Financial Ombudsman Service

complaint

Mr and Mrs Q have complained that advice they received from Barclays Bank Plc in 2006 to invest £100,000 in the Distribution fund of an Investment Bond for income was inappropriate.

They are represented by a third party adviser, which has said that:

- Mr and Mrs Q were not told that the capital investment was at risk.
- The complexity of the product meant that it was unsuitable for an investor with no/limited investment experience.
- The adviser led Mr and Mrs Q to believe that a greater income would be generated through the investment.

In the complaint form to this service, Mr and Mrs Q's representative gave a more considered presentation of their claim, which can be summarised as follows:

- The underlying assets in the fund recommended did not match Mr and Mrs Q's risk approach to investments.
- Their request for a zero initial charge was overlooked.
- Other tax-efficient alternatives; for example, a stakeholder pension and/or an ISA do not appear to have been considered or documented.
- The amount invested was too large, lacked diversification and adequate capital protection.
- Mr and Mrs Q's request for a secure fixed level of income was ignored.
- Mrs Q was a non-taxpayer and the recommended investment did not take advantage of her tax status.
- The returns Mr and Mrs Q could have achieved from an alternative fixed rate bond without risk to capital were understated in the point of sale documentation.
- The actions of Mr and Mrs Q in first switching to the "Natural Income" option, and then surrendering the investment in full, indicated their aversion to the level of risk shown by this product.

Mr and Mrs Q have requested the business to return them to the financial position if correct advice had been given.

background

Mr and Mrs Q's complaint was investigated by one of our adjudicators, who concluded that it should be upheld because the degree of risk represented by this investment (and the amount of capital they placed in it) was inappropriate for them.

The adjudicator also agreed with their representative that the actions of Mr and Mrs Q in switching to the "Natural Income" option, and then surrendering the investment in full, was indicative of their true attitude to investment risk.

He was satisfied that Mr and Mrs Q would have invested their capital premiums in a low risk-based product and, therefore, the business should calculate loss with regard to the return from an alternative product being 1% above Bank of England base rate, plus interest on any loss at the date of surrender at 8% per annum simple.

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

- Mr and Mrs Q had a disposable income of £990 per month and therefore they had the financial resources to recoup any capital losses, i.e. Mr Q could save almost £50,000 before he retired and they also held capital of £55,000 from a matured bond;.
- The investment had no initial charges and any income not taken could be reinvested in the fund;
- The recommended fund included a broad spread of assets which amounted to an overall risk rating of 'cautious', which matched Mr and Mrs Q's recorded approach to investment. The adjudicator's view ignores the role of the fund manager to adjust the asset allocation of the fund to meet its objective of being a 'cautious' investment;
- It did not consider that switching to the "Natural Income" option, and then surrendering the investment in full, was indicative of Mr and Mrs Q's attitude to investment risk. Rather, it demonstrates that they understood the nature of the investment or no longer had a need to withdraw £400 per month as their income position was sufficient for their day-to-day needs;
- The point about Mrs Q's tax status does not take into account their request for an investment product that attracted no initial charges. Any product that took advantage of her tax status would have incurred initial charges.

In the meantime, the adjudicator reconsidered his view that a comparison with the return equivalent to 1% above Bank of England base rate may not be appropriate, as this return does not incorporate *any* element of risk. He believed that using a 'benchmark' or 'index' incorporating an average return from fixed rate bonds and the APCIMS index more accurately reflected the degree of risk Mr and Mrs Q were prepared to take to establish their financial position when they surrendered the investment.

In response, Mr and Mrs Q's representative agreed with this revised approach to redress and had no further comments to make.

The business noted the adjudicator's revised view but it had no further comment to make as it maintained that the complaint should be rejected.

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 is that Mr Q was aged 61 at the point of sale and received an income which comprised a retirement pension from his long term employer, some small pensions from personal pension plans and a regular income from a temporary, part-time job. He intended to retire in around four years' time, at age 65.

Mrs Q was aged 54 at the time, received no income and was, therefore, a non-taxpayer. Their net disposable income was £95 per month and they required an income from £100,000 of £117,750 they held on deposit. This capital mainly came from the proceeds of a house sale and the value of a maturity bond. In addition, they held £55,000 in a guaranteed growth bond.

It is not evident why the business has based its responses on the position that Mr and Mrs Q had a net disposable income of £990 per month. This is not borne out by the documentation completed at the point of sale and, in any event, would raise questions as to why Mr and Mrs Q would want to put £100,000 of their capital at risk for additional income of £400 per month they did not appear to need. As their disposable income was recorded as £95 per month, I am satisfied that they did require to make use of newly-acquired capital to increase available income.

The suitability of the investment they were recommended 'turns' on whether it matches their appetite to investment risk.

While the business has said that it correctly matched Mr and Mrs Q's risk attitude to the risk profile of the investment fund, I am mindful that an investor's perception of a 'cautious' risk attitude can be different to a fund manager's concept of what constitutes a 'cautious' risk investment fund.

My understanding is that the Distribution fund contained a not insignificant element of UK and overseas equities, as well as a proportion of sub-investment grade corporate bonds and commercial and industrial property. As such, while I the business might appropriately 'risk-rate' the fund as 'cautious', I would not consider that it would usually be deemed suitable for investors with no previous experience of risk-based investments who considered they were 'cautious' in nature.

In my view, notwithstanding the risk warning on page 5 of the adviser's suitability report, persistent reference to the Bond providing an income of £400 per month, which is actually a withdrawal of capital, *would* give an inexperienced investor such as Mr and Mrs Q the impression that it could earn 5% (for distribution as income) in the same way as interest is earned on a deposit account.

While, also, the usual risk warnings were given about access to capital when investing in commercial and industrial property, I cannot see any evidence that Mr and Mrs Q were provided sufficiently strong warnings that their capital was subject to a significant risk, whether they took a 5% withdrawal or made no withdrawals at all, to give them a balanced view of the nature of this investment.

Mr and Mrs Q admitted to a 'cautious' attitude to risk because they wanted better returns than those offered by a bank or building society account which were unlikely to fall substantially in value over the course of the investment. It is not clear whether this requirement took account of capital withdrawals or referred to the inherent risk nature of the investment. If Mr and Mrs Q believed that 'cautious' meant limited capital loss, that they acted to surrender the investment after less than three years when they saw their capital reducing, and subsequently complained, indicates that their risk attitude did not match the risk profile of the fund.

Mr Q was proposing to retire in around three years' time when his total income was likely to reduce substantially (by around £220 per month) which would give them a monthly income deficit by then. I, therefore, do not consider it was appropriate for them in 2006 to commit £100,000 (or 58%) of their total capital to a risk-based investment for income when they would be heavily reliant on this capital to supplement their pension income.

Besides, the rates of interest available from capital-secure accounts at that time would have enabled Mr and Mrs Q to take an income equivalent to £400 per month, especially as Mrs Q was a non-taxpayer and could receive interest gross, without risk to their capital.

Moreover, while an investment bond incurs no personal liability to capital gains 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 Q is able to reclaim regardless of their respective tax status.

Mr and Mrs Q surrendered the bonds in the early surrender penalty period when they saw their capital reducing even after they opted to take "Natural Income" in 2007. Accordingly, they should not have to bear the cost of early surrender penalties. Sophisticated investors might appreciate that investments can be volatile and should be held for a certain period. I do not think that less sophisticated investors who do not understand this principle can be blamed for attempting to mitigate their losses by surrendering an investment when they see the effect of withdrawals on their capital. That they surrendered their bond early is another factor that persuades me that Mr and Mrs Q did not understand the investment they were advised to make and that it was not suitable for them.

decision

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

My intention is to place them in the position they would be in now if they had invested the original capital in a way designed to produce a return that presented little risk to their capital.

In accordance with the adjudicator's letter dated April 2013, I require Barclays Bank Plc to pay them redress calculated as follows.

fair compensation

To compensate Mr and Mrs Q 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 Q 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 Q 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 Q, plus interest at the rate of 8% per annum simple on this loss at the date they surrendered the investment to the date of settlement.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mr and Mrs Q wanted income with some growth with low risk to his 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 someone who wanted to achieve a reasonable return without risk to his capital. The APCIMS index for one who was prepared to take some risk to get a higher return.
- I consider that Mr and Mrs Q'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 Q 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 Q 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 it was surrendered.

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 surrender.
- 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.

<u>APCIMS index element</u>

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 Q 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 Q 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.

Kim Davenport
ombudsman