complaint

Mr T has complained that the investment bond recommended to him by Personal Touch Financial Services Ltd in 2005 was not suitable for him and that he has been financially disadvantaged as a result.

background

Our adjudicator who assessed the matter was of the view that the complaint should be upheld. In summary, he was not persuaded that the recommended bond was suitable based upon Mr T's circumstances and objectives at the point of sale.

In particular, our adjudicator did not consider that a medium to long term investment should have been recommended to someone who was planning to retire in four years' time – as recorded in the financial questionnaire completed by the advisor. In addition, he was not persuaded that Mr T had the capacity to replace any lost capital, given that it had derived of the downsizing of Mr T's home. It was further stated that the selected funds represented a higher level of risk than Mr T had been prepared to accept in 2005.

Additionally, the adjudicator did not consider that the disadvantages of taking immediate capital withdrawals from the new investment had been fully explained to Mr T – especially with regard to the likely negative impact this would have had on future growth and the initial capital amount.

The business did not agree with our adjudicator's findings, however, stating the following in summary:

- The investment was surrendered in 2010, and when taking account of the income withdrawals, it had produced a gain for Mr T.
- Mr T was recorded as having a "cautious to realistic" attitude to investment risk which was consistent with the overall asset allocation of the chosen funds; 10% property; 28% UK equities; 15% "other" equities; 42% fixed interest; and 3% other assets.
- Therefore, of the total equity exposure of 42%, two thirds of this was in UK equities.
- Two of the funds representing 20% of the overall portfolio offered protection against the value of the units dropping below 80%.
- Additional diversification was offered through a high percentage of fixed interest funds and property funds.
- The portfolio was regularly reviewed and fund switches undertaken as appropriate to reflect changing circumstances.
- With regard to the withdrawals from the bond, it had been identified that Mr T required 3% per annum of the value of his bond to supplement his income. If withdrawals had not been set up from the outset, there would have been an income shortfall.
- The key features document and suitability letter specifically set out that, if the income exceeded the growth on the bond, its value could reduce.
- Mr T had sufficient information to enable him to make an informed decision about the investment. He was also aware of the possible effect of taking withdrawals which exceeded the level of growth.

The adjudicator maintained his position on the matter, reiterating that Mr T should have been given a clear warning as to the effect of taking withdrawals from the outset of the investment. Mr T did not have the capacity to lose his capital, but his investment was exposed to risk based funds, it was stated. The adjudicator was not satisfied that Mr T was sufficiently aware of the risks to which his investment was exposed and that he would only have been willing to take minimal risk.

It was also stated that Mr T was a lower rate tax payer, but that the returns on the bond were taxed within the fund. Mr T would not have been able to claim the tax on the growth back from HM Revenue & Customs, however. The adjudicator also queried the level of withdrawals which had been stated by the business.

In response, the business commented that, even after the investment of £160,000 into the bond, Mr T still had £40,000 left on deposit. It wasn't accepted that Mr T should not have been advised to invest for the medium to long term given his proximity to retirement, as the bond offered some flexibility in the manner of taking withdrawals if required.

Mr T was in any case aware of the penalties for early encashment, as demonstrated by him waiting until these had been removed to fully surrender the bond. The bond structure also meant that Mr T received an enhanced allocation on his investment, it was stated.

With regard to Mr T's tax position, the business said that he fell comfortably within the basic rate tax bracket and so the bond was suitable in that regard. It also clarified the amount of income taken, which differed from the adjudicator's understanding of the position due to a reduction in the percentage of withdrawals to minimise capital erosion.

In summary, the business maintained its disagreement that the complaint should be upheld. As such, the matter has been referred to me for review.

my findings

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

There are several aspects of the complaint which require consideration to determine whether the advice given to Mr T was suitable. I have firstly taken into account the time period over which Mr T invested and I am satisfied that this of itself would not necessarily have rendered the advice unsuitable. The business' point relating to the potential to take partial withdrawals and the sliding scale of early encashment penalties would in my view mean that, even if Mr T required access to the whole amount after four years to coincide with his planned retirement date (and there was no suggestion that he would), a bond would not have been an unsuitable investment in itself. I do also note that Mr T held a further £40,000 upon deposit which he could have used if required.

I'm also not satisfied – based upon the information provided by the business relating to Mr T's income – that as a basic rate tax payer another type of investment wrapper would have been obviously more appropriate.

I do have concerns, however, regarding other aspects of the recommendation. For example, whilst I accept the business' point that Mr T had a clearly identified need to supplement his income, I have seen no persuasive rationale as to why the amount invested could not simply have been reduced proportionately by the first year, or two years', income requirement. Whilst I accept that any initial enhanced allocation would have been reduced, there would still be the effect that early capital withdrawals can have on the residual capital through effects such as the bid/offer spread when encashing units.

Turning then to matter of risk, Mr T's circumstances and investment history do not persuade me that he was an experienced or sophisticated investor and it's likely therefore that he was reliant upon what he was informed by the adviser. The available capital had been produced through the downsizing of Mr T's home and so would not have been easily replaced, especially in view of the level of Mr T's income and his intention to retire within a few years. Mr T's attitude to risk was recorded as "cautious to realistic" and I consider that, given the above set of circumstances, it is very unlikely that he wished to expose his capital to anything other than minimal risk, albeit whilst quite feasibly finding the prospect of returns over and above those available from deposit accounts to be appealing.

It is therefore of some additional concern that Mr T's capital was exposed to a total of 43% equity investment, a third of which was invested in non-UK equities and so had the additional exchange rate risks. I would acknowledge that the overall range of funds provided a reasonable level of diversification and I note the comment relating to the degree of capital protection offered by two of the funds, but this protection was not guaranteed and a 20% potential loss in those or the other funds would still in my view have been beyond what Mr T was prepared to sustain. The overall risk of capital loss, or even simply volatility, to which Mr T's capital was exposed would not in my view be consistent with the level of risk he was prepared to take.

This is especially so if I am also to take into account the income withdrawals required from the investment. The business has said that, due to market volatility, Mr T needed to reduce his withdrawals to prevent additional capital erosion. This tells me two important things; Mr T placed significant importance on capital preservation, to the extent that he was prepared to reduce the withdrawals, which had previously been recorded as being required to supplement his income – this doesn't strike me as a course of action which Mr T would have taken lightly if he felt that he needed that income to maintain his standard of living.

Further, that the exposure to risk based assets was too great, which led to the situation in the first place. I do accept that such a course of action may have been necessitated by extreme volatility in financial markets, but this type of exposure could have been mitigated by a reduced level of equity investment and more concentration on fixed interest assets, for example. It is of course also arguable that, had Mr T fully appreciated the risk of capital erosion or loss through this type of investment in risk based assets, and was made aware of the possibility of receiving the required level of income – with capital protection - through fixed rate bonds, he would instead have opted for this more cautious route.

I accept that it seems likely that Mr T would have become more aware of the concept of investment risk following attendance at annual review meetings – at one point resulting in the reduction of the amount of withdrawals – but this is not in my view the manner in which Mr T should have become aware of such issues. Had he fully appreciated this possibility from the outset, I consider it unlikely that he would have accepted the recommended investment strategy.

I have also noted the comments relating to the information provided in the sales literature, but the business will be aware that this would not in any case render an unsuitable recommendation suitable. Given Mr T's likely reliance upon the advice of the business' representative, it was the responsibility of the adviser to ensure that the recommendation was consistent with Mr T's circumstances, objectives, risk tolerance and capacity for capital loss.

Overall, for the reasons stated, I'm not persuaded that this was the case in this instance, and as such, I am of the view that the complaint should be upheld.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr T 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 T 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 T fairly, Personal Touch Financial Services Ltd should:

compare

- the performance of Mr T's investment

with

- the position he would now be in if 50% of his investment had produced a return matching the average return from fixed rate bonds with 12 to 17 months maturity as published by the Bank of England and 50% had performed in line with the FTSE WMA Stock Market Income Total Return Index ('WMA income index').

If there is a loss, Personal Touch should pay this to Mr T.

I have decided on this method of compensation because Mr T wanted income with small risk to his capital. I consider it arguable that an even lower risk benchmark would be appropriate for Mr T, but on balance I'm satisfied that this methodology would be an appropriate proxy for the type of risk – at the outside – which Mr T was likely willing, and in a position, to take with his capital.

The average rate from fixed rate bonds would be a fair measure for a consumer who wanted to achieve a reasonable return without risk to his capital. It does not mean that Mr T 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.

The WMA income index (formerly the APCIMS income index) is a combination of diversified indices of different asset classes, mainly UK equities and government bonds. I consider it to be a fair measure for a consumer who was prepared to take some risk to get a higher return.

Mr T's risk profile was in between, as I'm persuaded that he was prepared to take a *small* level of risk. I take the view that a 50/50 combination is a reasonable compromise that broadly reflects the sort of return Mr T could have obtained from investments suited to his objectives and risk attitude.

Although the comparison may not be an exact one, I consider that it is sufficiently close to assist me in putting Mr T into the position he would have been in had he received appropriate advice.

how to calculate the compensation?

The compensation payable to Mr T 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 amount Mr T received at the date surrendered.

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,* Personal Touch should work out what 50% of the original investment would be worth if it had produced a return matching the average return for fixed rate bonds for each month from the date of investment to the date surrendered and apply those rates to that part of the investment, on an annually compounded basis.

Personal Touch should add to that what 50% of the original investment would be worth if it had performed in line with the WMA income index from the date of investment to the date surrendered.

Any additional sum that Mr T 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 T 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 Personal Touch totals all such payments and deducts that figure at the end instead of periodically deducting them.

If there is compensation to pay, simple interest should be added to the compensation amount at 8% each year from the date surrendered to the date of settlement. Income tax may be payable on this interest.

my final decision

My final decision is that I uphold the complaint. In resolution of the matter, Personal Touch Financial Services Ltd should pay Mr T the amount calculated as set out above.

Philip Miller
ombudsman