

complaint

Mr and Mrs N complain about the advice LJ Financial Planning Ltd (LJFP) gave to them. They say that they were advised to invest in an EEA Life Settlement fund because it was low risk. But in fact it was a high risk investment and they have now lost money.

background

In 2009 Mr and Mrs N met with LJFP. They completed a fact find questionnaire in June and October 2009. This identified them as cautious investors. That is, they didn't *'want a high exposure to stock markets'*. But they were *'prepared to accept a relatively low level of risk on investments, in order to achieve potentially higher returns over the medium to long term'*.

The fact find also said that they were looking for higher returns than cash deposits, but without taking too many risks.

At the end of 2009 LJFP advised them to invest in an unregulated collective investment scheme (UCIS).

In February 2010 LJFP sent Mr and Mrs N a further recommendation to invest in the EEA Life Settlements Fund (EEA fund). The EEA fund was also a UCIS.

This letter appeared to suggest that Mr and Mrs N's attitude to risk had changed to *'moderate'*. That is, they were *'prepared to invest mid to long term in balanced mix of underlying assets, where risk is spread across a variety of investment types, with the aim of potentially higher returns'*. They also accepted that *'there will be some volatility and the risk of loss over the short term'*.

LJFP explained how the EEA fund worked and that the *'clear benefit to the buyer [of the policy] is that all costs are known'*. It didn't outline any risks. And it said that the *'only consideration is when the proceeds will be paid – a factor which requires a great deal of specialist expertise to determine and one in which EEA's investment adviser [...] is a market leader'*.

It explained that the fund aimed for investment returns of 9-10%

Mr and Mrs N agreed to invest in the EEA fund.

In September 2011 LJFP wrote to Mr and Mrs N. It explained that it had carried out a review of its procedures relating to UCIS because *'investments into this type of scheme have additional potential risks for clients'*. It explained that UCIS investments can be illiquid, and they can sometimes invest in assets which wouldn't be allowed in regulated collective investment schemes. It also explained that it might not be possible to have access to the Financial Ombudsman Service or the Financial Services Compensation Scheme.

LFJP told Mr and Mrs N that it had reviewed all of its clients with investments in UCIS. It said that that the number of UCIS investments in their portfolio was over the recommended limits. It said that the advice they had been given appeared *'to be unsuitable'*.

LFJP offered a free review with Mr and Mrs N. This was carried out in late September. Following this, Mr and Mrs N signed a form which said:

'I understand and accept the additional risks associated with unregulated collective investment schemes and that my holdings exceed your recommended guidelines. I do not wish to review my portfolio at this time or reduce my UCIS holding'

In October 2014 Mr and Mrs N complained about the advice to invest in the EEA fund. They complained that they had been told it was a low risk investment, when in fact it was high risk.

Two of our adjudicators looked at the complaint. They both thought it should be upheld. They thought that the EEA fund was clearly high risk, and was therefore unsuitable for Mr and Mrs N.

However, the second adjudicator thought that in September 2011, Mr and Mrs N could've chosen to sell their investment in the EEA fund. So he thought that they shouldn't be compensated for any losses they incurred after this point.

LJFP disagreed with the adjudicator's opinion. Essentially, it argued that the EEA fund was not high risk at the time, and that it was a suitable investment for Mr and Mrs N. It said that the risks associated with the EEA fund (medical advances, longevity and insolvent insurance companies) were specific risks within the life settlements marketplace. But it said that all *'investments are at risk from systemic and unsystemic risk factors'*.

It disagreed with the adjudicator that the level of returns couldn't be achieved if the investment was truly low risk. It explained how the EEA fund worked. It concluded that having *'investigated the potential returns and structure we were, and still are, happy that a lower risk fund can produce good returns'*. It also said that some *'risk must be taken and the main one in this case was liquidity as the other risks were diversified away as much as possible'*.

It also disagreed with the settlement proposed by the adjudicator. And it said that Mr and Mrs N chose not to sell their investment in the EEA fund in September 2011. This showed that they weren't that concerned with the risks of the investment.

The adjudicator didn't think the points LJFP raised made any difference, so the case was passed to me.

I issued a provisional decision in December 2015.

In my provisional decision I said:

'In order to decide whether the advice given to Mr and Mrs N was suitable, I'll first consider whether LJFP's advice to invest in the EEA fund was in line with their attitude to risk and investment objectives.

Was the EEA fund low risk?

Investments in traded life policies carry a number of specific risks which LFJP ought reasonably to have been aware of when it advised Mr and Mrs N to invest in the EEA fund.

The EEA offering memorandum outlines a few of these risks, including the following:

- *If the fund underestimates how long an insured may live, it may pay more for a life policy than the policy is worth;*
- *Several factors might affect the forecasting of an insured's life expectancy;*
- *The investment is 'essentially illiquid', so early withdrawal of capital might not be possible;*
- *The risk that the insurer might become insolvent and be unable to pay the claims.*

In addition, the EEA fund had a target return for investors of 8-10% per year. At the time the advice was given, the base rate was 0.5%. Other low risk investments such as government bonds were offering returns of around 2.5-3%. Risk and return are clearly linked. So an investment that looks to consistently generate a high level of return cannot reasonably be assumed to be low risk. In my view the significant difference between the returns offered by the EEA fund and low risk assets ought to have alerted LJFP to the fact that the fund was not low risk.

The FCA has also said that traded life policy investments are 'high-risk investments'.

So for these reasons I'm satisfied that the EEA fund was (and is) a high risk fund.

Was the investment suitable for Mr and Mrs N?

The fact find carried out in October 2009 established that Mr and Mrs N classified themselves as 'cautious' investors. They said that they would have a hard time tolerating losses in the next 3 years. The additional notes say that Mr and Mrs N 'wanted an investment that offered a higher return than cash deposits, but did not want to take too much risk'.

The suitability letter that LFJP sent to Mr and Mrs N in February 2010 says that their attitude to risk was 'moderate'. I've seen no evidence of another fact find between October 2009 and February 2010. So I'm unclear about why LJFP said that their attitude to risk in February 2010 was moderate, when it had been cautious in October 2009, and was cautious again in October 2010. But I don't think it matters.

I'm satisfied that the information Mr and Mrs N provided during the fact find in October shows that they were cautious investors looking for low risk investments. The EEA fund was recommended to them on the basis that it was a low risk fund. But I'm satisfied that in fact the actual risk attached to this fund was higher than this. So the advice LFJP gave was unsuitable.

Compensation

I've taken a different approach to the adjudicator in relation to the compensation payable to Mr and Mrs N. This is because I don't think that the calculation of compensation should end in October 2011.

I say this for the following reasons:

Between September and October 2011 Mr and Mrs N declined to reduce their portfolio's exposure to UCIS investments. LJFP had written to them in September 2011 to explain that given their attitude to risk, some of the advice they had previously received was unsuitable.

But the letter which LJFP sent to them was generic – it didn't explain the specific risks inherent in the EEA fund. It just said that having too much exposure to UCIS investments wasn't suitable given their attitude to risk.

So, Mr and Mrs N met with LJFP in September to discuss their portfolio. I haven't seen any evidence of what was discussed at this meeting.

Mr and Mrs N have said that at the time the EEA fund was doing OK, and they saw no reason to sell it.

LJFP has said that after this review Mr and Mrs N chose to sell one of their UCIS holdings, but keep the EEA fund. It said that they 'understood the risks'. But I don't think they did.

In my view, unless Mr and Mrs N were told at this meeting about the specific risks associated with the EEA fund, they would've had no reason to sell the investment. They weren't aware that the EEA fund was a high risk investment which was unsuitable for them.

And I think it's unlikely that LJFP specifically explained to Mr and Mrs N at that meeting that the EEA fund was a high risk investment that carried several significant risks. I say this because LJFP clearly thought at the time that the EEA fund was not high risk. And they have maintained this view in response to the adjudicator's opinion.

It follows that Mr and Mrs N didn't really have a specific reason to sell their investment in the EEA fund in October 2011. They still thought it was a low risk investment. As a result, I'm satisfied that compensation should be calculated from the start date of the investment to the date of my final decision.

And I agree with the adjudicator that LJFP should pay Mr and Mrs N £250 for the trouble and upset that they have been caused.'

LJFP said it disagreed with my provisional decision, but didn't provide any further comments. Mr and Mrs N agreed with the provisional decision and had nothing further to add.

my findings

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

Having done so, and since no further information was provided in response to my provisional decision, my final decision remains the same.

fair compensation

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

I think they would have invested differently. It is not possible to say *precisely* what they would have done, but I am satisfied that what I have set out below is fair and reasonable given Mr and Mrs N's circumstances and objectives when they invested.

what should LJFP do?

To compensate Mr and Mrs N fairly, LJFP must:

- Compare the performance of Mr and Mrs N'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.

LJFP should also pay interest as set out below.

- Pay Mr and Mrs N £250 for the trouble and upset that they have been caused.

Income tax may be payable on any interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
EEA Life Settlement	still exists	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 of my decision	8% simple per year from date of decision to date of settlement (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value

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

If at the end date the investment is illiquid (meaning it could not be readily sold on the open market), it may be difficult to work out what the *actual value* is. In such a case the *actual value* should be assumed to be zero. This is provided Mr and Mrs N agree to LJFP taking ownership of the investment, if it wishes to. If it is not possible for LJFP to take ownership, then it may request an undertaking from Mr and Mrs N that they repay to LJFP any amount they may receive from the investment in future.

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, LJFP 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* calculation 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 LJFP totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have chosen this method of compensation because:

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

my final decision

For the reasons given here and in my provisional decision, I uphold Mr and Mrs N's complaint.

My final decision is that L J Financial Planning Ltd must pay compensation to Mr and Mrs N as set out above.

L J Financial Planning Ltd should provide details of its calculation to Mr and Mrs N in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr and Mrs N accept or reject my decision before 25 January 2016.

Alessandro Pulzone
ombudsman