DRN-3460849

The complaint

Mr and Mrs B complain that investment advice they received from Lloyds Bank PLC was unsuitable for them. They're represented by a claims management company (CMC), which has said, in short, that the recommendation carried too much risk for Mr and Mrs B as they were first time investors with a limited capacity for loss.

What happened

In October 2000 Mr and Mrs B were advised to each place £7,000 into a unit trust ISA. At the time they were in their 30s and both working full-time, with a joint income of around £28,000. They had recently bought a new property and the fact find recorded that they had received a lump sum (around £46,000) from the sale of a previous property and wanted to invest some of it with an aim of earning better returns than those available from leaving it on deposit.

Mr and Mrs B were categorised as having a 'medium' attitude to risk, which led to both ISAs being invested in the equity-based Scottish Widows UK Growth fund. They maintained the investments until July 2003, when they were both surrendered, returning just under £5,000 each. A complaint about the potential unsuitability of the advice was then later made by the CMC on Mr and Mrs B's behalf in 2021.

Our investigator felt that the complaint should be upheld. She didn't think the advice to invest in the UK Growth fund had been suitable for Mr and Mrs B. She said, in brief:

- She couldn't see how Mr and Mrs B's 'medium' attitude to risk had been determined.
- They hadn't invested before and it was noted in the fact find that they'd never had money available for long-savings or investment.
- The UK Growth fund was made up of 97% equities, with the potential for significant volatility.
- This was unlikely to be the sort of risk Mr and Mrs B would've wanted to take, given their circumstances.
- They didn't need to expose their money to this level of risk to achieve their objectives.

The investigator recommended Mr and Mrs B be compensated by Lloyds based on a comparison of the performance of the recommended investments with our 'cautious' investment risk benchmark.

Lloyds didn't accept the investigator's view. It made several further submissions saying, in brief:

- Mr and Mrs B were in a position to accept a medium level of risk for the invested money and had capacity for loss. They were in their 30s, in permanent employment with no dependents and a small mortgage. They were left with 70% of their savings to fall back on.
- Although novice investors, this didn't mean they necessarily had to invest at a

cautious level of risk.
- Although equity investment could be volatile, the recommended fund included a diverse spread of equities across a variety of industries.
- The compensation recommended by the investigator was based on Mr and Mrs B having been cautious investors. However, the fact they didn't complain in 2003, when they experienced a significant loss on surrender, suggested they were, in fact, more likely medium-risk investors who were prepared to accept such losses.
- Their attitude to risk would've been determined by the adviser following a robust process of assessment and a review of documentation about investment risk and the fund.
- They had signed documents to confirm they understood the investments, documentation and the risks involved.

The investigator wasn't persuaded to change her opinion. Lloyds provided some further comments, stressing its view that the absence of a complaint by Mr and Mrs B in 2003 was a clear indication of their acceptance and understanding of a medium level of risk. Lloyds also challenged what it saw as incorrect assumptions made by the investigator about Mr and Mrs B's limited income, saying this wasn't supported by the evidence and that their circumstances supported the recommendation of the fund. Lloyds highlighted that two meetings with the adviser had taken place, some months apart, with sufficient time therefore given to Mr and Mrs B to consider the advice, having gone through a process that had provided them with comprehensive information and a clear understanding.

Despite these further comments, the investigator remained of the opinion that the complaint should be upheld. So, as no agreement could be reached, the matter was referred to me to review.

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.

Mr and Mrs B had around £46,000 cash available at the time of the advice, which it appears had come to them by way of the sale of a property. Given their ages, their employment status and the apparent absence of any dependents, it seems reasonable that they would have wanted to do something with some of that money to improve upon deposit returns. And indeed, that's what was noted in the fact find as their objective.

So, investing an amount of £14,000, around 30% of the cash available, appears to have been suitable. The fact that they had just taken out a mortgage has been noted by the CMC, but I don't think it's unreasonable that they might have chosen to proceed with that new liability while keeping the £46,000 separate to provide them with some flexibility. The management of finances in that way is not unusual.

So, the question at the heart of the complaint is whether it was then suitable to place the entire £14,000 into an equity-based fund. Lloyds has said that first-time investors shouldn't, by default, have to invest at a cautious level risk. It's pointed to Mr and Mrs B's ages and stable financial/employment situation to support its argument that they were in a position to accept the medium level of risk that would be associated with investing in a UK equity fund. And it's relied heavily on its view that the adviser would've adopted a detailed, structured process for determining their attitude to risk and then explaining the subsequent recommendation.

While I note the first point, I nevertheless think the default position is broadly that a novice investor is more likely than not to be a cautious investor. But, of course, there are then the specific circumstances, objectives and understanding of risk to consider that may lead to a reasonable conclusion that a medium, or even higher, level of risk is actually suitable.

The issue I have when looking at the evidence and specific circumstances in Mr and Mrs B's case is that there is nothing, beyond what Lloyds has now said about the process the adviser would have followed, to support why she concluded that the UK Growth fund was suitable for Mr and Mrs B. For instance, there's no documented explanation of how the medium-risk attitude to risk was determined.

Similarly, there's nothing in writing to confirm that the nature of investment risk in general, or specifically of the fund, was discussed or explained. Of note is the fact that the 'Summary and Recommendations' report issued to Mr and Mrs B doesn't mentioned the fund by name at all, or describe it in any way, saying only '*The fund choice/product agrees with your attitude to risk'*. While brochures about the fund and product may have been provided to Mr and Mrs B, this doesn't absolve the adviser from a responsibility to ensure understanding of what is being recommended.

I note Lloyds had cautioned against judging the process and documentation against current requirements, given that the advice was provided in August 2000. But it's nevertheless the case that a report was produced personally for Mr and Mrs B that gave the adviser the opportunity to explain her recommendation and why she was of the view that it was suitable for all of Mr and Mrs B's invested money to be placed in the one equity fund.

But the report was very limited in detail and featured much 'cut and paste' information. Without at least a passing reference to Mr and Mrs B – as novice investors wanting simply to achieve a better return than a savings account – understanding and wanting to take the risk associated with equity investment, I find it very difficult to conclude that the recommendation was suitable.

As noted, Mr and Mrs B's circumstances at the time don't, of themselves, entirely rule out a medium-risk equity investment being suitable. But despite their stable employment and their ages, they weren't in highly paid jobs, had just taken on a large new liability and had not previously had money to spare. This being so, it doesn't seem likely to me that they would've wanted to expose 30% of that money to the risk associated with equity investment.

Lloyds has highlighted that the UK Growth fund was a 'diverse' equity fund. But it was still reliant on only one type of volatile asset and the 10 largest holdings made up almost half the fund. On balance, I don't think it's likely that Mr and Mrs B would've understood and recognised the potential for volatility and loss that investing only in the UK Growth fund entailed. As such, I think a more cautious investment strategy would've been more suitable for them. So, I find that the complaint should be upheld.

I note Lloyds' comments about the fact Mr and Mrs B didn't complain when they made a large loss on surrender of the ISAs in 2003 and how this suggests an understanding, and acceptance, on their part of medium-risk investment. But given the significant and widely-reported market crash over the period for which the ISAs were held, I don't think any particular conclusions about Mr and Mrs B's likely understanding of risk at the time of the advice can be drawn from their decision to surrender several years later in 2003.

Putting things right

Fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr and Mrs B 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 B 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 B's circumstances and objectives when they invested.

What must Lloyds do?

To compensate Mr B fairly, Lloyds must:

- Compare the performance of Mr and Mrs B'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.

- Lloyds should also pay interest as set out below.

Income tax may be payable on any interest awarded.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
ISAs	No longer in force	For half the investment: FTSE UK Private Investors Income Total Return Index; for the other half: average rate from fixed rate bonds	Date of investment	Date ceased to be held	8% simple per year on any loss from the end date to the date of settlement

Actual value

This means the actual amount paid 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, Lloyds 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.

Why is this remedy suitable?

I have decided on this method of compensation because:

- Mr and Mrs B 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 B'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 B into that position. It does not mean that Mr and Mrs B 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 B could have obtained from investments suited to their objective and risk attitude.

My final decision

For the reasons given, my final decision is that I uphold the complaint and direct Lloyds Bank PLC to pay compensation to Mr and Mrs B as set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr and Mrs B to accept or reject my decision before 3 June 2022.

James Harris
Ombudsman