complaint

Mr and Mrs A's complaint concerns the investment recommended to them with SLS Capital by BKG Financial Services (now Cobra Financial Services Limited and referred to as "the business" hereafter). They say that they were told this was an "A *rated fund*" and if the company backing it failed, "*there were sufficient funds to reimburse investors*". Mr and Mrs A say they invested the sum of 400,000 Euros on the assurance from the business that it was "*completely safe*".

background

Our adjudicator issued her findings and gave her opinion that the complaint should succeed. She believed that the business could not be held responsible for the events that happened with the provider of the bond – SLS Capital. However, she considered that the product was only suitable for experienced investors and the adviser should have been aware of this. She found that the product recommended did not match with Mr and Mrs A's circumstances or risk profile.

Mr and Mrs A accepted these conclusions. The business did not. It said, in summary:

- The clients' appetite for minimal investment risk has never been disputed. The correspondence submitted demonstrated that despite an initial preference to preserve capital, their need for a high level of income in exchange for some element of risk was understood.

- It is unfortunate that sometimes a client's attitude to risk is incompatible with income or capital growth expectations. In such circumstances, either the financial objectives must be downgraded or a higher degree of risk accepted. Mr and Mrs A required an income of about 11% per year, which was not available from risk free sources such as bank deposits.

- The asset backed nature of the bond was felt appropriate given the strong cash flow and A-rated investment grade instruments that backed the fund.

- It is only recently that the Financial Services Authority (now the Financial Conduct Authority) reclassified this type of investment with the aid of hindsight after the misappropriation of funds. As the investment had been under regulatory scrutiny for some time, it follows that advisers should reasonably be able to rely on the product literature when giving advice.

- As confirmed by the adjudicator and the Financial Services Compensation Scheme, the misappropriation of funds could not have reasonably been foreseen.

- The fraud was entirely outside the business' control. Had this not occurred, Mr and Mrs A would be entirely happy with the investment. If the chronological sequence of events is considered, there is no link between the loss suffered by Mr and Mrs A and the advice given.

- It is understood that what evidence there is about the misappropriation indicates that this was the major contributory factor to the complete loss of value to the underlying

investments. Therefore, the misappropriation was a significant intervening factor that undoubtedly contributed to the clients' losses.

- In view of the above, the business refutes the adjudicator's opinion that the advice had a disregard for the interests of the client.

- It believes that the proposed redress fails to recognise the level of return was compatible with Mr and Mrs A's requirement at the time.

As this complaint has not yet been resolved, it has been referred to me for review.

I must decide this case on its individual merits. However, we have considered complaints about Keydata funds (which are broadly similar to the investment product Mr and Mrs A were advised to take out) 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 findings

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

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 financial advisers 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 business assessed the suitability of the product for Mr and Mrs A. As the business 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 a business should conduct itself.

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

From the evidence I have seen, it seems Mr and Mrs A were living in mainland Europe at the time they received the advice, and this seems to have been provided by the business by way of correspondence and telephone discussions. It does not seem that any face-to-face meetings took place.

From the sales documentation, my understanding of Mr and Mrs A's circumstances at the time of sale is as follows:

- they were in their mid fifties and retiring in mainland Europe;
- they had 400,000 Euros on deposit, which was the total of their life savings;
- they had a low tolerance to risk with the comment by the adviser: "*need to protect your capital at all times is of paramount importance. This strategy is best suited to a short term investor looking to invest in cash deposit*".

The business sent a letter of recommendation in June 2005. This included reference to the product with the statement, "*The bond provides a guaranteed return of 11% per annum over a 7 year period for a minimum investment of 125,000 (euros). Income will be paid quarterly in the host currency".*

It appears to me that Mr and Mrs A's main objective was to generate a regular income to provide for their retirement outside the UK. Comments relating to their need to protect capital and reference to a guaranteed income suggest to me that they were not willing to expose their capital to a significant degree of risk.

In assessing whether the advice Mr and Mrs A received was suitable, the key issue I must decide is whether the SLS plan represented a higher risk to their capital than they were willing to accept. In considering this issue I have carefully considered the documentation relating to the plan, along with any information the business had access to before making the recommendation.

Although the business has referred to the asset backed nature of the bond and reference to detailed assessments carried out, it still had a duty to ensure that any of the risks, however small they may have seemed, were pointed out to the consumers. This would have enabled them to make an informed choice when investing. I believe that the bond recommended was only suitable for a more experienced investor and by recommending it, the adviser failed to fully take into account the need to protect the capital.

Mr and Mrs A do not seem to have had much previous investment experience. I note the business has referred to them investing in property. However, I do not consider they could be regarded as sophisticated investors, and were likely reliant on the advice they received to enable them to understand the risks involved. Because of the type and complexity of investment, I am not persuaded that Mr and Mrs A had sufficient understanding of the potential risks involved.

As noted above, the investment represented the majority of Mr and Mrs A's available capital, and was also a substantial sum. Whilst Mr and Mrs A may have been seeking a high level of income, I am not persuaded they were prepared to take a significant degree of risk in order to achieve this.

I now turn to consider whether the SLS plan therefore represented a higher risk than Mr and Mrs A were willing to take. In considering the issue, I have carefully taken account of the documentation relating to the plan, much as I am sure the business did, along with any other information it had access to before making any recommendation.

The underlying fund for the SLS product consisted of traded life policies which had been grouped together on the basis the stated income stream and capital return of the plan could be generated and the premiums on the policies maintained. The overall returns were dependent on the accuracy of a financial model which was supposed to predict the maturity of these life policies. Also, this arrangement involved and relied on several separate and

unrelated businesses all providing different undertakings to ensure the product was monitored and administered correctly and properly.

The product had an international dimension because the different parties involved were based in different countries. For example, the special purpose vehicle was incorporated in Luxembourg and the underlying life policies were bought and sold within the US. This, in my view, would have further increased the risks with the monitoring and administration of the arrangement. There was the risk the underlying life policies would not mature in line with the model to pay the stated returns and be able to maintain the premiums on the policies. If policies had to be sold to meet any commitments there was a risk this could be at a discount to their purchase value and/or be difficult. Also, all this had to be achieved within a time frame, which in this case was five years, to provide the stated returns to the investor.

This was a fund with a significant overseas component that traded in unusual and opaque investments. There was also a reliance on a limited and specialist model for the valuation of the assets.

The risks involved in the investment 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 SLS plan. It is my view this plan would not have been suitable for all but the most experienced of retail investors and that the risk to the investor's capital was significant. Therefore, it would have been important for potential investors to understand that the fund presented a significant risk to their funds.

If the business had carefully considered the product literature (as it should have done) it would have realised that the plan was not suitable for investors such as Mr and Mrs A, who wished to protect their capital. The significant features of the plan were features that were, or should have been, apparent to the business in 2005.

I consider that a professional financial adviser should have appreciated that capital, and a significant proportion of the capital, which Mr and Mrs A were ultimately prepared to invest would be placed at significant risk. It is material that Mr and Mrs A wanted to invest in order to receive an income, with protection of their capital being of paramount importance. This is hardly surprising given that they were retired and likely to be reliant on this capital to generate a return for a number of years into the future. It seems they would have found it difficult to replace any loss to their capital.

Having carefully considered the available evidence, I find on balance that the recommendation by the business to invest in the SLS plan was entirely at odds with Mr and Mrs A's objectives and was not a suitable recommendation for Mr and Mrs A. Indeed, the advice demonstrated in my view a complete disregard for Mr and Mrs A's circumstances and risk profile.

fair compensation

As I have concluded that the business' recommendation to invest in the bond was not suitable for Mr and Mrs A, 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 Mr and Mrs A actually made. That is because assets in the bond they 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 SLS plan produces new circumstances where my normal approach to fair compensation should not apply. It is relevant, therefore, to note the information that is available to me about the circumstances of this investment and the liquidation of SLS.

As I understand the position, the investments made by Mr and Mrs A were part of the investments held by SLS Capital SA (SLS) registered in Luxembourg. Following its liquidation the Luxembourg based liquidator 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 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 bonds.

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 it 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 such cases 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 and Mrs A would not have been in this product but for the poor advice of the business and they have clearly suffered a loss of money. But I also need to be conscious of what is fair to the business. The business is and should be held to account for the poor advice it gave, but it was not responsible for the misappropriation of the funds.

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 and Mrs A's losses: namely the misappropriation. I also think that a court might find that there are no reasonable grounds for suggesting that the business 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 not all of Mr and Mrs A's losses flowed directly from the unsuitable advice on the part of the business. And on this basis a court might not require the business to compensate Mr and Mrs A for all or any of the losses they have incurred, notwithstanding the clearly unsuitable advice the business 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 business had a complete disregard for the interests of its clients 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 and Mrs A would not have been exposed to these risks had the business 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 and Mrs A back into the position they would have been had they not followed the advice to invest in the SLS bond. I say this because of:

- the nature of the advice the business gave was in my view clearly in error;
- its assessment of the needs of Mr and Mrs A and of the suitability of the product and it generally paid complete disregard to their interests;
- this was simply a class of investment that they should not have been in and would not have chosen but for the business' recommendation;

- the fact that there appears to be an inherent and significant weakness in the investment model used by SLS. 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 and Mrs A back in the position they would have been in, had they not followed the advice to invest in the bond.

my final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £150,000, I may recommend the business to pay the balance.

Determination and award: I uphold the complaint. My aim is to put Mr and Mrs A in the position they would now have been in but for the error by Cobra Financial Services Limited. As I have explained, I am satisfied that they would still have invested the original capital in a way designed to produce a return. As there is no compelling evidence about how the original capital would otherwise have been invested I consider it fairest to assume:

- With reasonable advice, Mr and Mrs A 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;

- The rate of return would have been by capital growth, rather than income, and may be taxable in the consumer's hands as a capital gain.

I therefore consider that fair compensation should be calculated on the basis of A + B – C as follows:

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 the date of payment;

C= the residual value of the investment that Mr and Mrs A made in the bond, which I assess to be zero for this purpose.

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 Mr and Mrs A agree to the business taking ownership of the investment if it wishes to. The business 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. In this situation Mr and Mrs A would need to cooperate to enable the business to make the necessary calculations and in order for the business to take ownership of the investment if it wants to.

My decision is that the business should pay Mr and Mrs A the amount produced by that calculation - up to a maximum of £150,000.

Recommendation: As the amount I consider to be fair compensation exceeds £150,000, I recommend that the business pays Mr and Mrs A the balance.

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

If the compensatable loss exceeds £150,000 and the business does not agree to pay this in full, any reassignment of ownership referred to above (including any future distributions) should only concern itself with any amounts which are in excess of the full compensatable loss. To identify this amount, the business should deduct £150,000 from the compensatable loss. The resulting figure is the amount Mr and Mrs A are entitled to retain by way of any future value and/or distributions. 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 £150,000 and the business decides to pay the entire amount, the business is entitled to take an assignment of the rights to all future value and distributions of the investment if it wishes.

If my award is not paid within 28 days of the business receiving notification that Mr and Mrs A have accepted my decision, simple interest is to be added to the investment loss at a rate of 8% per year from the date of my decision to the date of settlement.

Doug Mansell
ombudsman