complaint

The trustees, represented by a Claims Management Company, have complained about advice they received from The Prudential Assurance Company Limited in 2000 to invest £225,000 into a bond, in the with profits fund. The purpose of the advice was inheritance tax (IHT) planning so the bond was established in a loan trust.

The trustees' representative has said that the advice to invest such a large sum in a single fund was unsuitable. It has resulted in an increased risk of poor performance, mismanagement of the fund and of a market value reduction (MVR).

background

Our adjudicator recommended that the complaint should be upheld. In summary, he concluded that the advice to invest in this type of bond was generally consistent with a requirement to mitigate a potential IHT liability. He also concluded that the choice of investment fund, the with profits fund, was consistent with the level of risk the trustees had been prepared to accept. In the adjudicator's opinion, Prudential had adequately disclosed the potential application of a MVR in understandable terms.

But the adjudicator did also conclude that the advice to invest the whole amount in a single fund wasn't suitable. He accepted that the fund invested across of range of assets types. However, he considered the recommendation resulted in a lack of diversification, particularly as a range of other funds with an appropriate associated risk levels were available. On this basis, he had recommended the complaint should be upheld.

Prudential didn't accept the adjudicator's assessment. In response, it didn't agree that there had been alternative funds available with the right level of risk. In support, it argued that unlike a unit-linked fund, a with-profits fund is less exposed to the up and downs of investing directly into the stock market. Therefore, the risk attached to any unit-linked fund would have been greater than the trustees had been prepared to accept.

The additional arguments raised by Prudential didn't persuade the adjudicator to change his view. He still felt it was likely that alternative funds would've been available. If this wasn't the case and only one fund had been suitable, he thought that Prudential shouldn't have proceeded with its recommendation.

Prudential didn't agree, reiterating its arguments that an investment into the with profits fund had in itself provided a sufficient degree of diversification. It said that investing into alternative funds would have exposed the trustees to a greater level of risk than was consistent with the appropriate risk profile.

As an agreement hasn't been reached, this complaint has been referred to me to review.

my findings

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

The adjudicator's opinion of the complaint acknowledged that in many respects the advice given to the trustees was a suitable means by which to address the IHT planning objective. For instance, it seems that reasonable consideration was given to what represented an appropriate level of risk and to whether sufficient funds were left available as an emergency fund.

What appears to remain as the root of the disagreement is whether enough consideration was given to the diversity of the recommendation. On the face of it, placing the whole £225,000 into a single fund – albeit one that operates like the with profits fund, investing across a range of assets and smoothing returns to avoid volatility – does appear to ignore the benefits of spreading the investment across several funds.

Prudential has said that by investing in a range of assets the with profits is inherently diversified. I accept this to a degree. But the recommendation to use a single fund – particularly for such a large investment – does overlook the other benefits of diversification; such as how each fund will balance the range of assets in a different way and other differences in management.

The business has also suggested that the trustees' attitude to risk for this investment, having been categorised as a 2 – 'very cautious' on a scale of 1 - 4 meant there was little choice in what fund could be recommended. It has provided a 'suitability matrix' that shows the with profits fund as being the only category 2 fund available from a choice of only five funds. But the suitability report produced for the trustees at the time makes reference to being able to choose from, in addition to the with profits fund, a range of 25 unit-linked funds.

Clearly the majority of these would've carried a level of risk far beyond what was suitable for the investment in question here. But it does suggest that the advice was being provided in the context of there being options other than using only the with profits fund. But nowhere in the suitability letter is there reference to the apparent lack of diversification, or an explanation of why the adviser felt that the use of a single fund was not an issue.

In summary, I'm of the view that the lack of diversification in the recommendation made it unsuitable for the trustees' objectives. I think it's likely that if they'd been aware of the potential consequences of placing 'all their eggs in one basket' they would have sought to invest differently.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put the trust as close to the position it would probably now be in if the trustees had not been given unsuitable advice.

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

what should Prudential do?

To compensate the trust fairly, Prudential must:

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

Prudential 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
The bond	surrendered	for half the investment: FTSE WMA Stock Market Income Total Return Index; for the other half: average rate from fixed rate bonds	date of investment	date surrendered	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, Prudential should use the monthly average rate for the fixed rate bonds with 12 to 17 months maturity 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 payment out of the investment should be deducted from the *fair value* at the point it was actually paid so it ceases to accrue any return in the calculation from that point on.

If there are a large number of regular payments, to keep calculations simpler, I will accept if Prudential totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because:

- The trustees wanted income with some growth with a small risk to the trust's 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 the trust's capital.
- The WMA 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 the trust's risk profile was in between, in the sense that the trustees were prepared to take a small level of risk to attain the trust's investment objectives. So, the 50/50 combination would reasonably put the trust into that position. It does not mean that the trustees would have invested 50% of the trust's 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 the trustees could have obtained from investments suited to the trust's objective and risk attitude.

- The additional interest is for being deprived of the use of any compensation money since the end date.

my final decision

For the reasons given, my final decision is that I uphold the complaint. I redirect The Prudential Assurance Company Limited to pay the trustees compensation as set out above.

James Harris
ombudsman