Financial Ombudsman Service

complaint

Mrs C complained that advice she received from The Prudential Assurance Company Ltd in 1996 to effect an endowment savings policy to which she paid a monthly premium of £40.00 over a term of 14 years was unsuitable for her. She is represented in her complaint by a third party adviser.

The policy matured in August 2010 with a final value of £8,450.84 after Mrs C had paid total premiums of £6,720.00.

The business upheld her complaint as it was not satisfied that a policy which included life cover was appropriate and assessed whether or not she had suffered a financial loss at maturity when compared with the return she might have received from an alternative product that did not include charges for life cover. In the event, the business concluded that Mrs C had suffered no financial loss at maturity if she had received interest on her premiums at the rates payable on its 90-day notice account throughout the policy term.

Mrs C's representative said that this loss calculation was not appropriate as the business had concluded that Mrs C did not require life cover and not that she did not wish to invest. It submitted that the correct method for the calculation of her loss should compare the return she would have received from her premium assuming a rate equivalent to 1% above Bank of England base rate and the maturity value of the policy she effected. Any loss at maturity should then attract interest to-date at the rate of 8% per annum simple.

background

Mrs C's complaint was investigated by one of our adjudicators, who concluded that it should be upheld because he was satisfied that the consumer would have still invested her premiums, albeit in a product that did not include deductions for life cover she did not require.

Therefore, his initial view was that the business should use a return equivalent to 1% above the Bank of England base rate to establish whether an alternative product would have provided a greater return than the maturity value of her policy.

In response, the business did not agree with the adjudicator's view and referred to a relevant case study in Ombudsman News which concluded that the consumer in similar circumstances would have left his money on deposit. It also referred to Mrs C's representative's point that the endowment policy was not suitable for her attitude to risk.

The business also stated that it was not possible to determine what alternative investment Mrs C would have effected had she not taken out the investment and therefore it feels that, on balance, the basis it adopted for its loss assessment is fair and reasonable.

In response, the adjudicator reconsidered his view that a comparison with the return equivalent to 1% above Bank of England base rate may not be appropriate for an investor as this return does not incorporate any element of risk. He believed that using a 'benchmark' or 'index' incorporating an average return from fixed rate bonds and the APCIMS index more accurately reflected the degree of risk Mrs C was prepared to take to establish her financial position at the policy's maturity date.

The business responded that it was inappropriate in this complaint to apply these recently adopted guidelines to resolve a complaint the business had investigated in September 2011.

It requested the ombudsman to consider whether its original loss assessment was reasonable in the circumstances or whether this should be amended to take account of returns equivalent to 1% above bank of England base rate.

As no agreement has been reached in this complaint, it has been referred to me for review.

findings

I have considered all the available evidence and arguments from the outset, in order to decide what is fair and reasonable in the circumstances of this complaint. Having done so, I find that I agree with the most recent conclusions reached by the adjudicator, and for essentially the same reasons.

As the business has upheld Mrs C's complaint and carried out a loss assessment, the issue I have considered is whether this assessment is fair and reasonable in the circumstances of her complaint.

According to the documentation completed at the point of sale in July 1996, the endowment savings plan was advised as a replacement for a similar policy Mrs C wished to surrender to release capital due to a change in financial circumstances. While she had paid £30 per month to this policy, which was also due to mature in 2010, there is no evidence that Mrs C had complained about the sale of this policy. Therefore, as far as the adviser was concerned, it appears that he was simply replacing 'like-with-like'.

However, it was recorded that Mrs C wished to save for the future and, as she was in her late 40s at the time, life cover charges within the policy were likely to be significant as to compromise the potential of the policy realising a reasonable rate of return at maturity. In my view, therefore, it was not appropriate simply to replicate a previous policy she was intent on surrendering.

The business has upheld the complaint because the policy included life cover Mrs C did not require, and not because it represented a degree of risk she did not wish to take. Mrs C already received substantial life assurance benefits within her company pension scheme. While her attitude to risk is not recorded, it is reasonable to assume that she was willing to take some risk with a modest regular premium given she had a healthy monthly disposable income.
I am persuaded, therefore, that, but for the advice she received, Mrs C would have invested in a product that offered potentially greater returns than a bank or deposit-based account in return for a small degree of risk. The 'flowchart' in the factfind that refers to her savings need confirms that she did not wish to take a greater risk with her savings than a small degree of risk.

Therefore, I do not consider that comparison with a 90-day notice account or with the returns she could receive by applying 1% above Bank of England base rate would be appropriate in this case.

I am satisfied that the adjudicator's reasoning for choosing a 'benchmark' or 'index' rate is more pertinent to the degree of risk Mr C intended to take. I note the point made by the business that it was inappropriate in this complaint to apply redress guidelines recently adopted by this service to resolve a complaint the business had investigated in September 2011.

However, it has always been open to this service to award redress on a basis that most closely matched the nature and purpose of the type of investment the consumer would have effected. This does not mean that reference to Bank of England base rate would be appropriate in all cases, particularly where a consumer is prepared to take some degree of risk.

fair redress

To compensate Mrs C fairly, the business should put her as close to the position she would probably be in now but for the advice she received. I believe that Mrs C would have invested differently, although it is not possible to say *precisely* what she would have done differently. However, I am satisfied that the following basis of redress is fair and reasonable given her circumstances and objectives at the point of sale.

what should the business do?

The business should compare:

- the value of Mrs C's policy at maturity

and

- the position she would now be in if 50% of this amount had produced a return matching the average return from fixed rate bonds and 50% had performed in line with the APCIMS Stock Market Income Total Return Index ('APCIMS index').

If there is a loss, the business should pay this to Mrs C, plus interest at the rate of 8% per annum simple on this loss when the policy matured to the date of settlement.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mrs C wanted a worthwhile return with a small risk to her capital.
- The average rate is the rate for fixed rate bonds with 12 to 17 months maturity (as published by Bank of England). The APCIMS index is a mix of diversified indices representing different asset classes, mainly UK equities and government bonds.
- The average rate would be a fair measure for someone who wanted to achieve a reasonable return without risk to her capital. The APCIMS index for one who was prepared to take some risk to get a higher return.
- I consider that Mrs C's risk profile was such that she was prepared to take a small level of risk to attain his investment objectives. So, the 50/50 combination would reasonably put her in that position.
- This does not mean that Mrs C would have invested 50% of her money in cash and 50% in some kind of index tracker fund. Rather, I consider this a reasonable compromise that broadly reflects the sort of return she could have obtained from investments suited to her objective and risk attitude.

how to calculate the compensation

The compensation payable to the consumer is the difference between the *total fair value* and the *actual value* of his investment. If the *actual value* is greater than the *total fair value*, no compensation is payable.

actual value

This means the value of the policy at the date of maturity.

total fair value

This is value of the policy at the maturity date if the premiums had obtained a return using the method of compensation set out above. It is the total of ‘average rate element’ and ‘APCIMS index element’.

<u>average rate element</u>

To arrive at this value the business should:

- Find out the average rate for fixed rate bonds, as published by the Bank of England, for each month from the date of investment to the maturity date of the policy;
- The rate for each month is that published at the end of the previous month;
- Use the rate for each month to calculate the return for that month on 50% of the relevant portion of the investment;
- The calculation should be carried out on an annually compounded basis; that is, with the return added to the investment at each anniversary.
- Work out the value to the date of my decision.

<u>APCIMS index element</u>

To arrive at this value the business should:

- Work out the value of 50% of the policy if it had performed in line with FTSE APCIMS Stock Market Income (Total Return) index to the maturity date of the policy.

further information

- The information about the average rate can be found in the “Statistics” section of the Bank of England website. It is available under the section headed Interest and Exchange rates data / quoted household interest rates / fixed rate bonds / one year.
- The information about APCIMS index can be found in the website of the Association of Private Client Investment Managers and Stockbrokers or the FTSE Group.

final decision

My final decision is that I uphold Mrs C’s complaint and that The Prudential Assurance Company Ltd should pay Mrs C redress in accordance with the method set out above.

Kim Davenport
ombudsman