complaint

The complaint is about Coutts & Company's advice in 2007 to invest in funds to be held in an offshore bond.

Mr D complains that the bond was inappropriately invested and did not take account of his frequently expressed aversion to risk and his lack of experience with investments.

Mr D has estimated his losses at more than £450,000.

background

An adjudicator considered the complaint and concluded that it should be upheld. In summary, he said:

- The adjudicator agreed that Mr D was risk averse and said there is no record of how Mr D's risk tolerance was assessed before the recommendations were put to him.

- While Coutts says the risks were clearly laid out, there is little evidence of this in the recommendation letter.

- The recommendation letter suggests Mr D undertook his own investment research, which he denies.

- Mr D disagrees with Coutts's point that there was a "robust" discussion of risk. There does not appear to be a record of any discussion or of alternative, lower risk, strategies.

- In view of the total sum available for investment and Mr D's low risk tolerance, the income requirement could have been achieved without taking on the degree of risk represented by the initial investments, or (the income requirement) could have been negotiated down to accommodate Mr D's true risk tolerance.

Coutts responded with further points in support of its position. In summary, it said:

- Whilst the income return could have been achieved by investment in more secure products, this takes no account of the need for growth to maintain the real value of the fund. This would require investment in growth oriented assets where a higher level of risk is inevitable.

- In comparison, the investments made offered considerable security and protection and took into account that growth potential must be provided. This was through the four Coutts Orbita funds, with exposure to a wide range of markets and countries.

- The interview note from August 2007 recorded Mr D's concern about not wishing to keep all his assets within the wealth preservation and wealth enhancement sectors. He was keen to look for a 'higher' risk attitude through emerging markets investments.

- Although Mr D's views changed following the fall in the markets, this interview note shows he not only accepted a higher risk attitude but was keen to invest in a wider range of securities.

- In the earlier meeting note of 20 February 2007, Mr D confirmed he wanted a proportion of his monies placed within a higher risk environment.

- Mr D did have concerns about equity investment and the likely performance of the stock market. The inclusion of Orbita was aimed at managing volatility, whilst still providing opportunities for potential growth. These holdings were included specifically because of Mr D's concerns, rather than in spite of them.

- Coutts attached a document outlining the volatility of the Orbita Universal Strategies holding. Coutts commented on this and said the actual volatility is far lower than would be experienced from standard equity investment. Also, it said the fund provides a powerful hedge for the overall portfolio against a downturn in domestic or global stock markets.

- A non-cash investment was necessary to provide adequate protection against inflation for the fund capital, whilst ensuring income and capital security were also provided through investment within cash funds.

- As a proportion of the overall monies available, the Orbita exposure was not excessive, comprising below a third of the total value, and it provided additional diversification whilst limiting risk. The bond also contained three life deposit cash funds which gave a considerable level of capital security to support the portfolio.

The following is a summary of some additional points Mr D has recently made:

- The meeting note from May 2007 refers to another investor.
- The advice letter, sent after that meeting, reflects someone else's particular circumstances.
- He was inexperienced in investments.
- His circumstances and objectives were different in terms of his attitude to risk when investing with Coutts and his purchase of shares in the company he worked for.
- He purchased a very conservative holding in the company where he worked and the financing of it was due to an increase in the value of his home.
- He had no other investments and less than £10,000 in savings.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. Having done so, I agree with the adjudicator.

At the time of the investment advice, Mr D had significant assets and income. But he knew his employment was coming to an end (as a result of early retirement) and he was looking to replace his income by investing some of his capital. He was also looking for investment income to be tax efficient.

Mr D was advised to invest available funds of about £3 million on the following basis:

- £2 million in the offshore bond
- £1 million in a discretionary managed portfolio arrangement.

Coutts has different investment strategies. The bond investment involved the Wealth Preservation strategy. The discretionary investment was part of the Wealth Enhancement strategy. Mr D has not complained about the discretionary portfolio.

The bond involved cash deposits of £750,000 and £1,250,000 in higher risk (than cash) investments called Coutts Orbita Funds. All were funds of hedge funds.

A £250,000 investment was recommended in the Orbita Capital Return Strategy fund which was referred to as part of the Wealth Preservation strategy.

The other investments were in Orbita Funds that were referred to as part of the Wealth Enhancement Strategy, rather than the Wealth Preservation strategy, as follows:

- £500,000 - Global Opportunities Strategy
- £350,000 - European Growth Strategy
- £150,000 - Asian Growth Strategy.

Mr D complains that the bond was unsuitably invested and did not take account of his aversion to risk and his lack of experience with investments.

He was advised to repay his mortgage but chose not to – investing his capital instead. So it is arguable that he was not entirely risk averse. The same point can be made in relation to the existence of the discretionary managed portfolio managed on a Wealth Enhancement strategy.

In October 2007, the Orbita holdings were reporting small losses but Mr D was happy to leave the investments. Just a few months later he had concerns about volatility. His circumstances by this stage appear, however, to have changed since the advice was given.

This is not entirely surprising given that his circumstances were unsettled at the time of the advice – he was retiring but hoped to earn some income as a consultant but that arrangement was not settled and in any event Mr D had a known interest in property development.

Mr D's attitude to investment risk at the time of the advice was not recorded. Nor is it recorded how his attitude to risk was assessed. It is however the case that it is fairly clear that the Wealth Preservation is intended to be lower risk and the impression is given of lower risk investment in the recommendation letter. For example the Wealth Preservation strategy is referred to as minimising personal risk. The impression is also given of the hedge funds of fund being lower risk – for example their *'lower overall risk profile'* and or *'controlled volatility'* or *'moderate volatility'*.

In the absence of a clear explanation to the contrary the impression is given that the bond is to be lower risk. This is, by and large, consistent with what Mr D says about his attitude to risk.

It is was also understood and recorded that the bond was intended to supplement Mr D's earned income to cover his day to day expenditure. Put another way it was understood that Mr D was intending to rely on the money invested and the income it could produce. This too implies a lower risk approach as Mr D says he wanted.

Bearing in mind that the bond was two thirds of his available investment fund and that the other third was being invested on a higher risk basis it is not clear why it was necessary to take anything other than lower risk with the investments in the bond.

The Orbita funds were however risk based investments which Coutts says were intended to provide some growth as this was necessary.

I do not however agree that this was necessary. It was a choice not a necessity and it is not clear that it was clearly explained to Mr D and his properly informed agreement obtained to that course. Mr D says he did not want to take any risk with this part of his funds (ie the bond) and it was not essential that he did so.

I am not persuaded that Mr D had any particular investment experience before the advice in this case that would have meant that he had anything but a minimal understanding of investments. Nor am I satisfied that Coutts reasonably assessed, agreed and recorded Mr D's attitude to risk. There is not, therefore, any real evidence to demonstrate that Mr D did want to take higher risks with some of the money in the bond.

The fact that Mr D cancelled the investment just 16 months later does not suggest he was prepared to accept risk as he says.

In all the circumstances I agree with the adjudicator that the investments in the bond involved more risk than was necessary or suitable for Mr D's purposes.

It is also unclear why it was thought appropriate for Mr D to sell all of shares to the value of over £3 million and to invest most of his capital when his financial position was unsettled and uncertain. This left a relatively small amount of accessible cash on deposit, which also seems to me to have been unsuitable at the time.

I also consider that Mr D will inevitably have suffered distress and inconvenience as a result of the investment losses suffered on the unsuitable investments. The investments were supposed to be lower risk and maintaining the value of the funds and the income they could provide were important to Mr D as is reflected by his decision to cancel the investment so soon after they began. I consider that a payment of £300 is appropriate in the circumstances.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr D as close to the position he would probably now be in if he had not been given unsuitable advice.

I take the view that Mr D would have invested differently. It is not possible to say precisely what he would have done differently. But I am satisfied that what I set out below is fair and reasonable given his circumstances and objectives when he invested.

To compensate Mr D fairly, Coutts must pay Mr D £300 in respect of distress and inconvenience and also compare:

- the performance of Mr D’s investment to the point it was surrendered or encashed

with

- the position he would have been it the investment had produced a return matching the average rate for fixed rate bonds with 12 to 17 months maturity as published by the Bank of England

If there is a loss, Coutts should pay this to Mr D together with interest on that loss from the date of surrender or encashment to the date of payment of the compensation. The interest is to be paid at the rate of 8% simple interest per year. Income tax may be payable on the interest.

I have decided on this method of compensation because Mr D wanted to achieve a reasonable return without risking any of his capital. Mr D was prepared to invest for a longer period of time – but with some flexibility.

The average rate would be a fair measure given Mr D’s circumstances and objectives. It does not mean that he 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 the capital. I consider that it is sufficiently close to assist me in putting Mr D into the position he would have been in had he not received inappropriate advice.

how to calculate the compensation?

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

The actual value is the value Mr D would receive if he terminated the investment on the date of my decision.

The fair value is what the investment would have been worth if it had obtained a return using the method of compensation set out above.

To arrive at the fair value, Coutts should find out the monthly average rate for fixed rate bonds for each month from the date of investment to the date of my decision and apply those rates to the investment, on an annually compounded basis.

Any additional sum that Mr D paid into the investment should be added to the fair value calculation from the point it was actually paid in.

Any withdrawal or income payment that Mr D received from the investment should be deducted from the fair value calculation 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 will accept if Coutts totals all such payments and deducts that figure at the end instead of periodically deducting them.

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. (The £300 compensation for distress and inconvenience I mentioned above is included in the £150,000 maximum award not additional to it.)

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Coutts should pay Mr D the amount produced by that calculation (if lower than £150,000) plus interest as set out above or the maximum of £150,000 plus interest on that some as appropriate.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £150,000, I recommend that Coutts pays Mr D the balance and interest on it as above.

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

Philip Roberts
ombudsman