

## **complaint**

Mrs C has complained that she was advised to invest by Care Asset Management Limited in a Keydata product when the provider was already in financial trouble and on the point of entering receivership. Mrs C has also stated that it was not suitable to have invested £100,000 of her capital, considering her circumstances and fragile financial position. She was reliant on the money for income, it has been stated, and it was unlikely that the capital could ever be replaced if she incurred losses.

## **background**

The circumstances leading to this complaint, and my initial conclusions, are set out in my provisional decision of 2 May 2013, a copy of which is attached and forms part of this final determination.

I invited both parties to let me have any further comments they wished to make. The IFA responded and disagreed with my provisional decision. It pointed out that I had stated within that decision that Mrs C had applied for and received compensation from the Financial Services Compensation Scheme (FSCS). The IFA understands that Mrs C would have assigned her rights to complain about the investment to the FSCS and that the FSCS was taking legal action to recover its compensation payments. The IFA has referred to another complaint which was dismissed by this service because the consumer had received compensation from the FSCS and had assigned their rights in the process. As such, it is of the view that this complaint should be dismissed on the same basis.

Mrs C accepted the provisional decision and made no further comments.

## **my findings**

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

As part of our investigation of Mrs C's complaint, we became aware that Mrs C had successfully claimed to the FSCS and received compensation for her Keydata investment. This was because the file from the IFA indicated that it had written to its clients, including Mrs C, in September 2010 notifying them of their opportunity to apply for compensation from the FSCS. Additionally, it was the case that Mrs C actually wrote to the IFA in December 2010 and asked for her complaint to them to be suspended whilst her claim to the FSCS about the Keydata plan was investigated.

Accordingly, it is my understanding that, by accepting the payment of compensation, Mrs C would have assigned to the FSCS her rights to complain about the Keydata investment against any relevant third parties such as the IFA. This usually allows the FSCS to recover from these particular third parties any amounts it has previously paid out as compensation.

Therefore, before proceeding with the complaint, we would require the consumer to arrange with the FSCS for their rights to be reassigned back to them. In this case, Mrs C did arrange with the FSCS for her rights to be transferred back to her and she sent us the relevant document of reassignment completed in September 2011 which had been signed by her and the FSCS. On the basis of this, we have been able to continue with our investigation of Mrs C's complaint.

As a result, Mrs C's eligibility to bring a complaint to us, and my ability to issue a final determination on the matter, is not in doubt and it would therefore not be appropriate for me

to dismiss the complaint. However, as I have said in my provisional decision, the interest payable within the direction for redress needs to take into account the compensation Mrs C has already received from the FSCS and this is explained in more detail within the section which deals with the award.

As neither party has raised any additional points regarding the actual merits of the case, I see no reason for me to depart from the conclusions set out in my provisional decision.

**my final decision**

My final decision is that I uphold Mrs C's complaint and I direct Care Asset Management Limited to pay her compensation in accordance with the calculation of redress as detailed in my provisional decision.

Philip Miller  
**ombudsman**

## PROVISIONAL DECISION

### summary of complaint

Mrs C has complained that she was advised to invest in a Keydata product when the provider was already in financial trouble and on the point of entering receivership. Mrs C has also stated that it was not suitable to have invested £100,000 of her capital, considering her circumstances and fragile financial position. She was reliant on the money for income, it has been stated, and it was unlikely that the capital could ever be replaced if she incurred losses.

### background to complaint

The adjudicator was of the view that the complaint should be upheld, stating in summary that, given Mrs C's circumstances, lack of investment experience and requirement for a "secure" investment, the recommendation to invest in the Keydata plan was unsuitable. The adjudicator further stated that the plan itself and the risks were complex and these would also have been difficult for Mrs C to understand.

The IFA disagreed with this assessment for the following reasons.

- The adjudicator's view that the Keydata investment had represented a significant risk to capital had been reached with the benefit of hindsight. There had been several studies on life settlements which had not reached the same conclusion, including the modelling provided by KPMG and the Merlin Stone report dated October 2007.
- Mrs C was recommended an investment that offered a fixed return over a fixed term. It was also listed on a recognised exchange and was traded daily and contained assets which had a credit rating of no less than "A-". The underlying activities to which the funds were deployed were of secondary importance. Essentially, the investment was a corporate bond, which is universally accepted as low risk.
- A life settlement fund is arguably significantly less complex than the risk factors associated with equity investments. This is because of the implications of global economics, Government fiscal policy, corporate management and the complex actions of fund managers.
- Whilst it has been argued by the adjudicator that it would have been difficult for Mrs C to understand the risks of the investment, the suitability report described the scenarios under which the return of the capital was at risk.
- Mrs C was not a naïve and vulnerable investor. The IFA's records demonstrated that she received a significant part of her income through dividends from her family business, of which she was a director. Mrs C's son was also involved in the decision to invest in the Keydata plan and both of them were participating in on-going discussions with their accountants concerning the business and their personal tax planning.
- Mrs C was aware that her required level of income may have been unsustainable without ongoing drawdown of capital, but she was prepared to accept this to maintain her lifestyle.

- It has been assumed by the adjudicator that Mrs C would have had her original capital, plus a reasonable rate of return, had she not invested. However, there was no evidence to support how Mrs C would otherwise have invested and the return she required was higher than that available at the time on a risk-free basis.
- The view expressed by the adjudicator, in that consideration had not been given to the effect of the product's failure on Mrs C's financial position, was rejected. Furthermore, the product did not fail and there are on-going negotiations with the administrator as to the restructuring of the investment, which could return the capital and the promised yield.

After receiving a copy of the adjudicator's written assessment and the response from the IFA, Mrs C made the following comments:

- It was reiterated that Keydata was already in serious financial trouble when she was advised to invest her money.
- Mrs C considered that the IFA should have advised her to only invest half the recommended amount so she would be protected by the FSCS. Mrs C was not made aware of the FSCS limit on compensation.
- Regarding Mrs C's financial experience and background, it was stated that she had never been a business woman in charge of finances. All financial affairs were conducted by her late father-in-law and late husband. She was a director of the family company in name only. Since the death of her husband, her son had not been able to help her, which is why she relied on the IFA for suitable advice.
- Mrs C also stated that, over the last 30 years, she has been a carer and she now lives in a small rented flat for which she pays £780 a month. She receives £1,000 a month from her state pension and investments and so has needed to draw down on the funds paid to her by the FSCS to subsidise her living costs.

I must decide this case on its individual merits. However we have considered complaints about Keydata bonds before and published a decision which sets out our general approach to such complaints on our website. The decision is in the investment section of our online technical resource which can be found by clicking the publications tab.

### **my provisional findings**

I have included above only a brief summary of the complaint background, but I have read and considered all the evidence and arguments available to me from the outset.

When considering what is fair and reasonable, I am required to take into account relevant: law and regulations; regulator's rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

I am therefore mindful of the general legal position including: the law relating to negligence, misrepresentation and contract (including the express or implied duty on professional IFAs to give advice with reasonable skill, care and diligence); and the law relating to causation and foreseeability.

There is no dispute that this was an advised sale of an investment product where the IFA assessed the suitability of the product for Mrs C. As the IFA gave advice about regulated investments, I have taken account of the regulatory regime that applied at the time which includes the relevant FSA principles and rules on how an IFA should conduct itself.

Therefore, taking the relevant considerations into account, it seems to me that the overarching question I need to consider in this case is whether the recommendations given were suitable for Mrs C in her particular circumstances.

In doing so I need to take into account the nature and complexity of the investments and Mrs C's financial circumstances, needs and objectives; understanding and relevant investment experience; and tolerance to investment risk.

Mrs C invested £100,000 in the Keydata Defined Income Plan (issue 8). The product provider Keydata Investment Services Limited (Keydata) acted as Mrs C's agent and purchased the plan. The issuer of the plan was Lifemark, which was a Luxembourg based special purpose vehicle.

When Mrs C met the adviser in January 2009, a record of her personal and financial circumstances was made as follows.

- Mrs C was aged 70 and had been widowed for several years.
- Mrs C had an annual income of approximately £9,000 and expenditure of £32,000.
- The income consisted of a pension of approximately £8,000 pa with the remainder formed of an annuity
- Mrs C's expenditure included rent of £12,000 pa and household expenses of £7,000.
- Mrs C had savings of approximately £140,000 and personal investments amounting to approximately £32,000.
- Mrs C was recorded as having a "secure" risk profile.

The IFA also made a separate note of the meeting. It was stated that Mrs C had recently inherited a lump sum, but it was also noted that her living expenses exceeded her income and that she was a director of the family company, from which she received a dividend. The IFA also recorded that Mrs C and her son wished to improve her income without taking a high level of risk.

It was recorded within the fact find that Mrs C's "secure" risk profile was the third lowest category out of eight. It was indicated as being a higher risk than "protected" and "negligible risk" but lower than "secure plus" and "cautious".

Following this meeting, the IFA sent a letter to Mrs C on 11 February 2009. It recommended that Mrs C invest £50,000 in a fixed rate account. It proposed that she invest a further £20,000 in a Halifax saver account so that both accounts would pay total interest of £1,900 pa. The IFA stated that Mrs C could make withdrawals of £14,400 pa from an offshore investment bond held by the family company, but there would still be an income deficit of £6,200 pa. It was confirmed that the deficit would need to be met by the balance of Mrs C's remaining capital of £100,000 and, as a result, the IFA recommended the Defined Income Plan. £14,400 of this was to be invested within ISA wrappers over two consecutive tax years.

It appears to me that the overall objective was to restructure Mrs C's available capital to produce a higher income which would assist her in meeting her annual requirement. Notably, it was intended that the capital would be invested to be consistent with her "secure" attitude

to risk. Notwithstanding what I consider to be the somewhat confusing differences between the “secure”, “secure plus”, “protected”, “cautious” and “negligible” risk ratings available to Mrs C, I am of the view that she would have been entitled to believe, by virtue of a generally accepted definition of the word “secure”, that she was investing in a very cautious manner.

This would be consistent with Mrs C’s overall circumstances, in that she was retired and would be reliant upon the capital she had to not only produce income, but also cater for other needs which may arise. So, I need to consider whether the Keydata plan represented a higher risk than Mrs C was willing, or in fact in a position, to take.

The ‘Risk Factors’ section of the plan key features gave the different risks for the plan. The potential problems with these types of investments are now well known. So it is important to avoid the benefit of hindsight in the assessment of these matters today. That said, in my view, it was clear from the description and the other information reasonably available to the IFA at the relevant time that the plan 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.

It is helpful to set out a description of the investment. I note the Financial Services Authority (FSA) 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 life settlement products. The FSA’s Final Notice in respect of Norwich and Peterborough Building Society dated April 2011 provides a helpful summary in slightly more accessible terms of the same plan:

*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”). N&P offered a further 22 Keydata Products which were investments in bonds issued by Lifemark SA (“Lifemark”).*

*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, and 70% policies/30% cash for the bonds issued by Lifemark. SLS and Lifemark each 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.*

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.*

These concerns were apparent (or should have been) to a financial professional at the time and should have been taken carefully into account in assessing the suitability of the Keydata Defined Income Plan. Accordingly in my view, to a professional IFA, this investment would have needed to be suitable for a very cautious investor like Mrs C.

Indeed, given only what was known, or should have been known, about the Keydata investment by the IFA at the relevant time, I have real doubt - given the opaque nature of the investments and the significant uncertainty around accurate valuation and liquidity - whether such a fund would have been suitable for all but the most experienced of retail investors, and certainly not for an investor such as Mrs C.

It is not sufficient in my view for the IFA to simply assert it relied on the headline description of the investment when making its assessment of suitability. Similarly, it would not be fair and reasonable for the IFA to rely on warnings within its suitability letter where there could be a risk to capital. Rather 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 Mrs C.

Having reviewed the plan literature I consider that a professional IFA should have appreciated that capital would be placed at significant risk. As stated previously, it is material that Mrs C was retired and widowed and was reliant on this capital to provide an income in retirement. She had what I consider may be categorised as having a very cautious attitude to risk and, having carefully considered the available evidence, I find on balance that the IFA's recommendation to invest in the Keydata plan was entirely at odds with Mrs C's objectives.

The IFA has suggested that Mrs C had to take the level of risk inherent with the Keydata investment to achieve the required returns and meet her income needs. I would not dispute

that Mrs C was recorded as needing to generate an income to meet her annual expenditure. However, it is not simply a case of recommending an investment that provides the highest possible return. Instead, the IFA should have recommended an investment appropriate for its client's overall investment needs, circumstances and attitude to risk.

I have noted the comment that Mrs C was prepared to accept some capital reduction due to her income requirements and I accept that a degree of capital erosion over time may have been acceptable to Mrs C on the basis that that this was likely to be quite limited. However, I consider that, whilst Mrs C may have been prepared for her capital to reduce as a result of income taken, she would not have been prepared for additional reductions to be incurred due to irreplaceable losses on the investment value.

The actual level of risk represented by the Keydata plan not only imperilled the income required by Mrs C, but also the entirety of the capital invested in that plan. Put simply, and also taking account of the quite high proportion of Mrs C's overall assets it represented, I am not of the view that it adhered in any reasonable sense to the "secure" risk rating recorded for Mrs C, or that if such risks had been fully appreciated by Mrs C, she would have been prepared to accept them.

The IFA has argued that other types of investments widely available to retail investors are just as complex, if not more so, as the Defined Income Plan. Whilst I have taken account of these other type of investments, their availability does not alter my view on the suitability of the plan in question. Whether or not another investment is as complicated as the Keydata plan does not have a material bearing on whether the actual recommendation given to Mrs C by the IFA to invest in the Keydata plan was suitable for the risk she was prepared to take with her capital.

The IFA has further argued that Mrs C would have had an understanding of the investment and its risk as a result of her involvement with, and experience of, the family business. It has also been suggested that her understanding of the plan and its risks would have been improved because her son had attended the meeting with the IFA.

Mrs C has in fact stated that she was a director of the family business in name only and financial matters regarding the business were not left to her. I note that her personal investments at the time of the advice were also predominately in deposit accounts. Regardless of this, however, it remains the case that Mrs C sought advice from the IFA and was entitled to rely on that advice. It appears that this is what she did, and even though she was accompanied by her son, he would similarly have been reliant upon the business' advice in terms of the investment of his mother's capital. I do not believe it likely that either Mrs C or her son in fact appreciated the nature of the risks involved in the Keydata plan.

In short, it is my view that the Defined Income Plan was not suitable for Mrs C. In fact, given Mrs C's age at the time, her objectives and her attitude to risk, I am of the view that the advice demonstrated a complete disregard for Mrs C's individual circumstances and interests.

This is not a view reached with hindsight. I have based my findings on the product's suitability for Mrs C 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 reasonable expectation of how the plans would operate.

Having reached this view, I now need to consider what Mrs C would have done “but for” the advice she received.

I have not seen anything which suggests to me (and I find it highly unlikely) that she would have invested in the plan, if it had not been recommended to her. Nor am I persuaded that she would have invested in the plan, if things had happened as they should. The investment was not suitable for her needs and circumstances, and I do not think she would have invested, had she appreciated the risks.

Overall I think it most likely that Mrs C would have invested this capital into another investment suitable for a very cautious investor. I appreciate that Mrs C would in all likelihood not have obtained the return required to meet her income needs, but faced with the prospect of either reducing her income or facing a potential significant or total loss of her capital, I consider that she would have opted for the former. On balance, I consider that a fair benchmark to indicate the investment return on her investment is 1% more than the Bank of England base rate, compounded yearly from the date of investment until the date the loss crystallised.

I note that the loss crystallised in November 2009. Mrs C had been retired at the time of the advice and when the loss crystallised. The money invested was intended to provide an income to meet her expenditure which included rent. Mrs C has been deprived of a significant proportion of her money since that date and this is money which I consider Mrs C was relying on to provide income. I am satisfied that being deprived of this money has caused significant financial detriment. As a result, I am satisfied that it is appropriate to award an interest rate of 8% pa simple on this sum from the date the loss crystallised until the sum is paid.

### **my provisional decision**

For the reasons set out above, my provisional decision is that I uphold the complaint. I am of the view the Keydata plan should not have been recommended to Mrs C.

My aim is to put Mrs C in the position she would now have been in but for the IFA’s poor advice. In deciding how to assess fair compensation I consider it fairest to assume;

- With reasonable advice, Mrs C would have had the original capital intact plus a reasonable rate of return.
- The rate of return on the original capital would have been equivalent to 1% more than Bank of England base rate from time to time compounded yearly.

I therefore intend to award compensation on the following basis.

A= the capital invested, 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 a return of the Bank of England base rate plus 1% per annum, compounded annually from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised) or until the date that the last income payment was made if later;

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

D= A+B-C

My provisional decision is that the IFA should pay Mrs C the amount produced by that calculation (that is amount D) up to a maximum of £100,000. To that sum the IFA should add interest from 13 November 2009 at the rate of 8% pa simple until this award is paid.

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.

As it is my understanding that, on payment of this redress, the Financial Services Compensation Scheme (FSCS) will require repayment of its compensation to Mrs C, no allowance should be made for any sum received from FSCS in the calculation of the investment loss. However, Mrs C has had use of this money since it was paid in 2011. Accordingly, although the amount D should not be reduced, the sum used to calculate the interest payment should be reduced by the amount received from the FSCS from the date it was paid onwards.

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.

I understand that in some cases, consumers have received income payments after Keydata defaulted. It is only fair that such payments are taken into account in my award and I have allowed for this possibility in the award formula. It should be noted that the income payments do not include any distributions made following the Bondholder Notice dated February 2013 which is discussed further below.

In relation to C: I understand that the fund cannot be encashed. For that reason, as set out above, for the purpose of C the investment should be treated as having a nil value. However, that is provided that Mrs C agrees 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. I would ask Mrs C to note that carefully. She 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.

I am aware that a recent Bondholder Notice dated February 2013 indicates that there may be a further distribution to bondholders. I consider that as part of any arrangement to pay the award and to take ownership of the investment it would be reasonable for the business to make appropriate provision for it to receive any future distribution whenever paid. This would cover a situation where the consumer receives the distribution before the award has been paid and/or before transfer of ownership to the business has been completed. It would also cover a situation where the distribution is incorrectly paid directly to Mrs C even though ownership has been transferred.

Recommendation: As the amount I consider to be fair compensation may exceed £100,000, I am minded to recommend that, in this situation, the business pays Mrs C the balance.

This recommendation is not part of my determination or award. It does not bind the business. Whether Mrs C can accept my decision and go to court to ask for the balance is uncertain. Mrs C may want to consider obtaining independent legal advice before deciding whether to accept this decision.

Mrs C 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.

If the compensatable loss exceeds the limit an ombudsman can award and the business does not adopt the recommendation to pay the award in full, any assignment 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 business should deduct £100,000 from the compensatable loss. The resulting figure is the amount that the consumers are entitled to receive (e.g. retain) by way of future value and/or distributions (including any money received following the February 2013 Bondholder Notice). Any value or distributions that might be made over and above this amount may be assigned to the business, if the business decides to take a transfer of those rights.

If the compensatable loss exceeds £100,000 and the business decides to pay the entire compensatable loss, the business is entitled to take, if it wishes, an assignment of the rights to all future values and distributions of the investment.

It is my understanding that HMRC has made certain provisions so that it may be possible for compensation paid in relation to a Keydata fund that involved an ISA/PEP to be transferred into an ISA wrapper. I am unable to give any more information or advice about this matter.

However, information can be found on the HMRC.gov.uk website by entering “ISA reinstatement” in the search box on the home page. I can only suggest that if Mrs C would like to explore this further she contacts HMRC directly or seeks appropriate independent advice.

Philip Miller  
ombudsman