Financial Ombudsman Service

**complaint**

Mr R complains about advice given by John Joseph Financial Services Limited ('the IFA'), during August 2005, to invest £100,000 into a Keydata Secure Income Bond issue 1 (the Keydata bond),. The capital invested was from the surrender of an existing plan, held within a Self-Invested Personal Pension Plan (SIPP). Mr R says that the Keydata bond was mis-sold.

To assist him in bringing his complaint Mr R has engaged a professional representative.

**background**

An adjudication was issued in February 2013, which explained the reasons for recommending Mr R's complaint should be upheld.

This document explained that relevant law and regulations; regulator's rules, guidance and standards, and codes of practice good industry practice at the time, the general legal position including the law relating to negligence, misrepresentation and contract (including the express or implied duty on professional advisers to give advice with reasonable skill, care and diligence) along with the law relating to causation and foreseeability had been considered when deciding a fair and reasonable outcome to the complaint.

This was an advised sale, where the IFA had assessed the suitability of the product for Mr R, and the regulatory rules and principles in force in 2005 had been reviewed when assessing the advice given.

The money available for investment was held in a SIPP and came from the surrender of an existing holding. It was agreed that the new investment would be used to provide an income in retirement for Mr R. Mr R and the IFA had agreed that for this particular tranche of capital, it was important for it to be invested using a 'cautiously realistic' exposure to risk. The IFA says that Mr R understood that to mean that he was prepared to invest over the longer term, but that he was wary of stock market volatility.

This indicated that although Mr R was open to some element of investment risk, he was not prepared to invest where there was a possibility that he could lose a substantial part of his capital. It seemed that Mr R did have some understanding and experience of investing previously. He was prepared to invest some capital or take a business decision without seeking advice where he felt comfortable doing so. In the particular circumstances surrounding the complaint, Mr R had approached the adviser for professional advice.

The IFA says that he relied on the product literature, the representations made by Keydata, and his own research before he was sufficiently comfortable to recommend the Keydata bond to Mr R. On 10 August 2005 the IFA wrote to Mr R and set out a summary of their discussions, and the actions agreed. The IFA had assured Mr R that the capital would be returned on maturity; that the investment was not linked to equities, and that the IFA considered it to be of minimal exposure to investment risk. In brief various investment options had been discussed, including investing the pension fund in commercial property (which was discounted) and that agreement had been reached on which investment would be used.

The letter said:

> *2.1. The Keydata Secure Income bond is a 5 year investment offering an annual income of 7.5% with full return of capital*
>
> *2.2. There is an option to roll-up the income giving a fixed return of 43.5% plus your original capital after 5 years.*
>
> *2.3. The bond will invest in a mixture of cash and insurance contracts. The insurance contracts with the bond have a fixed maturity value and are bought at a discount to this, creating the potential for this high income.*
>
> *2.4. This means that the income /growth payments and return of capital are not linked to the performance of equities. Furthermore, the bond will only invest in contracts issued by institutions rated 'A' or better by rating agency Standard and Poors. 'AAA is the highest Standard & Poors rating, quantified as 'superior'. 'CCC' is the lowest rating and is classed as 'extremely vulnerable'. 'A rating equals 'good'.*
>
> *2.5. The bond has been structured to produce 7.5% income and full capital repayments at maturity. As with any bond (such as a corporate bond), there are risks and capital is not guaranteed.*
>
> *2.6. We have looked at the product in detail and believe this offers a lower risk investment than investment which invest in high yield corporate bonds or equities. We have included a question and answer page which you should read in conjunction with the key features so you can be aware of the risks, and understand why we feel these risks are minimal.*
>
> *2.7. You agreed to invest £100,000 of the proceeds into this fund on a roll-up basis.*

The IFA told us that Mr R had changed adviser and any redress (assuming that the complaint was upheld) should be capped at the date Mr R appointed the new adviser.

The adjudicator considered this, but was not persuaded by that argument. The IFA had provided the advice and should be held responsible for any losses which arose for that advice. The intended term of the investment was for five years, and penalties applied on early surrender. Arguably, if another adviser had recommended surrendering this bond within that term, penalties would have been incurred.

The adjudication discussed the issues of risk, the foreseeability of any misappropriation and the legal issue of causation and loss.

The Financial Services Authority (now Financial Conduct Authority) had imposed a financial penalty on Norwich and Peterborough Building Society for failing to give its customers suitable advice in relation to the sale of Keydata products, and this notice provided a helpful description of the investment:

> *"The Keydata Products were based on investments in corporate bonds. On behalf of investors, Keydata purchased bonds which were issued by special purpose vehicles incorporated in Luxembourg. The first Keydata Product offered by N&P was the Secure Income Bond ("SIB") Issue 3, for an investment in a bond issued by SLS Capital SA ("SLS") … The funds raised through the issue of the bonds (i.e. the amount invested by retail customers in the products through Keydata) were then invested in a portfolio of US life insurance policies and cash. The Keydata product materials stated that the investment mix was intended to be 60% policies/40% cash*

> *for the bonds issued by SLS … SLS purchased life insurance policies from elderly US citizens, paid the premiums due on those policies, and collected the maturity payment due under the policy when the individual died."*

It was clear from the description and the other information reasonably available to the IFA at the relevant time that the bond was not a secure investment and presented some considerable risk to capital.

Investors could lose money if the insurance companies issuing the insurance contracts defaulted on their obligations, or if the issuer of the Bond went into liquidation, or if factors changed which affected the rate at which insurance contracts mature. There was also the possibility that investors could lose money if the traded insurance contracts fell in value, or if certain assets did not mature in a way predicted by the financial model.

The FSA found that the product material revealed a number of significant distinctive features to the bond, including the following:

- *Although the Keydata Products were intended to return capital in full at the end of the investment period, they offered no capital guarantee, and put all capital invested at potential risk.*

- *The successful performance of the Keydata Products depended on the accuracy of actuarial models used by Keydata. There was a risk that significant technological or pharmaceutical development could impact on the accuracy of the models and when insurance policies were likely to mature.*

- *The bonds had a fixed term of 5 or 7 years. This meant that Keydata undertook to return funds to investors on the date when the bond matured, even if, at that point in time, it had insufficient funds because the insured individuals were living longer than anticipated.*

- *The underlying insurance policy assets were not traded on an exchange in the way that stocks and shares are. The resale market for these assets also created a risk that, if it became necessary to sell an insurance policy to make funds available, this might take longer than anticipated, and might only be possible at a reduced value, reducing the value of the portfolio.*

- *The Keydata Products involved investment in a single specialist asset class (US senior life insurance policies) through a single issuer (at first SLS, then Lifemark). Although a percentage of the investment was to be held in cash, this was not held as a separate investment, but was intended to be used to pay the insurance premiums, income payments and operational costs associated with the investment.*

- *The Keydata Products had a significant international dimension: the underlying assets were US life insurance policies, and the issuers of the bonds were based in Luxembourg.*

Also, the assurance provided by household names such as HSBC and KPMG was largely illusory. Their roles were strictly limited and provided no real assurance about the controls over or quality of the investments or fund management arrangements. It was important for advisers to take these matters into account when assessing the suitability of the product for an individual investor, and for potential investors to understand that the fund presented a significant risk to their funds. Given the opaque nature of the investments and the significant uncertainty around accurate valuation and liquidity it was doubtful whether such a fund would have been suitable for all but the moist experienced of retail investors.

These concerns should have been apparent to a financial professional at the time and taken carefully into account in assessing the suitability of these bonds. The adjudicator felt that to a professional financial adviser, these investments would not and should not have been suitable for a 'cautiously realistic' investor as the IFA had defined Mr R to be.

It was important for advisers to take these matters into account when assessing the suitability of the product for an individual investor, and for potential investors to understand that the fund presented a significant risk to their funds. It was not sufficient for the adviser to simply assert that they relied on the headline description of the investment when making their assessment of suitability. They should be exercising professional judgement about the inherent nature of the investment and its suitability for their client's particular investment needs. The IFA should have identified those significant risks inherent in this product and taken them into consideration when recommending the investment to Mr R. The adjudicator concluded that this investment was not suitable for Mr R.

This was not a view reached with hindsight. The findings were based on the product's suitability for Mr R based on what the IFA at the time of the advice knew or could be expected to find out about the investment and based on a reasonable expectation of how the bond would operate.

The adjudicator concluded that the recommendation made by the IFA to invest in the bond was not a suitable recommendation for Mr R and that the advice demonstrated a complete disregard for his individual circumstances and interests.

The adjudicator considered what Mr R would have done "but for" the advice he received. There was nothing to suggest that Mr R would have invested in the bond, if it had not been recommended to him, or that he would have invested in the bond, if things had happened as they should. The adjudicator concluded that Mr R would not have invested had he had appreciated the risks. Most likely, Mr R would have invested into another investment suitable for a cautiously realistic investor and a fair benchmark to indicate the investment return on his investment would be 1% more than the Bank of England base rate compounded yearly from the date of investment until the date the loss crystallised in November 2009.

The IFA was invited to review the findings.

The IFA said that it was unable to accept that the recommendation was unsuitable for Mr R. He was not looking to invest in cash, and neither was he an inexperienced or cautious investor. It suggested that the conclusions drawn were based on an impermissible use of hindsight. It did not agree that it had disregarded Mr R's interests but instead that it gave thoughtful and considered advice. The failure of the Keydata bond was as a result of misappropriation of the underlying assets which were outside the scope of any duty the IFA owed to Mr R; were unforeseeable; and not caused by any alleged error or omission on the part of the IFA.

The IFA commented that if the Financial Ombudsman Service was proposing not to apply the law in this case, in line with applicable court authorities, it needed to say so, and explain why. Further it did not agree that the proposed redress was fair or reasonable and neither did it represent fair compensation because the IFA did not have a complete disregard for Mr R's interests, and did not cause his loss.

Other points which it wished to respond to included:

- The money available for investment formed a relatively small part of Mr R's wealth and assets; he was a wealthy man and an experienced investor with diverse investment experience.

- At all times it had treated Mr R as having a cautiously realistic attitude to risk.

- Mr R had managed some of his investments himself included a portfolio of traded endowment policies (TEPs) which indicated a good understanding of investment matters and risk.

- Mr R had decided to surrender the existing holding because he was unhappy with the returns it provided although it felt it was unrealistic to expect a return above 4% per annum; allied with capital security.

- The recommendation had been agreed with Mr R and he was an active participant in the dialogue.

- It did not agree with the conclusions drawn over the risks attached to the Keydata Bond –to the extent that it was actually material to the losses resulting from the fraud. It felt that the investment risks of the Keydata bond were no more than low-medium or medium risk which it considered matched a cautious- realistic investor, and when compared against other investment classes sold in 2005. It believed that a reasonably competent IFA would have considered the Keydata bond as less risky than equities or a high yield bond and that no competent IFA would have considered that the Keydata bond would display the level of volatility inherent in equities.

- It was wrong to suggest that Mr R was not prepared to invest in a product where he might lose a substantial part of his capital. He was prepared to invest in equities either generally or specifically, and that the investments he personally managed exposed his assets to risk of capital loss.

- The size of the investment in the Keydata bond when set against the size and structure of the rest of Mr R's portfolio was reasonable and proportionate.

- The scope of the other holdings allowed the IFA to make recommendation in all classes of risk in appropriate concentrations, because Mr R was a cautious/realistic investor. It did not mean that Mr R was unwilling to accept a product which placed his capital at risk.

- The Keydata bond at the time it was recommended could have reasonably been expected to reduce the volatility in Mr R's investment portfolio as a whole. The risk to which the Keydata bond was subject were not the same risks which affected the performance of the other assets held.

- The sum released by the surrender of the existing investment was greater than the £100,000 recommended for investment.

- It was not reasonable to suggest that the IFA should have looked at the investment in isolation. If that had been the case the IFA might have been open to criticism for exposing Mr R to an unreasonable concentration of risk.

- The IFA had not assured Mr R that the capital would be returned on maturity and it denied it had said it considered the Keydata bond to be of minimal exposure to investment risk. It referred to the letter dated 10 August 2005 and the Q&A attached; as clarification.

- It had provided a general description of the nature of the risks and felt it was important that any client did not lose sight of the overall picture as far as risk is concerned. If an IFA were to provide explicit warnings and explanations in relation to every conceivable risk posed by an investment there was a danger that the client might not understand the key risks. It denied that an unduly in-depth level of written analysis had to be provided.

- It agreed that the subsequent change of advisory firm did not alter the responsibility for recommending a suitable product. The point it wished to make was that after this change neither Mr R nor his subsequent adviser considered the advice or the investment to be unsuitable. The point had not been made in any attempt to cap any redress award, but more likely that the third party adviser had reviewed and affirmed the ongoing suitability of the advice.

- It was unclear on what basis the conclusion was reached that an element of capital protection had been sought – over and above that which the Keydata bond provided. The underlying assets clearly had a value until the fraud (which could not have been foreseen at the time the recommendation to invest in the bond) was made.

- It agreed that many of the risks identified in the adjudication should have been clear as they were detailed in the Keydata Key Features Documents and Q&A provided to Mr R. Those risks had been discussed with him so that he was fully aware and understood the risk associated with the investment.

- The IFA said the underlying assets were both commonplace and readily understandable. There was nothing complicated unusual or esoteric about a life policy where premiums are paid by the insurer and a fixed lump sum paid on the death of the life assured. It felt the Keydata bond issuer was simply standing in the shoes of the individuals or businesses which initially took out the policies.

- The IFA was satisfied that the Keydata bond was suitable for Mr R. It believed that he would have proceeded with the investment had he received such risk warnings as it had been suggested he should had been, but was not, given.

- It was clear that that one or more of the entities (involved in the administration of the Keydata bond) failed to perform their function adequately. It was not fair or reasonable to conclude that the IFA should have known that would be the case in 2005.

- Although the adjudication had concluded that the Keydata bond was only suitable for the most experienced of retail investors. There had been no suggestion from the FSA (or reasonably competent advisers) at the time that this might be the case. In its view the risks outlined in the adjudication would be no greater than the risk of a product based on bonds equities or other commodities maturing at any given time, or products like the TEP portfolio managed by Mr R where there was a large and established secondary market.

- The assessment of risk posed by a particular investment involves the judgement of a professional, and the courts had consistently held that an error of judgement will not amount to negligence unless it was such as no reasonably well-informed and competent member of the profession could have made.

- It did not believe that Mr R was entitled to any form of compensation as it did not feel it had acted with completed disregard for Mr R's circumstances. It did not cause the loss which it said stemmed from operator fraud.

- Given Mr R's personal circumstances, the Keydata bond was a useful addition to Mr R's portfolio, diversifying it, and the risks to which it was exposed.

- It was familiar with the lead cases of Mr & Mrs K and Mr W published on our website. The circumstances of this case were closer to the circumstances in Mr W's case and no compensation should therefore be due.

As part of its response to the Financial Ombudsman Service, the IFA said that he had informed his Professional Indemnity (PI) insurers of the complaint, but its response had been that the complaint would not be covered under the terms of policy, as it contained an insolvency exclusion clause which had been activated by the insolvency of Keydata and SLS Capital SA.

The adjudicator reviewed the points made by the IFA and pointed out that many had already been comprehensively addressed in the adjudication. She explained that the remit of the Financial Ombudsman Service was set by Parliament and that its role was to decide complaints with a minimum of formality using a fair and reasonable test, which was different to that of a court.

Further, it was not in dispute that Mr R had approached the IFA for advice and was entitled to rely on the recommendation given by a professional financial adviser. The contention that Mr R should have interpreted and assessed the product suitability for himself ignored the fact that it was recommended by the IFA. Mr R was entitled to rely on that advice, and that was exactly what he had done.

Although the IFA maintained that the risks attached to the Keydata bond were modest, and the underlying assets were both commonplace and readily understandable, the adjudication had highlighted some of those risks. The adjudicator said it was unrealistic for the IFA to attempt to compare the structure of the Keydata bond with a life policy.

Moreover, Mr R would not have been in that class of investment if not for the negligent advice given by the IFA and would not have been exposed to those risks if the IFA had carried out his responsibilities properly. As such it was fair and reasonable to hold the IFA responsible for the unsuitable advice regardless of any arguments about a break in the chain of causation and the remoteness of loss.

Mr R's representatives also provided their response to the adjudication:

- Mr R had said he was at all times a cautious investor and was not prepared to risk his capital in anything other than low risk funds, particularly when he needed to make provision for his retirement.

- The fact that Mr R held substantial assets did not mean that he wanted to take any risks with any of his money and that was why he had sought advice from the IFA in the first place.

- The comments made by the IFA in terms of the reasons for surrendering the original holding were a complete fabrication of the actual facts. In a letter dated 23 February 2007 to the IFA, Mr R had discussed the cost of purchasing the capital guarantees which the holding offered, as well as the options to purchase and sell the fund at a later date to rebase the capital. Mr R was seeking to recover the cost of the guarantee as it had not materialised as expected.

**my findings**

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

I acknowledge the points about the IFA's insurance position, and any potential lack of cover. I note that it is investigating alternative avenues with the aim of securing indemnity cover. However, the business remains liable for any redress awarded at final decision (and accepted by the consumer) and it is legally bound to pay, not its PI insurer.

I also have to be mindful of what is fair to Mr R.

Mr R has complained that the recommendation which he received from the IFA was unsuitable. However we have considered complaints about Keydata funds before and published a decision which sets out our general approach to such complaints on our website. I note that the IFA is aware of those previous findings as it has discussed the lead decisions as part of its response.

Each complaint is reviewed on its own merits. The purpose of issuing lead decisions is so that our approach is generally known. That provides a business with the opportunity to review any complaint it may have about that particular product and address the complaint accordingly.

In the circumstances of Mr R's complaint – the IFA says that it has always treated Mr R as holding a cautiously realistic approach to investment risk. Its definition of 'cautiously realistic' refers to holding low risk investments, being wary of stock market investment, and wanting to benefit from long term investment returns.

It is difficult not to conclude from this description that Mr R was only prepared to consider low risk investments for the sum of money he was discussing with the adviser. That money was under discussion because the capital guarantee which Mr R thought he had secured had not materialised. That is persuasive evidence, in my view, of an investor looking for a measure of security in any capital invested.

The IFA has made the point that if I conclude that the advice was unsuitable that no compensation should be paid to Mr R. That is because there are more similarities to the case of Mr W published on our website where we concluded that no compensation was due.

In Mr W's case, he was advised to repay borrowing and invest in a range of different assets. The investment in Keydata represented a small proportion of the amount invested.

In Mr R's case, the investment made was as a result of selling an existing holding. There is a dispute about the reasons for the sale of that investment. The IFA says that Mr R was disappointed about the performance of the investment. Mr R said in a letter in February 2007 that he was disappointed because he had paid a fee to guarantee the investment. I prefer Mr R's reasons for surrendering the original investment. I am satisfied that guarantees were important to him.

Mr R had an outstanding mortgage and had invested a substantial sum in traded endowment policies and was projecting these would make significant returns. The IFA said the mortgage was to fund further purchases of endowment policies and the ongoing premiums. Mr R also had commercial properties and some investment in equities. There is no record of his circumstances completed at the time the investment in Keydata was made in 2005.

I am satisfied that Mr R already had assets that exposed him to some risk. The addition of the Keydata investment did not reduce the risk for Mr R's investments as a whole. In fact, this was a substantial proportion of the pension fund that was intended to provide income for Mr R in retirement. The £100,000 was also a substantial part of Mr R's SIPP.

The IFA agrees with the specific risks which set out in the adjudication, and contained in the Keydata product literature. Those risks were identifiable within the literature and my assessment is not made using the benefit of hindsight. Other Keydata bonds have failed largely because the underlying investment structure was found to be unsustainable, and were unconnected to the events which surround any misappropriation of assets from the SLS backed Keydata bonds.

The IFA should have independently assessed and scrutinised those risks before making a professional judgement as to the suitability of the Keydata bond for Mr R. I have read the latest assessment it provided as to its understanding of those risks, and having done so I agree that the IFA held a complete disregard for Mr R's circumstances and objectives when making that recommendation to invest in the Keydata bond.

Whilst I note the comments made concerning any break in the link between causation and the remoteness of loss, the plain fact is that Mr R would not have been in the Keydata bond, but for the recommendation given by the IFA. It was poor advice, and in my opinion given with a complete disregard for Mr R's circumstances and needs. Mr R should be compensated for that negligent advice accordingly.

**my final decision**

I have concluded that the IFA's recommendation to invest in the Keydata bond was not suitable for Mr R so I need to consider what fair compensation should be. Usually I seek to put the investor back in the position they would have been in but for the poor advice.

However, there is a problem with assessing the true value of the investment into the Keydata bond. That is because assets in the bond Mr R invested in were taken and have not been recovered. It is not clear what the inherent value of the SLS investments were before the misappropriation. It is therefore not clear what the relative contributions are, of the underlying investment performance and the misappropriation, to the overall position that there is no value for investors.

So I need to decide whether or not the misappropriation from the Keydata bond produces new circumstances where my normal approach to fair compensation should not apply.

I have taken note of the following information as available to me about the circumstances of this Keydata bond and the liquidation of SLS.

As I understand the position, the investments made by Mr R were part of the investments held by SLS Capital SA (SLS) registered in Luxembourg. Following its liquidation the Luxembourg based liquidator (Baden and Baden) announced that *"At this stage and with all due precaution, it does not appear that there are any remaining assets left."*

The UK administrator for Keydata (PwC) explains *"The underlying assets in relation to these plans were liquidated and misappropriated. This means that investors will not receive any income payments or return of their capital, unless recovery actions are successful. SLS Capital is now in liquidation."*

Following an investigation, the UK Serious Fraud Office (SFO) concluded in April 2011 that:

*"After extensive consideration we concluded that we had insufficient evidence to secure a prosecution in this case. As a result we decided to focus our efforts on tracing the assets of SLS Capital SA rather than attempting to prosecute. We are continuing to do this."*

In November 2012, the SFO confirmed that despite substantial effort to trace the assets, it has been unable to do so and it was unlikely to do so in the future. As a result, it closed its file.

What precisely occurred between 2005 and 2009 is not clear. However, given the findings of the SFO it seems that there is little (or perhaps more realistically no) hope of any value being recovered from the SLS managed Keydata bonds.

The position, however, is different from that of other Keydata products. The underlying assets associated with other Keydata funds are also seen (at least for the purposes of the Compensation Scheme) as having little or no value. While the issues with SLS caused significant financial damage to Keydata, I understand that there were also inherent problems with the investments associated with the other Keydata funds.

There is a further complication. As far as I can ascertain from the information available to me, there is no clear view about the inherent value of the SLS investments before the misappropriation. So it follows that is difficult to assess the relative contribution of the underlying investment performance, on the one hand, and the misappropriation, on the other.

My approach to cases such as this is difficult to describe in general terms – much depends on the particular combination of circumstances. But two points can be made:

First, no liability attaches to an adviser who has given satisfactory advice. Second, particular difficulties arise in assessing fair compensation when it seems clear that (as in this case) the consumer would not have been in that class of investment at all had it not been for the negligent advice. In such circumstances I might assess fair compensation to be awarded against the provider of the unsuitable advice to put the customer back in the financial position they would have been in but for the poor advice, notwithstanding that such an award may not be made by a court.

But I would need to be persuaded that such an approach represented "fair compensation" in the individual case. It seems to me that in assessing what represents fair compensation; I should have regard to the applicable legal principles. But I should also take into account the nature of the advice given and the impact of any award on the parties and reach a view on what I consider to be fair in all the circumstances of the case.

Mr R would not have been in this Keydata product but for the poor advice of the IFA – and he has suffered a significant loss of money. But I also need to be conscious of what is fair to the IFA. The IFA is and should be held to account for the poor advice it gave, but it was not responsible for the misappropriation of the funds; or for the fact that insurance was not in place to cover such an eventuality.

The legal principles of causation and remoteness that might be applied to cases such as this are highly case sensitive and I cannot be definitive about how a court might apply these principles. As such, the most I will be able to consider is what a court is likely to find, when confronted with this particular set of facts.

In my view, a court might consider that the available balance of evidence about the sequence of event reveals that there was an intervening force that caused (at least part of) Mr R's losses: namely the misappropriation. I also think that a court might find that there are no reasonable grounds for suggesting that the IFA could, in August 2005, have foreseen that the assets underlying the bond might be misappropriated by a third party.

Accordingly a court might conclude that Mr R's losses did not flow directly from the unsuitable advice on the part of the IFA. And on this basis a court might not require the IFA to compensate Mr R for the losses he has incurred notwithstanding the clearly unsuitable advice the IFA gave.

But in assessing fair compensation, I am not limited to the position a court might reach. I think there are other factors in cases such as these, given in particular the specific circumstances of financial investments and advice that I should consider.

In particular, it seems to me that in assessing fair compensation, I should take into account the nature of the advice that has been given. In the present case, I consider that the IFA had a complete disregard for the interests of its client in giving this advice.

It is frustrating that in the present case the evidence available to me from the relevant authorities here and in Luxembourg is not sufficient to make a wholly reliable assessment of the underlying value of the bonds or the impact the misappropriation had on the value of the investment.

However, in all the circumstances of this case, I cannot lightly ignore the fact that Mr R would not have been exposed to these risks had the IFA carried out its responsibilities properly.

Taking all these factors into consideration, I conclude that I should assess fair compensation in this case as putting Mr R back into the position he would have been had he not followed the advice to invest in the Keydata bond. I say this because of:

- the nature of the advice the IFA gave was in my view clearly in error;

- its assessment of the needs of Mr R and of the suitability of the product generally paid complete disregard to his interests;

- this was simply a class of investment that he should not have been in and would not have chosen but for the IFA's recommendation;

- the fact that there appears to be an inherent and significant weakness in the investment model used by Keydata. Other very similar Keydata bonds failed largely as a result of factors other than this misappropriation; and

- what I consider to be a fair outcome to this complaint.

Accordingly, I conclude that it would be fair and reasonable to make an award in the particular circumstances of this case – regardless of any arguments about a break in the chain of causation and the remoteness of the loss from the (poor) advice given.

Having considered the factors that I have set out in this decision, I reasonably conclude that I should assess fair compensation as putting Mr R back in the position he would have been in, had he not followed the advice to invest in the bond.

I have also considered what award I should make in respect of interest given that, as outlined above, Mr R's loss crystallised on 13 November 2009. My normal approach is to award 8% simple per year (before tax) on crystallised losses, unless it is clear that another rate would more accurately reflect the costs to the particular consumer for being out of the money concerned.

The 8% figure is not intended to be an interest rate in the way that a bank deposit account pays interest. Rather it is a rate which I consider to be a fair yardstick for compensating consumers for a wide range of possible losses and lost opportunities they may have incurred. The consumer might, for example, have:

- borrowed money, or continued to borrow money, at credit card or loan rates which they would not have done if the money had been available to them;

- saved or invested the money in some way producing a variety or possible returns;

- spent the money on holidays, home improvements, or any number of goods which might have given them an unquantifiable return;

- or any combination of these things.

The 8% simple interest rate is gross and is subject to tax – and is a rate often (but not always) used by the courts in not dissimilar situations.

At the time he invested his money, Mr R was 63 and continued to work. This was separate to the retirement planning assets held in the SIPP. The loss crystallised four years later.

However, Mr R did have certain assets. So, whilst the crystallised loses will have given rise to distress and potentially inconvenience to Mr R I think the extent of his assets at the time, suggest that a rate of 8% might be excessive in this case. I therefore consider that a fair rate of interest is 2.5% simple per year following the crystallisation of the loss in November 2009 or the date of any income payment if later.

Where I decide that a complaint is upheld, I have the discretion to make a money award requiring a financial business to pay fair compensation plus any interest and/or costs that may be appropriate. If I consider that fair compensation exceeds £100,000, I may recommend that the business pays the balance.

**determination and award**

I consider that fair compensation should be calculated as follows:

A = the capital invested (£100,000), less any amounts paid out by way of withdrawals, distributions of capital or before-tax income;

B = a return on the amount from time to time of A by way of capital growth equivalent to 1% more than Bank of England base rate compounded yearly from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised) or the date of the last income payment, if later;

C = the residual value of the investment that Mr R made in the Keydata which I assess to be zero for this purpose.

D = A+B-C

For clarification, A and B above should work as follows. Any sum paid into the investment should be added to the calculation from the point in time when it was actually paid in so it accrues the 'reasonable rate of return' within the calculation from that point on.

Any reduction to the investment (excluding the final encashment payment) should be deducted from the calculation at the point in time when it was actually deducted so it ceases to accrue the 'reasonable rate of return' within the calculation from that point on.

In relation to C, I understand that the fund cannot be encashed. For that reason, as set out above, for the purposes of C the investment should be treated as having a nil value.

However, this is provided that the holding can be transferred and the trustees of Mr R's SIPP agree to the IFA taking ownership of the investment if it wishes to. The IFA would then be able to obtain any value of the investment as and when that value can be realised plus any distributions made from it.

Should such a value/distribution mean Mr R recovers in excess of the compensatable loss; the scope of that assignment or undertaking should be as follows:

If the compensatable loss exceeds £100,000 and the IFA does not adopt the recommendation and pay the award in full, any assignment or undertaking should only concern itself with any amounts in the distribution which are in excess of the full compensatable loss as calculated.

To identify this amount, the IFA should deduct £100,000 (the amount of Mr R's money award) from the 'compensatable loss'. This is the amount that Mr R is entitled to receive by way of future value and/or distributions. Any value or distributions that might be made over and above this amount may be assigned to the IFA or Mr R can provide an undertaking to return those sums, if the IFA decides to take a transfer of those rights.

If possible the redress should be paid into Mr R's SIPP. If it cannot be paid into the pension arrangement it should be paid to him as a cash sum. My understanding is that the payment of compensation is not liable to income tax. But, if Mr R pays the compensation into a pension he will be entitled to tax relief at his marginal rate of tax. I think the compensation should be reduced by 20%.

If the compensatable loss exceeds £100,000 and the IFA decides to adopt the recommendation and pay the entire compensatable loss, the IFA is entitled to take, if it wishes, an assignment of the rights to all future value and distributions of the investment or obtain an undertaking from Mr R to repay any amounts received.

I would ask Mr R to note this carefully. Mr R will need to cooperate with the IFA to enable it to make the necessary calculations and in order for it to take ownership of the investment if it wants to.

If there is a difficulty in arranging the transfer of ownership of a particular holding, then Mr R should (as an alternative) arrange for a letter of undertaking agreeing to pass any future value received from the affected holdings to the IFA.

**recommendation**

My recommendation is that the IFA should pay Mr R the amount produced by that calculation (that is amount D) up to a maximum of £100,000. To that sum (D) the IFA should add interest from 13 November 2009 (or the date of the last income payment if later at the rate of 2.5% simple per year until this award is paid.

If the amount produced by the calculation of fair compensation exceeds £100,000, I recommend that the IFA pays Mr R the balance.

If the IFA considers that it is legally obliged to deduct income tax from the interest element of my award (i.e. the interest added to D), it must send a tax deduction certificate with the payment.

A small number of consumers have accepted an ombudsman's final decision and have then attempted to go to court to ask for further compensation in excess of our maximum limit. But the law on whether or not this is possible is uncertain. Mr R may want to consider getting independent legal advice if the compensation exceeds our limit.

Mr R should also read our factsheet "compensation over £150,000", which explains our current award limit and the lower limit of £100,000 for complaints referred to this service before 1 January 2012. It also explains certain implications of accepting our ombudsmen's decisions. The factsheet can be found in the *consumer factsheets* section of our *online technical resource* which can be found by clicking the *publications* tab.

Roy Milne
**ombudsman**