complaint

Mrs A has complained that advice she and the late Mr A received from Bradford & Bingley plc ("the business") in 2000 to invest £50,000 in an investment bond and in 2002 to invest a further £50,000 in two investment bonds with different providers in equal shares was unsuitable. Each bond invested in the with-profits fund. She is represented in her complaint by a third party adviser.

Specifically, her representative has said that Mrs A and the late Mr A sought financial security for their capital saved from their regular earnings. They wished to invest initially for capital growth, and then for income when they were due to retire. They were not risk–takers, and Mrs A only discovered the risks involved in these investments when she surrendered the bonds in 2008 and a market value adjuster (MVA) applied to the fund values on surrender.

background

Mrs A's complaint was investigated by one of our adjudicators, who concluded that the complaint should be partially upheld. Briefly, he considered that the choice of an investment bond, investing in the with-profits fund, itself was not unsuitable for their financial requirement or inconsistent with their 'cautious' attitude to risk. He also noted that the documentation completed at the point of sale did set out the risks associated with this type of investment in understandable terms, including the potential for a MVA to be applied in the event that the bonds are surrendered.

While the adjudicator was satisfied for Mrs A and the late Mr A to invest £50,000 of their available capital in 2000, he was inclined to believe that the advice to invest a further £50,000 in 2002 placed too much of their available capital in risk-based products.

Accordingly, he recommended that the business should offer Mrs A redress on the assumption that only £25,000 should have been invested in the with-profits bond in 2002, with the remainder receiving a return equivalent to that available from fixed rate bonds.

In response, Mrs A's representative did not accept the adjudicator's assessment and said that:

- With regard to the advice given in 2000, the choice of the with-profits fund was not an issue; however, the amount committed to investment of almost 50% of their available capital was too great;
- Also, Mr A was only four years from retirement and their capacity to replace any losses to such a large portion of their capital savings would have been limited;
- Following the advice they received in 2002, almost 86% of their total capital savings was held in risk-based investments which exposed too much of their capital to the risks associated with a with-profits fund when they were both close to retirement;
- Mrs A does not accept the offer made in the assessment. She says that they were very cautious investors and the capital they held on deposit was acquired by working overtime and through careful saving to build a nest egg for their retirement. They only agreed to invest on the understanding that they would suffer no capital losses when they needed access to their funds;
- Mrs A requested that the whole of the advice they received in 2000 and 2002 should be considered unsuitable and that redress should be based on the return they could expect to have received from their total investment of £100,000.

In reply, the business did not accept the assessment either, pointing out that Mrs A and the late Mr A had previously held a with-profits bond and were comfortable with this type of investment. It has also stated they were warned of the exposure to risk-based investments, and after they accepted the advice in 2002 they still retained sufficient capital on deposit.

Mrs A's representative made additional points that:

- Mrs A and the late Mr A were unsophisticated investors; not risk-based, lump sum investors;
- They required capital security and were unaware of how a market value adjuster (MVA) might be applied and its consequences;
- Too much was exposed to these 'non-qualifying' policies which were not suited to their tax position and affordability. 20% tax was being deducted from the funds profits which they could not reclaim and this deduction would not have occurred had ISA based with-profit or corporate bonds funds been recommended;
- The funds recommended lacked adequate diversification, which heightened the risk of poor fund management and the possible effects of an MVA;
- The long term nature of the bonds and amount invested was likely to reduce their age allowance received at age 65;
- The potential for tax free income from ISA based funds was not discussed;
- Alternative and tax efficient pension funds were not considered;
- Mrs A received her state pension at 60 but was intending to continue working beyond this age. Since Mr A died in 2008 she has had to work part-time to survive. She relied on state pension for income. Their investments were intended to see them through their retirement;
- She surrendered the bonds because Mr A had died and she needed the funds. She was not informed about MVAs or the tax implications;
- She is not able to quote the surrender values she received or the penalties that applied to the fund values at the time other than "it was thousands".

As an agreement has not been reached on the matter, 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 conclusions reached by the adjudicator, and for essentially the same reasons.

The basis of the original advice given to Mrs A and the late Mr A is that they wished to invest for capital growth before considering 'phased' retirement from age 60 by making use of their state pension entitlement, income from their savings and investments and working part-time. They estimated that they would require an income in retirement of approximately 40% and 70% of their respective incomes at the time. They had accumulated a substantial capital sum on deposit through a disciplined approach to saving from their income.

Significantly, they already held a with-profit bond since 1995 worth approximately £35,000 by 2000, which would indicate that they did have previous experience of risk-based investments (and the same type of product, in particular, representing a similar degree of risk). Mrs A and the late Mr A wished to invest further capital they held on deposit by adopting a 'cautious' attitude to risk.

Given neither Mrs A nor the late Mr A had any pension provision other than basic state pension, it is likely that, in 2000, if they were contemplating retirement from age 60 on a reduced income, they would still expect to rely on income from other sources, especially as the late Mr A would not become eligible for basic state pension for a further five years. As it is, sadly, Mr A died before he reached state pension age.

In their circumstances in 2000, it is likely that they would hold any investments for the longer term, initially for capital growth and then for income from age 60 to supplement state pensions and continued income from employment.

Mrs A and the late Mr A were advised to invest approximately 59% of their available capital sum in a With-Profit bond, which increased their holding in ‘cautious’ risk-based investments to approximately 70%, with the remaining 30% held in instantly accessible deposit accounts.

By 2002, they had increased substantially their capital savings from disposable income and both of their With-Profit bonds had increased in value.

Although they were both within five years of their intended retirement age, they were content to continue investing cautiously for capital growth for five years or more with the intention of drawing an income in the future, if required.

Accordingly, they agreed to invest a further sum of £50,000 equally across two further with-profit bonds. This advice increased their holding in these bonds to around 86% of their total capital savings.

On balance, I am satisfied that the advice Mrs A and the late Mr A received in 2000 was suitable for their needs as it allowed them to achieve a worthwhile return from a ‘cautious’ fund which did invest in a diverse range of assets. Neither of them was eligible for state pension for at least six years, and their joint income and capital they retained on deposit following the advice did not leave them vulnerable financially.

I am inclined to agree with the adjudicator that the advice they received in 2002 did ask them to invest too much capital from the additional savings they had accumulated from income in the two years since they were first advised. This left them with only 14% of their total capital savings in instantly accessible deposit accounts, although it is likely that the proceeds from the original bond they took out in 1995 would be available free of penalties unless an MVA applied at that time.

With regard to the potential application of an MVA deduction on surrendering these investments, notwithstanding that they already held a similar investment since 1995 to know how these products operated, the nature of a MVA, and the circumstances under which one would apply, was set out by the adviser in each of the suitability letters he provided in 2000 and 2002.

I might be inclined to question an investment in a with-profit fund if an investor requires the proceeds at a specific point in the future, for example, at retirement, when the possibility exists that an MVA could apply when they needed the money. However, the future plans of Mrs A and the late Mr A appeared to be quite flexible as to how and when they would use their bonds for income in retirement. Regardless, the bonds were intended to provide an income and not to be surrendered in full.

Even though Mrs A and the late Mr A were not intending to access their bonds for income for at least six years from 2000, and the late Mr A was not eligible for basic state pension until around nine years' time, they still appeared to be able to save a substantial part of their income between 2000 and 2002. In other words, it seems that they could live off a modest income.

Therefore, as the late Mr A died before he was eligible for basic state pension, I am unable to appreciate why Mrs A needed to surrender all the investment bonds in full, given she would have been receiving her state pension by then and she still held a substantial capital sum in instantly accessible deposit accounts. This was not her intention in 2000 or 2002 (when she confirmed that she could live off 40% of her earnings). Accordingly, if her financial position has recently changed to the extent that she required the capital sum provided by all these bonds, this requirement differs from the evidence that existed at the point of sale which indicates that she required a very modest income in retirement.

In any event, I do not agree with Mrs A's representative's point that any taxable gain (as it is calculated) when all the bonds were surrendered was likely to jeopardise her age allowance if she was only in receipt of state pension. I do not believe that the advice should be assessed by reference to the tax consequences of the gains Mrs A might have made on surrendering the bond they took out in 1995.

On balance, I am satisfied that the advice Mrs A and the late Mr A received was not unsuitable if they had had invested £25,000, rather than £50,000, in 2002, i.e. £12,500 in each of the two bonds, thereby leaving them a more appropriate level of capital on deposit.

fair compensation

To compensate Mrs A fairly, Bradford & Bingley should put her as close to the position she would probably now be in if they had not been given unsuitable advice.

I think Mrs A and the late Mr A 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 requirements, in July 2002.

what should the business do?

To compensate Mrs A fairly, for each bond effected in 2002, Bradford & Bingley should

compare

- the performance of 50% of the investment in each the bonds

with

- the position Mrs A would be in if that 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 on its website since 2002 over the same period of time

If there is a loss, Bradford & Bingley should pay this to Mrs A, plus interest on this loss from the date each investment was surrendered to the date of settlement.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mrs A and the late Mr A wanted to achieve a reasonable return without risking any of their capital;
- They were prepared to invest for a longer period of time, but with some flexibility;
- The average rate would be a fair measure given their circumstances and requirements. It does not mean that they 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 their capital;
- The interest on the loss from the date surrendered is for being deprived of the compensation money since that date.

how to calculate the compensation

The compensation payable to Mrs A is the difference between the *fair value* and the *actual value* of her investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

If there is compensation to pay, simple interest should be added to the compensation amount at 8% each year from the date surrendered to the date of settlement. Income tax may be payable on this interest.

actual value

This means the actual value of 50% of the investment in each bond at the date they were surrendered.

fair value

This is what that investments would have been worth if they had obtained a return using the method of compensation set out above. To arrive at this value Bradford & Bingley should:

- find out the average rate for fixed rate bonds, as published by the Bank of England, for each month from the start date of each investment to the date they were surrendered
- 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
- the calculation should be carried out on an annually compounded basis; that is, with the return added to each investment at each anniversary
- work out the value to the date surrendered

additional capital

50% of any additional sum that Mrs A and the late Mr A paid into the investment should be added to the calculation from the point it was actually paid in.

withdrawals and income payments

50% of any withdrawal or income payments that Mrs A and the late Mr A received from the investment should be deducted from the calculation at the point it was actually made so it ceases to accrue any return in the calculation from that date.

If there are a large number of regular payments, to keep calculations simpler, I will accept if the business adds all those payments to the *actual value* and compares that total with the *fair value* instead of periodically deducting them.

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.

decision

My final decision is that I uphold Mrs A's in part.

I require Bradford & Bingley plc to pay Mrs A redress calculated on the basis set out above.

Kim Davenport
ombudsman