

complaint

Mr and Mrs W have complained about the advice that they received in 2008 from an appointed representative of Money Wise Independent Financial Advisers Limited ("the business" hereafter) to invest into its cautious portfolio within an offshore investment bond. Specifically, they have argued the business had not accurately recorded their requirement for a short-term investment in preparation to redeem their mortgage when the redemption penalty had expired. As the recommended bond had encashment penalties for the first five years, Mr and Mrs W believe it was inconsistent with their requirements.

Furthermore, Mr and Mrs W have also complained that the risk attached to the cautious portfolio was inconsistent with that they were willing to accept.

background

The adjudicator assigned to the case recommended that the complaint should be upheld. In summary, he did not consider the available evidence supported Mr and Mrs W's suggestion that they only wished to invest for a short term. However, the adjudicator did find that the risk posed by the investment was inconsistent with that Mr and Mrs W were willing to accept. In light of the information provided by the business, the cautious portfolio invested in a range of assets including fixed interest securities, equities, property and 'alternatives'. The adjudicator believed this resulted in the risk being greater than Mr and Mrs W were willing to accept.

The business did not accept the adjudicator's assessment. In response, it has argued:

- Mr and Mrs W's requirement was to invest over the medium term, and the capital was not required to redeem their mortgage when the redemption penalty had expired in 2011. On this basis, it considers the capital has been invested in line with their requirements.
- The cautious portfolio is a discretionary managed portfolio, and at any one time invests into a range of different investment funds. Moreover, Mr and Mrs W had not invested into the portfolio at the outset, but invested 50% of their capital into the portfolio in 2009 and the remaining 50% in 2011. Mr and Mrs W agreed to transfer their capital from cash into the cautious portfolio on each occasion.
- At these points the exposure to equities and alternatives were less than the model portfolio in 2008. In particular, the proportion of the cautious portfolio invested into alternatives was 10% in 2009 and 17% in 2011. And a significant share of the alternatives invested into a relatively low risk absolute return fund. Overall, the cautious portfolio was not inconsistent with a cautious risk profile.
- Mr and Mrs W have remained invested into the cautious portfolio, and if they had disagreed with the investment approach they have had the opportunity to disinvest from the portfolio at the time they had complained or at any time since.
- Nevertheless, it has argued Mr and Mrs W have made a gain on their original investment; as such have suffered no financial loss taking into account the regular withdrawals taken from the investment.

Having carefully considered the arguments, the adjudicator remained of the opinion the complaint should be upheld. On the basis the portfolio had scope to invest across a range of

investment funds spanning a wide range of asset classes, he considered the level of risk attached to the portfolio was inconsistent with the risk Mr and Mrs W were willing to accept.

In relation to whether Mr and Mrs W had suffered a financial loss, he highlighted that this would only be determined in reference to the position they would have been in but for the event they have complained about. In the absence of compelling evidence, he had considered the benchmark, which would reflect the return a consumer could broadly achieve with a cautious risk to their investment. Using the benchmark, it could be the case Mr and Mrs W had suffered a financial loss.

In their final submission to this service, Mr and Mrs W have highlighted the following:

- Contrary to the business' assertions, they had concerns about the investment at the outset, which were not adequately addressed by the business' appointed representative or the business itself.
- The business has relied on the paperwork completed in August 2008. It has, however, not provided the details of the subsequent meeting that had taken place in November 2008, in which they had decided to invest into this offshore investment bond. During this meeting, they have stated their attitude to risk had become more cautious due to the onset of the financial crisis.
- Their requirement to achieve greater growth on the capital prior to utilising it to redeem their mortgage when the redemption penalty had expired has not been met. Moreover, the failure to invest their capital into the cautious portfolio in a timely manner, whilst substantial management fees were debited, has adversely affected the investment.
- The investment into higher risk investment assets still constituted a significant share of the portfolio, which would still not be consistent with their cautious risk profile.
- They do not agree they have not suffered a loss, as the business has suggested, and comment that the income produced by the investment has been not come out of the bond but been applied to cover its charges.

As no agreement has been reached, the matter has been referred to me for review.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

At the point where the investment was first discussed with Mr and Mrs W, they were both retired and apparently wished to invest some of their capital to achieve growth with the potential for some income. It was recorded Mr and Mrs W were prepared to invest for the medium to long term.

They were assessed as having a cautious attitude to risk. This was defined as follows:

"You are not prepared to substantially jeopardise the value of your invested capital, although you accept in adopting this approach you may not see significant growth. You still expect to see a reasonable return although you understand over the longer term shares and equity based deposits have outperformed cash deposit or fixed interest securities. This is a more

stable investment for a cautious investor who does not wish to exercise much responsibility in the timing of taking out their money. Over the medium to long term, inflation may erode their savings."

The representative recommended Mr and Mrs W invest £175,000 in an offshore bond utilising the business' own cautious portfolio.

However, although the recommendation was made in September 2008, the investment did not actually go ahead until November. In addition, the investment was for £100,000 rather than the original amount.

It is not clear what happened between these two dates, and there seems to be no documentary evidence of any discussions that took place. However, it is evident Mr and Mrs W wished to place less of their available capital into this investment.

Although the recommendation was to invest in the cautious portfolio, I understand that initially the capital was entirely placed in a cash fund. The adjudicator asked the business to clarify why this was. However, it could only surmise that the state of the financial markets, given this was at the height of the credit crisis, was the reason the investment was placed in a cash fund. The business has told us that half the investment was switched into the cautious portfolio in September 2009 and the remainder in May 2011.

Having considered the advice given to Mr and Mrs W, I am not persuaded they only wished to invest for a short term. It seems clear they were made aware that this was intended to be a medium to long term investment. Although they did have a mortgage, it seems that repayment was discussed but this was not an approach they wished to take.

However, I find myself in agreement with the adjudicator that investing in the cautious portfolio was not compatible with Mr and Mrs W's risk profile.

It seems from the definition set out above that they wished to avoid volatility, and were effectively prepared to sacrifice some potential for investment growth to allow greater security of their capital.

The cautious portfolio which was recommended contained a range of asset types spread over a number of funds. The business has explained it was managed on a discretionary basis.

However, I am also aware that the portfolio contained investments in what would generally be regarded as high risk areas. These included investing in recycling facilities and forestry. A number of the funds appear to be either unregulated collective investment schemes (UCIS) or qualifying investor funds, which are only meant to be marketed to certain categories of investor. These include sophisticated investors or those with significant investable capital. Mr and Mrs W do not seem to fall into any of the relevant categories.

Considering the fund as a whole, I am conscious that it contained a substantial proportion in areas such as equities and alternative investments, with a relatively low percentage in safer asset classes such as cash or fixed interest securities.

I appreciate the points the business has made that when the capital was actually switched into the cautious portfolio, in 2009 and 2011, it contained lower proportions in equities and alternative investments than when the advice was given. But these areas still represented a

significant level of risk, and it seems the discretionary approach adopted by the fund manager allowed quite some leeway in the types of investment that could be included and the percentages in such areas.

Therefore, on balance I am not persuaded the portfolio was a suitable recommendation for Mr and Mrs W, taking account of their apparent wish to retain a degree of security with their capital.

I have considered the point that the capital was not initially invested in the cautious portfolio, but rather this took place later in two separate tranches. The business has suggested that a decision was taken to defer investing in the fund because of the uncertain economic situation.

However, given that the offshore bond carried relatively high charges, there was a significant prospect of capital erosion because the returns generated by the cash fund would have been outweighed by the charges. If it was felt that it was not the right time to invest in the cautious portfolio, it would have been more appropriate to defer the investment entirely until the opportunity was right.

I would add that if Mr and Mrs W were concerned about investing in such conditions, this would also seem to imply some reluctance on their part to take much risk with their capital.

I note the business has argued that Mr and Mrs W have not made a loss. However, it is not clear to me whether it has made this assessment using the method of calculating redress the adjudicator proposed. However, if that does prove to be the case, then Mr and Mrs W will not be entitled to any compensation.

On this point, I also note Mr and Mrs W say the income produced by the bond has not been paid to them, but rather has gone towards meeting the charges. If that is correct, these payments should not be taken into account in the calculation. Only income or withdrawals paid to Mr and Mrs W should be included.

Although the business has commented that Mr and Mrs W have retained the investment within the cautious portfolio, despite making a complaint about the advice, I consider it was reasonable for them to await the outcome of the dispute before deciding what action to take. I do not consider this is evidence the investment was suitable for them.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr and Mrs W 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 W would have invested differently. It is not possible to say *precisely* what they would have done differently. But I am satisfied that what I set out below is fair and reasonable given their circumstances and objectives when they invested.

To compensate Mr and Mrs W fairly, the business must
compare

- the performance of Mr and Mrs W's investment;

with

- the position they would now be in if 50% of their investment had produced a return matching the average return from fixed rate bonds with 12 to 17 months maturity as published by the Bank of England and 50% had performed in line with the FTSE WMA Stock Market Income Total Return Index ('WMA income index').

If there is a loss, the business should pay this to Mr and Mrs W.

I have decided on this method of compensation because Mr and Mrs W wanted growth with small risk to their capital.

The average rate from fixed rate bonds would be a fair measure for a consumer who wanted to achieve a reasonable return without risk to their capital. It does not mean that Mr and Mrs W would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with little risk to the capital.

The WMA income index (formerly the APCIMS income index) is a combination of diversified indices of different asset classes, mainly UK equities and government bonds. I consider it to be a fair measure for a consumer who was prepared to take some risk to get a higher return.

Mr and Mrs W's risk profile was in between, as they were prepared to take a small level of risk. I take the view that a 50/50 combination is a reasonable compromise that broadly reflects the sort of return Mr and Mrs W could have obtained from investments suited to their objectives and risk attitude.

Although the comparison may not be an exact one, I consider that it is sufficiently close to assist me in putting Mr and Mrs W into the position they would have been in had they received appropriate advice.

how to calculate the compensation?

The compensation payable to Mr and Mrs W is 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.

The *actual value* is the value Mr and Mrs W will receive if they terminated the investment on the date of my decision.

To arrive at the *fair value*, the business should work out what 50% of the original investment would be worth if it had produced a return matching the average return for fixed rate bonds for each month from the date of investment to the date of my decision and apply those rates to that part of the investment, on an annually compounded basis.

The business should add to that what 50% of the original investment would be worth if it had performed in line with the WMA income index from the date of investment to the date of my decision.

Any additional sum that Mr and Mrs W paid into the investment should be added to the *fair value* calculation from the point it was actually paid in.

Any withdrawal or income payment that Mr and Mrs W received from 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 the business totals all such payments and deducts that figure at the end instead of periodically deducting them.

my final decision

I uphold the complaint. My decision is that Money Wise Independent Financial Advisers Limited should pay Mr and Mrs W the amount calculated as set out above.

If my award is not paid within 28 days of Money Wise IFA Limited receiving notification that Mr and Mrs W has accepted my decision, simple interest is to be added at a rate of 8% gross a year from the date of my decision to the date of settlement. Income tax may be payable on this interest.

Doug Mansell
ombudsman