Financial Ombudsman Service

complaint

Mr and Mrs A have complained through a third party representative that advice they received from HSBC Bank Plc to place £20,000 in a medium ‘risk-rated’ fund of an investment bond was unsuitable for them.

Specifically, they consider that the risk presented by this investment was too great for their personal and financial circumstances at the point of sale in September 1999.

They also submit that they were led to believe that they could not take an income from the investment until it had been in force for ten years.

background

Mr and Mrs A’s complaint was investigated by one of our adjudicators, who concluded that it should be upheld because the size of the investment represented a substantial proportion of their total capital and was exposed to a degree of risk that did not match their previous investment experience.

Indeed, the adviser acknowledged in the documentation he completed at the point of sale that, by placing 74% of their total savings in ‘balanced’ risk investments and 26% in ‘capital-secure’ accounts, this advice did present a greater degree of risk than they were willing to accept.

Therefore, as the adjudicator could find little evidence to indicate that Mr and Mrs A wished to adopt a ‘balanced’ attitude to risk for this size of investment, she believed that the advice subjected their capital to a greater risk than they would have been prepared to accept. She also noted that Mr A was the sole income earner and they could not afford to put their capital at too much risk, particularly if it might be required by Mrs A to support her through retirement.

In response, the business disagreed with the adjudicator’s view and said that:

- The adjudicator had not responded to Mr and Mrs A’s point that withdrawals could not be made from the investment until the investment had been in force for ten years. Both the application form Mr and Mrs A signed and the adviser’s ‘reasons-why’ letter confirmed that the investment should be left for 12 months (and not 10 years) to achieve capital growth before withdrawals are taken;

- It considers it entirely reasonable for Mr and Mrs A to be advised to invest part of Mr A’s redundancy sum over the long term to achieve potential growth. While this sum was part of an early retirement ‘package’, Mr A was several years from retirement and was earning an income as self-employed, in addition to an early retirement pension from his previous employer;

- Although Mrs A was a housewife, and relied on Mr A’s income, it did not accept that they required all their capital to remain on deposit to support her through retirement. Mr A was still working and there was no evidence to suggest that he would not continue to do so for the foreseeable future. Hence, he would continue to support

Mrs A financially over the medium-to-long term this investment was intended to be held;

- The adviser did not state at the time that the recommended funds presented a greater risk than Mr and Mrs A were willing to take. His statement that the recommendation fell outside the guidelines was drawing to Mr and Mrs A's attention that the advice may be higher than would normally be recommended to investors with a 'balanced' attitude to risk. Once further advice was given in the near future, the spread of their investments would become 'balanced'. Mr and Mrs A were not forced to accept this advice; it was their choice to do so and the summary document which made them aware of the degree of risk to their capital.

- If Mr and Mrs A's capital should have remained secure and immediately accessible specifically for the future benefit of Mrs A, this would suggest that the capital should not have been put at risk at all. Accordingly, any redress awarded should be based on deposit rates.

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 conclusions reached by the adjudicator, and for essentially the same reasons.

Mr and Mrs A requested advice in September 1999 to invest part of a redundancy lump sum Mr A had recently received from his employer in addition to an early retirement pension. He was several years from retirement and decided to start-up a self-employed business. Mrs A was a housewife with no recorded income.

I note that, although Mr A had only just become self-employed, and therefore could not have known what this annual earnings were likely to be in any event, the personal financial questionnaire confirmed that that he earned a specific annual income which, together with his retirement pension, gave Mr and Mrs A a net disposable income of £1,350 per month.

I am inclined to doubt that this accurately reflected their financial position at the time and that their income position was less secure than the documentation suggests.

At that time, Mr and Mrs A held capital sums of £29,000 on deposit and Mr A owned stocks and shares with an approximate value of £5,000.

Therefore, when accepting the advice, as the adviser recorded at the time, they held approximately 74% of their total capital savings in 'balanced' risk-based investments. While the adviser has documented that this gave them an 'unbalanced' portfolio of risk, this position would be rectified when *"further investments are considered later in the year…".* I assume by this that some of the remaining £9,000 they held on deposit was intended to be switched to a (lower) risk-based product to reduce the overall risk profile of their investments. However, that could reduce further the amount of capital they held that was secure and was immediately available in circumstances where Mr A's earnings at the time could not have been reliable.

I have also considered that, while Mr A is recorded as a basic rate taxpayer, Mrs A was undeniably a non-taxpayer. As such, I am not persuaded that an investment bond was a suitable product for them. While there is no personal liability to capital gain tax or basic rate income tax on the bond proceeds, the investment fund itself is subject to tax, equivalent to basic rate tax, which neither Mr nor Mrs A is able to reclaim.

Notwithstanding that I can find no evidence to indicate that Mr and Mrs A were informed that they could not make withdrawals from the investment for ten years, they began to request one-off capital withdrawals from the bond from January 2009, initially equal to the amount it had 'earned' in excess of the original capital sum invested. However, in February 2011, Mr and Mrs A withdrew £8,000 which could not be supported by the performance of the bond, which they acknowledged when they withdrew the excess value of the bond above £10,000 in July 2011 without any apparent regard for any potential income tax implications whenever the bond is fully surrendered.

On balance, given Mr A's income position at the point of sale was unpredictable, Mrs A's tax status and their previous investment experience, I am not persuaded that they should have invested a capital sum in this product, and in a fund that presented a significant investment risk - 74% of their total capital savings was then held in risk-based products. I am not persuaded how this position would have been redressed by switching a further capital sum to a lower risk-based investment later in the year.

However, given Mr A was several years from retirement, and was intent on continuing to earn an income for the foreseeable future, I am inclined to believe that Mr and Mrs A were prepared to invest some of his redundancy lump sum with a small degree of risk which gave them a reasonable prospect of a return that would exceed the interest they were then currently receiving by holding their capital on deposit.

decision

My final decision is that I uphold Mr and Mrs A's complaint.

On the understanding that Mr and Mrs A have retained the investment to-date, I require HSBC Bank Plc to pay them redress calculated on the basis set out below.

fair compensation

To compensate Mr and Mrs A fairly, the business should put them as close to the position they would probably now be in if they had not been given unsuitable advice. I believe that Mr and Mrs A would have invested differently and, although it is not possible to say *precisely* what they would have done differently, I am satisfied that what I set out below is fair and reasonable given their circumstances and objectives when they invested.

what should the business do?

To compensate Mr and Mrs A fairly, the business should compare:

- the performance of their original investment

and

- the position they 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 Mr and Mrs A.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mr and Mrs A wanted some capital growth with low risk to their 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 investors who wanted to achieve a reasonable return without risk to his capital; the APCIMS index is for one who was prepared to take some risk to get a higher return.
- I consider that Mr and Mrs A's risk profile was in between, in the sense that they were prepared to take a small level of risk to attain their investment objectives. So, the 50/50 combination would reasonably put them in that position.
- It does not mean that Mr and Mrs A would have invested 50% of their capital 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 Mr and Mrs A could have obtained from investments that suited their objective and risk attitude.

how to calculate the compensation

The compensation payable 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 cash value of the investment at the date of the redress calculation.

total fair value

This is what the investment would have been worth if it had obtained a return using the method of compensation set out above. It is the total of 'average rate element' and 'APCIMS index element'.

average rate element

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 date of settlement;

- 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 surrender.

APCIMS index element

To arrive at this value the business should:

- Work out what 50% of the relevant portion of the investment would have been worth, if it had performed in line with FTSE APCIMS Stock Market Income (Total Return) index to the date of surrender.

additional capital

The relevant portion of any additional sum that Mr and Mrs A paid into the investment should be added to the calculation (split equally between average rate element and APCIMS element) from the point in time when it was actually paid in so that it starts to accrue a return in the calculation from that point on.

withdrawals and income payments

The relevant portion of any withdrawal or income payment that Mr and Mrs A received from the investment should be deducted from the calculation (split equally between average rate element and APCIMS element) at the point it was actually paid so it ceases to accrue any return in the calculation from that point on.

If there are a large number of regular payments, to keep calculations simpler, I shall accept if the business adds all those payments to the *actual value* and compares that total with the *total 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.
- 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.

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