Financial Ombudsman Service

summary of complaint

Mr A has complained though a third party adviser that advice he received from Lloyds Bank PLC ("Lloyds") in 2005 to invest a capital sum of £73,000 across three 'cautious' risk rated funds with an investment bond for income was unsuitable.

background to complaint

Mr A's complaint was investigated by one of our adjudicators, who concluded that it should be upheld.

Briefly, he found that the capital available for investment had been bequeathed to Mr A from the value of his late wife's estate. Although Mr A held modest sums in other investments, including an OEIC, a stocks and shares ISA and a PEP, that carried a greater degree of risk than the funds chosen for the bond, the adjudicator was not persuaded that Mr A would have been willing to take any risk with this capital sum he had inherited.

The adjudicator considered that the bond included no guarantees that it would produce sufficient returns to cover the income Mr A wished to take from it and, therefore, there was a real risk that any returns it made may not ensure that the original capital value of the bond would remain intact.

Also, Mr A was a retired widower and, even though he held some investments that gave him a limited experience of risk, the majority of his capital remained on deposit which he relied on to supplement his income.

The adjudicator also felt that, being in his mid-70s on a modest income, Mr A had limited means to replace any capital lost from this investment on which he was relying for income indefinitely.

In response, Lloyds did not agree with the adjudicator's assessment and said that:

- Mr A had some previous experience as an investor so would have gained an understanding that investment values can vary. The 'cautious' risk nature of the chosen funds was suitable as the evidence shows that he was willing to take some risk;
- as the advice still left him more than 50% of his capital savings in cash, a guaranteed return of capital was not a requirement. His capital of £73,000 was invested in equal shares in three funds that provided a broadly based cautious investment;
- while the funds invested had come from his late wife's estate, it is more than likely that he would have wanted to protect it from the effects of inflation;
- Mr A was well aware that the investment represented a greater risk than leaving his capital on deposit and lower risk than his existing investments;
- in 2009, Mr A transferred the servicing to a new adviser and, therefore, any concerns with this investment ought to have been raised at that time;
- Mr A wanted to retain control of his funds and, while he was satisfied to commit to the investment for at least five years, he wanted the option to access his capital;
- the income withdrawals of less than the 5% annual allowance enabled him to supplement his income without jeopardising his 'age allowance';
- while Mr A's previous investments were smaller and had been taken out earlier in retirement, they represented a greater degree of risk than the advice he received;
- the transfer of his stock and shares ISA to another ISA manager in 2009 suggests that he was willing to retain risk-based investments. Nevertheless, it was reasonable for Mr A to take a more cautious approach given his increased age and the source of

funds. This does not mean that he was unwilling to take any investment risk at all, especially as he did not require a capital guarantee;

- on the balance of probabilities, it is more likely that Mr A would not have wanted the value of his capital to be eroded in real terms by leaving it all in deposit-based accounts;
- following the advice, Mr A was still left with very substantial cash based savings of £95,000 (or more than 56% of his capital savings) for any shorter term needs;
- although the adviser's suitability report did not specifically mention the effects of inflation, this does not appear to have been a concern to Mr A.

As agreement could not be reached the complaint has been passed to me to be reviewed.

my findings

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

My understanding of Mr A's circumstances in September 2005 is that he was a retired widower in his mid-70s, earning just over £11,000 per annum. This income comprised basic state pension, an occupational pension and interest from capital savings, which gave him a disposable income of around £200 per month. He held capital of almost £170,000 on deposit, plus modest sums in an OEIC, a stocks and shares ISA and a PEP. Mr A required an additional fixed income of £250 per month for *"days out and other luxuries etc."*

The adviser established that Mr A wished to take a 'cautious' approach to investment risk through a series of risk profile questions, which confirmed, among other things, that he valued capital security ahead of maximising returns. This would appear to be at odds with the section in the adviser's suitability letter, which confirms: *"I discussed with you* [Mr A] *whether you required any of the funds you are investing to have capital guaranteed. You confirmed that guaranteed return of capital is not an over-riding requirement for you."*

As such, I am not persuaded that Mr A's cautious approach to risk would allow him to take a fixed income from the bond regardless of the effect of these withdrawals on its capital value.

While Mr A did hold other forms of investment at the time, he does not appear to have previously taken out an investment bond. Therefore, while the existence of these other investments would have given him an insight into risk, he would not have been familiar with the terms of an investment bond until this product was explained to him by the adviser in September 2005.

Mr A was receiving an income from his capital savings held on deposit at the time, which does not appear to have provided a worthwhile rate of interest. He required an additional fixed income of £250 per month from some of this capital and was persuaded that an income bond would meet this need.

He was presented with a proposal by the adviser that: *"If you draw 4.11% on the initial investment* [of £73,000]*, this equates to £3,000 per annum (£250 per month) which will be generated from the investment"* and *"Your priority was to effect an investment which produced a fixed level of income of £250 per month".*

Also, with regard to Mr A's ISA allowance, the adviser confirmed in the 'factfind' that: *"You have not utilised your ISA allowance in the current tax year (2005/2006). This has not been* *recommended as ISAs do not generate a fixed level of income."* Mr A could have interpreted this to mean that an investment bond did generate a fixed income.

While the adviser does mention that the "income" taken by Mr A is actually a withdrawal of capital, it was not emphasised to him that the investment bond needed to produce a return of at least 4.11% to provide this level of income if his original capital investment of £73,000 was not to be eroded. Indeed, although appropriate warnings were given to Mr A about the risks inherent in this type of investment, in my view, the contents of the suitability letter give Mr A the distinct impression that the investment bond would "earn" an income of 4.11% per annum and so preserve his capital investment.

If Mr A required a fixed income of £250 per month from the bond, he was simply required to request capital withdrawals of £250 per month if he had no regard for the effect on his original capital investment. The investment bond, however, was not guaranteed to "earn" a fixed income of £250 per month which the suitability letter he received would appear to imply.

There was no explicit warning given to Mr A that a rate of return of 4.11% to achieve this outcome was not guaranteed even though it was central to the adviser's recommendation that the bond could provide greater returns (income) than his existing deposit accounts.

In my view, persistent reference to the bond "producing" an "income", which is actually a withdrawal of capital, gave Mr A the impression that it could earn this level of income in the same way as interest is earned on a deposit account. I cannot see that Mr A was provided sufficiently strong risk warnings that his capital was subject to risk, whether he took a regular monthly withdrawal of 4.11% or made no withdrawals at all, to give him a balanced view of the nature of this investment. That Mr A was advised to invest in 'cautious' risk-rated funds made it less likely that the bond would consistently produce a return of 4.11% per annum which would *generate* a monthly income of £250.

As it was, the rates of interest that were available from high interest-yielding fixed term, fixed rate bonds, for example, under 'special offers' to elderly investors at that time would have produced the fixed income he required and guaranteed that his capital would remain intact. Notwithstanding that interest from these products is generally paid net of tax, I would have expected these alternatives to have been put to Mr A for consideration in the first instance.

I note that Lloyds has pointed out that, in 2009, Mr A transferred servicing rights to this investment to a new adviser firm and, therefore, responsibility for assessing the merits of the original advice he received passed to this new adviser at that time.

However, I understand that, in changing servicing agent in 2009, Mr A followed the adviser he originally dealt with in 2005 when this adviser ceased to represent Lloyds and moved to the new adviser firm. Also, there has been no material activity on this investment since 2009 to suggest that there has been further adviser intervention other than when Mr A surrendered the bond in February 2011 before making his complaint.

Therefore, I am not inclined to restrict Lloyds' liability for this advice to the date the servicing agent for this investment changed.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr A 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 A would have invested differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr A's circumstances and objectives when he invested.

what should Lloyds do?

To compensate Mr A fairly, Lloyds must compare the performance of Mr A's investment with that of the benchmark shown below.

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

Lloyds should also pay Mr A any interest, as set out below. Income tax may be payable on the interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
Investment Bond	surrendered	average rate from fixed rate bonds	date of investment	date surrendered	8% simple p.a. on any loss from the end date to the date of settlement

actual value

This means the actual amount paid from the investment at the end date.

fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark.

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Lloyds should use the monthly average rate for the fixed rate bonds with 12 to 17 months maturity as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other payment out of the investment should be deducted from the *fair value* 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 Lloyds totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because Mr A wanted to achieve a reasonable return without risking any of his capital.

The average rate for the fixed rate bonds would be a fair measure given Mr A's circumstances and objectives. It does not mean that Mr A 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 additional interest is for being deprived of the use of any compensation money since the end date.

my final decision

I uphold the complaint. My decision is that Lloyds Bank PLC should pay the amount calculated as set out above.

Lloyds Bank PLC should provide details of its calculation to Mr A in a clear, simple format.

Kim Davenport
ombudsman