

## **complaint**

Mrs A has complained that advice she received from CIS Unit Managers Limited ("the business") on three occasions in 2001, 2004 and in 2007 to make increasing regular contributions to three 'medium' risk investment funds of a unit trust was unsuitable for her as the investment represented a greater degree of risk than she was prepared to take. She is represented in her complaint by a third party adviser.

Specifically, her representative has said that:

- The business did not accurately establish Mr A's appetite or capacity for risk;
- The underlying assets in the fund do not match her approach to investment;
- Disclosure of the product risks, diversification and policy charges were not made clear to her;
- Other, more tax-efficient, alternatives appear not to have been considered or documented;
- Mrs A had very little pension provision but no advice appears to have been given on the tax benefits of contributing to a personal pension policy;
- The product recommended invested in funds with high exposure to equities, currency risks and other risky asset classes;
- It would have expected contributions to be placed in a high interest savings account or similar savings product that would see her guarantee the safety of her investment;
- Mrs A was not asked to consider reducing her outstanding mortgage liability risk-free, thereby reducing her monthly outgoings.

## **background**

Mrs A's complaint was investigated by one of our adjudicators, who concluded that it should be upheld because he noted that, at each point of sale, Mrs A's disposable income appeared to be insufficient to support the level of contributions she was advised to make. As she also took significant capital withdrawals over the course of the investment, he considered that the advice was unaffordable.

The adjudicator also felt that, while the risk profile of the funds was consistent with an investor who disclosed a 'medium' attitude to risk, Mrs A's previous investment experience did not suggest that she would be prepared to accept this level of risk. Indeed, one of the funds was reclassified in 2006 as an 'adventurous' fund.

He, therefore, recommended that Mrs A should receive redress based on a comparison of the actual performance of this investment and the return she would receive at 1% above Bank of England base rate.

In response, the business said that:

- It appreciated the point about the 'affordability' of the investment;
- It is correct to say that the US Growth Trust fund was reclassified in 2006 from 'balanced' to 'adventurous';
- However, it did not agree that the redress formula based on a rate equivalent to 1% above Bank of England base rate was appropriate, as this implied that Mrs A wished to invest in risk-based products;

- If it was found that Mrs A could not have afforded an alternative from of investment at the eventual level of contribution, in all likelihood, the money would have remained on deposit to make up any deficit in her net disposable income;
- The adjudicator's view of Mrs A's true risk profile would suggest that deposit savings was the likely destination of her contributions had she been correctly advised;
- Accordingly, redress based on a return equivalent to Bank of England base rate, payable as interest taxable at 20%, was more appropriate and it would accept an adjudication on this basis.

When the adjudicator put these points to Mrs A's representative, it said:

- While it welcomed the adjudicator's decision in principle, it did not agree with the business's argument that redress should be based on Bank of England base rate or that it should be taxed;
- It suggested that Mrs A should have invested, albeit in a lesser risk product and quoted a particular fund that was based on the principle of a with profit investment which represented a 'cautious' approach to risk. Therefore, a less risky and more appropriate fund was available to Mrs A's needs and redress based on a rate equivalent to 1% above Bank of England base rate was appropriate.
- If such a return was taxed, Mrs A would be penalised financially and deprived of her annual ISA allowance. Any offer by the business to provide a tax credit may not be reclaimable as her tax position will be taken as being in the current tax year and not that at the point of sale;
- It also understood that UK dividends within the recommended fund are already taxed at 10% and paid directly to HMRC by the fund managers. To tax the clients again at 20% would therefore be unreasonable;
- Any capital gain would also be subject to their annual allowance and accommodated via their annual tax return.
- Also, Mrs A did not appear to hold cash ISAs, which the adviser should have recommended her to utilise in the first instance.

In reply, the adjudicator was inclined to agree with the point made by the business that Mrs A's financial circumstances would suggest that she needed to adopt a capital-secure approach to savings.

In the meantime, he has notified both CIS Unit Managers Limited and Mrs A's representative that redress based on a comparison with the return equivalent to Bank of England base rate may not be appropriate as this return may not necessarily reflect the return she might have received from deposit-based savings. He believed that using a 'benchmark' or 'index' incorporating an average return from fixed rate bonds more accurately reflected the return she would have received in determining her financial loss.

In a further response, Mrs A's representative said that, as the redress methodology had changed, it suggested that an award based on 50% Bank of England base rate, plus 1%, and 50% one-year fixed rate bond rates should be put to Mrs A.

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.

My understanding of Mrs A's financial position each time she received advice is that the original and the eventual levels of contribution she agreed to make do not appear to be sustainable from her disposable income. I agree with the conclusion made by the adjudicator that the successive advice she received in 2001, 2004 and in 2007 did present an ongoing affordability issue, evidenced also by the significant number of capital withdrawals she has made from the ongoing value of the investment.

I am also not persuaded that Mrs A could be regarded as an investor who would be prepared to adopt a 'balanced' attitude to risk that she would be comfortable with investment funds which presented a significant exposure to UK and overseas equities.

In my view, therefore, the ongoing advice Mrs A received was neither suitable nor affordable.

With regard to an appropriate basis for redress, I note that appears to be some inconsistency in the ongoing presentation of Mrs A's compliant by her representative. On the one hand, it submitted that it "*would have expected contributions to be placed in a high interest savings account or similar savings product that would see her guarantee the safety of her investment.*" On the other hand, it later argued that she would have been comfortable with a particular fund that offered a 'cautious' exposure to risk.

I would not be prepared to nominate the particular fund quoted by Mrs A's representative to provide the basis for redress because I cannot safely conclude that the nature and terms of this fund was the one that particularly suited her.

In any event, if this fund does present a 'cautious' exposure to risk, I do not consider that this provides an appropriate basis for redress given it is questionable whether Mrs A ultimately could afford the advice she received. Specifically, based on the information Mrs A provided of her financial position each time she received advice, I do not appreciate how she was able to afford an eventual contribution of £300 per month to this investment.

Therefore, an important consideration in the redress proposal is that the contributions it appears Mrs A could not afford to make are returned to her. In other words, redress should be based on a 'benchmark' rate that guaranteed her capital remained secure and accessible (after accounting for the capital withdrawals she has already made).

The rate of return adopted to determine any financial loss made by Mrs A is not treated as "interest" even if loss is calculated by reference to an interest rate and, therefore, the return otherwise made by her contributions is not subject to deduction of income tax at 20%.

If, however, Mrs A has already fully surrendered the investment, any interest applied from the date her loss was realised on surrender is an *enhancement element*, which is taxed as interest at the basic rate of 20% since its purpose is to compensate her for having been deprived of the use of her money (i.e. the amount of the loss) since she surrendered the investment.

On balance, therefore, in upholding this complaint, I consider that redress should not be based on investment products that presented any degree of risk to her capital, let alone the degree of risk represented by the three funds she selected.

## **fair compensation**

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

I agree that Mrs A would have invested differently. It is not possible to say *precisely* what she would have done differently. But I am satisfied that what I set out below is fair and reasonable given her circumstances and objectives when she invested.

To compensate Mrs A fairly, the business must:

compare

- the performance of Mrs A's investment

with

- the position she would now be in if 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 at the date of this decision, the business should pay this to Mrs A.

I have decided on this method of compensation because I consider that Mrs A wanted to achieve a reasonable return without risking any of her capital. She was prepared to invest for a longer period of time, but with some flexibility.

The average rate would be a fair measure given Mrs A's circumstances and objectives. It does not mean that she would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with no risk to her capital.

## **how to calculate the compensation?**

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

The *actual value* is the value Mrs A will receive if it is surrendered at 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.

The adjudicator has explained how to arrive at the *fair value* and the business should note that guidance carefully. In summary, to arrive at the *fair value* the business should find out the monthly average rate for fixed rate bonds from the date of investment to the *date of this decision* and apply them to the investment, on an annually compounded basis.

## ***additional capital***

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

***withdrawals and income payments***

Any withdrawal or income payment that Mrs A 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 the business totals all such payments and deducts that figure at the end instead of periodically deducting them.

**decision**

My final decision is that I uphold Mrs A's the complaint and I require CIS Unit Managers Limited to pay her the amount calculated as set out above.

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

If the business considers that it is legally obliged to deduct income tax from this interest award, it must send a tax deduction certificate with the payment. Mrs A may reclaim any tax overpaid from HM Revenue and Customs, if her circumstances permit her to do so.

Kim Davenport  
**ombudsman**