement couldn't be reached, the case was passed to me to consider.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done so, I've reached the same conclusions as the investigator and for broadly the same reasons.

I should start by saying that a lot of Coutts's reply to the investigator's letter is based on the historical performance of this particular fund. But I don't agree that's a fair and reasonable way of establishing whether the fund was suitable for Mr and Mrs M – in the same way that we wouldn't conclude that an investment is unsuitable purely because it's performance has been unsatisfactory. In my view, the issue of suitability is resolved by reference to what Mr and Mrs M had explained they wanted from their investment, and the risk they were prepared to take in order to achieve their objective.

In looking at the recommendation letter and the summary of what they told the adviser they wanted, I'm not persuaded Mr and Mrs M were after an investment that carried the level of risk to their capital that this investment did. I'm satisfied that despite their overall wealth, and the other investments which they held in their broader portfolio, they had a specific objective in mind with this particular sum of money – and that was 'moderately risk averse' or 'cautious'. I think this is key, because in my view, by specifying their risk tolerance with this sum, Mr and Mrs M expected to be advised accordingly.

Whilst I acknowledge there is reference to Mr and Mrs M broader portfolio, and other investments, in relation to risk I'm satisfied that Mr and Mrs M were looking at this sum in isolation. In this regard, I note that Mr and Mrs M dispute ever indicating they were interested in hedge funds – in the absence of a fact-find or any other evidence, I can't resolve this issue of fact. Whilst I note what Mr and Mrs M have said, I would say that having received a recommendation letter that specifically said that this is what they wanted, I would've expected them to query why the letter was saying they had asked for advice on hedge funds if that wasn't something they had said.

However, I'm not persuaded this makes a difference to the outcome of this complaint. It isn't uncommon for consumers to have ideas about where they'd like their money to be invested without fully appreciating the risks involved. It was for the adviser to reconcile what the consumers said they were looking for, versus the amount of risk they were willing to take with this money. As part of this, it was for the adviser to probe and understand, in far more detail, what the consumers understood by 'hedge funds' and whether they appreciated the related risks of funds which were not regulated in the UK. I've seen insufficient evidence that this was done. In my view had the adviser taken such further steps, it would've become clear that this investment was not what Mr and Mrs M were looking for

Furthermore, I'm also not persuaded that the investment was properly described to Mr and Mrs M in a way that was fair, clear and not misleading. Despite what Coutts has said, I'm not persuaded it was ever accurate to describe this particular UCIS as a 'cautious' investment. The FCA (and its predecessor, the FSA) has been clear that it considers a UCIS a high risk investment which is unlikely to be suitable for the majority of retail investors. This is because the fact that it wasn't regulated meant that the fund manager had a much broader discretion as to the investment strategies it would use, how the fund would be managed and what assets it would invest in.

And I'm not persuaded that the specific risks relating to this particular fund were actually discussed or raised with the consumers at the time.
For example, the fund's factsheet explicitly says that the 'product is illiquid by nature' – and this feature does not seem compatible with a 'moderately risk averse' consumer which Mr and Mrs M were.

I acknowledge there was a brief mention of the specific ways in which this investment could be redeemed – but crucially, the adviser never used the word 'illiquid' when describing this investment to Mr and Mrs M. This made it sound like the only issue with redeeming was the timing and speed of redemptions. So I don't agree that the risk of Mr and Mrs M not having access to their money at all was properly disclosed.

I’m also not persuaded that the underlying strategies and investments were aligned with a ‘cautious’ investment, which is what Mr and Mrs M were told they were buying. The key features document of the fund explains, among other risks, that it used complex underlying instruments (such as derivatives), had underlying ‘sub-advisors’ which were not required to make public disclosures regarding their performance, and was exposed to currency fluctuations – in addition to the illiquidity mentioned above. In my view, taking all these risks into account, describing this investment as a ‘cautious’ one wasn’t accurate.

So overall, I don’t agree that this investment was ‘cautious’ or carried a ‘low risk’ of capital loss. And for the reasons I’ve given above, I’m satisfied that Mr and Mrs M were clear their appetite for risk with this element of their wealth was cautious or low. This means that the recommendation to invest £300,000 in this particular UCIS was not suitable for them. In my view, this means that Mr and Mrs M should’ve been advised to invest differently.

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put Mr and Mrs M as close to the position they would probably now be in if they had not been given unsuitable advice.

I take the view that Mr and Mrs M would have invested differently. It is not possible to say *precisely* what they would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr and Mrs M's circumstances and objectives when they invested.

What must Coutts do?

To compensate Mr and Mrs M fairly, Coutts must:

- Compare the performance of Mr and Mrs M's investment with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investments. If the *actual value* is greater than the *fair value*, no compensation is payable.

- Coutts should also pay interest as set out below.

Income tax may be payable on any interest awarded.

Investment name	Status	Benchmark	From (“start date”)	To (“end date”)	Additional interest
Orbita Capital Return	Still exists and liquid	For half the investment:	Date of investment	Date of my final decision	8% simple per year from final

Strategy		FTSE UK Private Investors Income Total Return Index; for the other half: average rate from fixed rate bonds			decision to settlement (if not settled within 28 days of the business receiving the complainant's acceptance)

Actual value

This means the actual amount payable from the investment at the end date.

Fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark.

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Coutts should use the monthly average rate for one-year fixed-rate bonds as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other distributions paid out of the investments should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simpler, I'll accept if Coutts totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically. If any distributions or income were automatically paid out into a portfolio and left uninvested, they must be deducted at the end to determine the fair value, and not periodically.

Why is this remedy suitable?

I have decided on this method of compensation because:

- Mr and Mrs M wanted Capital growth with a small risk to their capital.

- The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to their capital.

- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is a mix of diversified indices representing different asset classes, mainly UK equities and government bonds.

  It would be a fair measure for someone who was prepared to take some risk to get a higher return.

- I consider that Mr and Mrs M's risk profile was in between, in the sense that they were prepared to take a small level of risk to attain their investment objectives. So, the 50/50 combination would reasonably put Mr and Mrs M into that position. It does not mean that Mr and Mrs M would have invested 50% of their money in a fixed rate bond and 50% in some kind of index tracker fund. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mr and Mrs M could have obtained from investments suited to their objective and risk attitude.

My final decision

I uphold the complaint. My decision is that Coutts & Company should pay the amount calculated as set out above.

Coutts & Company should provide details of its calculation to Mr and Mrs M in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mrs M and Mr M to accept or reject my decision before 28 October 2022.

Alessandro Pulzone
Ombudsman