Financial Ombudsman Service

summary of complaint

This complaint has been brought by a firm of solicitors on behalf of Mr B. It concerns the advice he received from HFM Columbus Partners LLP (the IFA) to invest in a Keydata investment. Mr B believes the investment was unsuitable, particularly in view of the associated risks and the fund being invested in traded life policies.

my provisional decision

I issued my provisional decision on this complaint on 30 October 2013 substantially upholding this complaint, a copy of which is attached.

In summary, I was not persuaded that Mr B would have invested in the plan if it had not been recommended to him. I felt that the investment was not suitable for Mr B's needs and circumstances, and I did not think he would have invested had he appreciated the risks.

The redress I felt appropriate was based on the likelihood that Mr B would have invested his capital into another investment suitable for his circumstances and needs.

Both parties have responded to my provisional decision.

In response to my provisional findings, the IFA stated it did not have any further comments to make.

Mr B also accepted my provisional decision.

my findings

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

As neither party has further substantive comment to make, I am satisfied that my overall findings set out in my provisional decision remain fair and reasonable. For the sake of completeness, I have set out again how I consider fair compensation should be calculated in this case. I have also provided some clarification in relation to any distributions received (or that may be received) since the fund defaulted in November 2009, as recently explained by the adjudicator in an e mail.

my final decision

For the reasons set out above and in my provisional decision, my final decision is that I uphold this complaint.

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £100,000, plus any interest and/or costs that I consider appropriate. If fair compensation would exceed £100,000, I may recommend that the business pays the balance.

My aim is to put Mr B in the position he would now have been in but for the IFA's unsuitable advice. In deciding how to assess fair compensation I consider it fairest to assume;

- With reasonable advice, Mr B would have had the original capital intact plus a reasonable rate of return;

- The rate of return on the original capital would have been equivalent to 1% more than Bank of England base rate from time to time compounded yearly.

determination and award

I uphold this complaint and consider that fair compensation should be calculated as D, where:

A = the capital invested in the Keydata plan, less any amounts paid out by way of withdrawals, distributions of capital or before-tax income;

B = a return on the amount from time to time of A, by way of a return of the Bank of England base rate plus 1% per annum, compounded annually from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised) or until the date that the last income payment was made if later;

C = the residual value of the investment that Mr B made in the Keydata plan, which I assess to be zero for this purpose.

D = A + B – C.

My final decision is that HFM Columbus Partners LLP should pay Mr B the amount produced by this calculation (that is the amount D) up to a maximum of £100,000. To that sum the IFA should add interest from 13 November 2009 (or from the date that the last income payment was made if later) at the rate of 8% per year simple until this award is paid.

As it is my understanding that on payment of this compensation the FSCS will require repayment of its compensation to Mr B, no allowance should be made for any sum received from the FSCS in the calculation of the investment loss. However, Mr B has had use of this money since it was paid.

Accordingly, although the amount D should not be reduced, the sum used to calculate the interest payment should be reduced by the amount Mr B received from the date of the FSCS payment. Mr B should provide evidence of the date at which the payment was made and the amount received.

If the IFA considers it is legally obliged to deduct income tax from the interest (ie the amount to be added to part D only), it must provide Mr B with a tax deduction certificate so he can reclaim any tax from HM Revenue and Customs if he is eligible to do so.

For clarification, A and B above should work as follows. Any sum paid into the investment should be added to the calculation from the point in time when it was actually paid in so it accrues the ‘reasonable rate of return’ within the calculation from that point on.
Any reduction to the investment (excluding the final encashment payment) should be deducted from the calculation at the point in time when it was actually deducted so it ceases to accrue the ‘reasonable rate of return’ within the calculation from that point on.

I understand that in some cases, consumers have received income payments after Keydata defaulted. It is only fair that such payments are taken into account in my award and I have allowed for this possibility in the award formula. It should be noted that the income payments do not include any distributions made following the Bondholder Notice dated February 2013 which is discussed further below.

In relation to C, I understand that the fund cannot be encashed. For that reason, as set out above, for the purpose of C the investment should be treated as having a nil value. However, that is provided Mr B agrees to the IFA taking ownership of the investment if it wishes to. The IFA would then be able to obtain any value of the investment as and when that value can be realised plus any distributions made from it.

I am aware that a Bondholder Notice dated February 2013 (and some later notices) indicate that there may be further distributions to bondholders. I consider that as part of any arrangement to pay the award and to take ownership of the investment it would be reasonable for the IFA to make appropriate provision for it to receive any distributions if it is entitled to, taking account of the redress calculation and any assignment rights.

This would cover a situation where Mr B receives the distribution before the award has been paid and/or before transfer of ownership to the IFA has been completed. It would also cover a situation where the distribution is incorrectly paid directly to Mr B even though ownership has been transferred. I would ask Mr B to note that carefully. He will need to co-operate with the IFA to enable it to make the necessary calculations and in order for it to take ownership of the investment if it wants to.

In the event that the full compensatable sum exceeds our limit and the IFA only pays up to that limit, then any distributions would be paid in accordance with the approach set out in the recommendation section of this decision. So in short, if the business decides to limit its payment to the financial limit, any value, including any distributions that have or will be paid shall be retained or paid to Mr B until the amount received (excluding any interest payment) has reached the full compensatable loss due. Then any further distributions/value in excess of this sum can be taken by the IFA.

Similar to the situation with the FSCS payment, in the event that Mr B has already received any distribution payments, but these were paid after 13 November 2009, they should not be deducted from the amount D. Rather the sum used to calculate the interest payment should be reduced by the amount Mr B has received from the date of the distribution payments. Again, Mr B should provide evidence of the date at which any payment was made and the amount received.

I understand that this case may involve an award that would exceed our limit of £100,000. If so, the amount of any distribution that should be paid to the business will depend on whether the business decides to pay the full award or not and the extent to which any distribution exceeds the amount the consumer is entitled to receive. To cover this situation, I make a recommendation as follows:

recommendation

If the compensatable loss (figure D in the above calculation) exceeds £100,000,
I recommend that the IFA pays Mr B the balance. Interest at the rate specified above would then be added to this figure. This recommendation is not part of my determination or award. It does not bind the IFA. Whether Mr B can accept my decision and go to court to ask for the

balance is uncertain. Mr B may want to consider getting independent legal advice before deciding whether to accept this decision. And in the circumstances, I have given Mr B a longer time (three months) to notify me whether he accepts or rejects my decision.

If the compensatable loss exceeds £100,000 and the IFA does not agree to pay this in full, any reassignment of ownership referred to above should only concern itself with any amounts which are in excess of the full compensatable loss. To identify this amount, the IFA should deduct £100,000 from the compensatable loss. The resulting figure is the amount Mr B is entitled to retain by way of any future value and/or distributions. Any value or distributions that might be made over and above this amount may be assigned to the IFA, if the IFA decides to take a transfer of those rights.

If the compensatable loss exceeds £100,000 and the IFA decides to pay the entire amount, the IFA is entitled to take an assignment of the rights to all future value and also any distributions (whenever paid) of the investment if it wishes.

Simon Rawle
ombudsman

PROVISIONAL DECISION

summary of complaint

This complaint has been brought by a firm of solicitors on behalf of Mr B. It concerns the advice he received from HFM Columbus Partners LLP (the IFA) to invest in a Keydata investment. Mr B believes the investment was unsuitable, particularly in view of the associated risks and the fund being invested in traded life policies.

background to complaint

In April 2008, Mr B sought investment advice from the IFA. Acting on the advice of the IFA, Mr B invested £120,000 in the Keydata Defined Income Plan (issue 1).

The product provider, Keydata Investment Services Limited (Keydata), acted as Mr B's agent and purchased the plan. The issuer of the plan was Lifemark S.A., which was a Luxembourg based 'special purpose vehicle'. The plan was invested for a term of five years. Keydata went into administration on 8 June 2009 and defaulted on 13 November 2009. Mr B consequently experienced a significant loss.

Mr B previously submitted a claim to the Financial Services Compensation Scheme (FSCS). The FSCS accepted the claim and paid compensation. As this did not fully compensate him for his losses, Mr B opted to continue pursuing his complaint against the IFA. The FSCS subsequently reassigned the rights of the policy back to Mr B. As a result, we were able to consider the complaint.

The adjudicator who investigated the complaint was of the view that the complaint should be upheld because the recommendation to invest in the Keydata bond was unsuitable for Mr B, considering his circumstances. Also, she felt the plan itself and the risks were complex and these would have been difficult for Mr B to understand.

In response to the adjudicator's opinion on the merits of this complaint, the IFA made a number of points including:

- The recommended product was suitable for Mr B's aims and objectives at the time when the IFA gave him advice, especially considering Mr B was assessed as being prepared to accept investments with a low risk of capital erosion.

- widely accepted that life settlements offer investors the potential for returns which are almost entirely uncorrelated to other investment markets.

- There is clear evidence to suggest that the FSCS agrees that the product is low risk. Furthermore, the FSCS found nothing to suggest that the product entailed higher risk than corporate bond funds or equities.

- Regardless of its view of the complexity of the product, the regulator at the time, the Financial Services Authority (FSA), did not consider the risks to consumers to be significant. Despite raising other extreme concerns in October 2007, the FSA raised no concern about the low risk categorisation being attributed to the investment or about the population to which it was being sold. Moreover, during an audit in 2009, the FSA concluded that the sale of this product was suitable for low risk investors.

- Additionally, Mr B had been made aware that capital was not guaranteed and might not be returned in full if the actuarial model failed to perform as predicted.

- The prospect of an insured living longer than anticipated was likely to result in reduced returns and not capital loss, assuming that premiums were maintained.

- The IFA detailed the reasons why it took the view that the associated risks such as carrier risk, lapse risk, longevity risk and counterparty risk were not significant and that the overall risk of the bond had been mitigated.

- At the time of advice, there was nothing generally being said in the public domain raising any industry or regulatory concern about life settlements as an asset class, the Keydata life settlement backed products or Keydata itself.

- The IFA could not have discovered the inaccuracies stated in Keydata's marketing material and it would not have recommended the product to Mr B if the true facts were materially different from those actually represented by Keydata.

- It would be unfair and unreasonable for the IFA to be found to have given unsuitable advice based on misrepresented facts when it firmly believed the information given to it by Keydata was reliable.

- Keydata was a regular recipient of industry awards and provided third party administration services to Blue Chip companies such as HSBC. There was nothing to indicate any potential problem with Keydata life settlement backed products. On the contrary, the strength of the secondary life settlement market was increasing on a yearly basis whilst credit continued to be freely available within the market.

- Investment losses resulted from well-intended but ill-judged intervention which disrupted the proper management of the fund, as opposed to any failing in the product or the advice provided by the IFA.

- It would be unfair and unreasonable for the Financial Ombudsman Service to decide that the IFA should pay financial redress to Mr B if his financial detriment was caused by the wrongdoing of Keydata and its directors.

- The fund was regularly reported as performing as expected until the onset of the credit crunch, a phenomenon the IFA could not have reasonably foreseen. The credit crunch placed possible liquidity pressure on a fund that was already facing greater pressure than the IFA had otherwise understood because of high levels of undisclosed fees paid to connected parties, and apparent mis-management outside of represented parameters.

- Additionally, the liquidity issues were compounded by subsequent regulatory action, which again the IFA could not have foreseen.

I must decide this case on its individual merits. However we have considered complaints about Keydata bonds before and published a decision which sets out our general approach to such complaints on our website. The decision is in the *investment* section of our *online technical resource* which can be found by clicking the *publications* tab.

my provisional findings

I have read and considered all the evidence and arguments available to me from the outset, in order to decide what is fair and reasonable in all the circumstances of this complaint. I have included above only a summary of the complaint background. But I have carefully considered everything Mr B and the IFA have provided in order to decide what is fair and reasonable in all the circumstances of this complaint.

When considering what is fair and reasonable, I am required to take into account relevant law and regulations; regulator's rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

I am therefore mindful of the general legal position including: the law relating to negligence, misrepresentation and contract (including the express or implied duty on professional IFA's to give advice with reasonable skill, care and diligence); and the law relating to causation and foreseeability.

There appears to be no dispute that this was an advised sale of an investment product where the IFA assessed the suitability of the product for Mr B. As the IFA gave advice about regulated investments, I have taken account of the regulatory regime that applied at the time which includes the relevant FSA principles and rules on how a business should conduct itself.

Taking the relevant considerations into account, it seems to me that the overarching question I need to consider in this case is whether the recommendation of the Keydata product was suitable for Mr B's particular circumstances and objectives.

In doing so I need to take into account the nature and complexity of the investments and Mr B's financial circumstances, needs and objectives; understanding and relevant investment experience; and tolerance to investment risk.

The documentation completed by the adviser at the time of advice recorded:

- Mr B was 67 and a widower;
- He had retired from his main employment;
- He was receiving state benefits amounting to £2,640 per annum and an annual pension income of £6,480;
- He owned his main residence valued at £760,000 and for which he had an existing interest-only mortgage for £330,000;
- He held £150,000 on deposit;
- He was entitled to the income generated from the invested trust monies of his late wife's residual estate for the remainder of his life; he was also entitled to receive capital at the discretion of the trustees.

It was further recorded that Mr B's main priority was to maintain his standard of living in retirement. He also wanted to mitigate his estate's liability to inheritance tax. From his £150,000 held on deposit, Mr B wanted to invest £140,000 to generate the additional income he required. He did not require the potential for capital growth on this investment.

The Suitability Letter completed by the adviser in March 2008 recorded Mr B's attitude to investment risk as *'low'*. The report stated this meant Mr B preferred the security of cash, fixed interest and other low volatility investments and accepted this might result in low rates of return being earned on his portfolio. It was further recorded that although Mr B would feel uncomfortable if his investments fell and rose sharply in value, he was willing to accept some investment risk in order to achieve improved returns.

The adviser recommended that Mr B invest £120,000 into the Keydata Secure Income Plan (issue 15). The adviser stated the plan was a fixed term account paying a fixed rate of return over the five-year term. He further stated that the plan was recommended because it provided an attractive rate of income for a lower risk investment not linked directly to the equity market.

In a subsequent letter, the adviser informed Mr B that the Secure Income Plan had reached its maximum capacity of £1 billion and Keydata had subsequently launched its successor, the Defined Income Plan. The adviser had therefore invested Mr B's funds in the latter plan which he stated comprised of the same underlying assets as the Secure Income Plan.

In assessing whether the advice provided to Mr B was suitable, the key issue I must decide is whether the Keydata plan presented a higher risk than Mr B was willing to accept. In considering this issue, I have carefully considered the documentation relating to the plan, along with any information the IFA had access to before making the recommendation.

It is helpful to set out a description of the investment. I note the FSA imposed a financial penalty on Norwich and Peterborough Building Society for failing to give its customers suitable advice in relation to the sale of Keydata life settlement products. The FSA's final notice in respect of Norwich and Peterborough Building Society dated April 2011 provides a helpful summary in slightly more accessible terms of this type of plan:

> *The Keydata Products were based on investments in corporate bonds. On behalf of investors, Keydata purchased bonds which were issued by special purpose vehicles incorporated in Luxembourg. The first Keydata Product offered by N&P was the Secure Income Bond ("SIB") Issue 3, for an investment in a bond issued by SLS Capital SA ("SLS"). N&P offered a further 22 Keydata Products which were investments in bonds issued by Lifemark SA ("Lifemark") . . . The funds raised through the issue of the bonds (ie the amount invested by retail customers in the products through Keydata) were then invested in a portfolio of US life insurance policies and cash. The Keydata product materials stated that the investment mix was intended to be . . . 60% policies/40% cash for the bonds issued by SLS, and 70% policies/30% cash for the bonds issued by Lifemark. SLS and Lifemark each purchased life insurance policies from elderly US citizens, paid the premiums due on those policies, and collected the maturity payment due under the policy when the individual died.*

The potential problems with these types of investments are now well known. So it is important to avoid the benefit of hindsight in the assessment of these matters today. That said, in my view, it was clear from the description and the other information reasonably available to the IFA at the relevant time that the plan was not a secure investment and presented some considerable risk to capital.

Investors could lose money if the insurance companies issuing the insurance contracts defaulted on their obligations, or if the issuer of the bond went into liquidation, or if factors changed which affected the rate at which insurance contracts mature. There was also the possibility that investors could lose money if the traded insurance contracts fell in value, or if certain assets did not mature in a way predicted by the financial model.

The FSA found that the product material revealed a number of significant distinctive features to the bond, including the following:

- Although the Keydata products were intended to return capital in full at the end of the investment period, they offered no capital guarantee, and put all capital invested at potential risk.
- The successful performance of the Keydata products depended on the accuracy of actuarial models used by Keydata. There was a risk that significant technological or pharmaceutical development could impact on the accuracy of the models and when insurance policies were likely to mature.
- The bonds had a fixed term of five or seven years. This meant that Keydata undertook to return funds to investors on the date when the bond matured, even if, at that point in time, it had insufficient funds because the insured individuals were living longer than anticipated.

- The underlying insurance policy assets were not traded on an exchange in the way that stocks and shares are. The resale market for these assets also created a risk that, if it became necessary to sell an insurance policy to make funds available, this might take longer than anticipated, and might only be possible at a reduced value, reducing the value of the portfolio.

- The Keydata products involved investment in a single specialist asset class (US senior life insurance policies) through a single issuer (at first SLS, then Lifemark). Although a percentage of the investment was to be held in cash, this was not held as a separate investment, but was intended to be used to pay the insurance premiums, income payments and operational costs associated with the investment.

- The Keydata products had a significant international dimension: the underlying assets were US life insurance policies, and the issuers of the bonds were based in Luxembourg.

These concerns were apparent (or should have been) to a financial professional at the time and should have been taken carefully into account in assessing the suitability of the Keydata plans. Accordingly in my view, to a professional IFA, these investments would not and should not have been considered suitable for investors unwilling to accept a significant degree of risk like Mr B.

It has been suggested by the IFA that Mr B was prepared to take a degree of risk. I do not doubt that to be true. However, to my mind that does not justify the IFA recommending an unsuitable investment.

Further, it is not sufficient in my view for the IFA to simply assert it relied on the headline description of the investment when making its assessment of suitability. Similarly, it would not be fair and reasonable for an IFA to rely on warnings within the plan's marketing material. Rather the IFA should be exercising professional judgement about the inherent nature of the investment and its suitability for a client's particular investment needs. The IFA should have identified those significant risks inherent in this product and taken them into consideration when recommending the investment to Mr B.

Having reviewed the plan literature, I consider that a professional IFA should have appreciated that Mr B's capital would be placed at significant risk – and exposed to a far greater degree of risk than Mr B was willing to accept. I am not persuaded that Mr B was willing to invest such a large amount of his capital into an investment with the risk characteristics I have set out above.

Having carefully considered the available evidence, I find on balance that the IFA's recommendation to invest in the Keydata plan was entirely at odds with Mr B's circumstances and requirements.

I appreciate that the life settlement products offer investors the potential for returns and are likely to be composed of a different asset type compared to other investments markets. However, these factors do not justify the IFA recommending an unsuitable investment.

The IFA has also pointed out that the investment would not be complex for Mr B's understanding. I note that the suitability letter says that Mr B had a reasonable knowledge of investments as he already had investments and pension contracts. However, I also note that the IFA provided a risk tolerance questionnaire used, it says "to determine the client's attitude to risk". In this document, Mr B in answer to the question, *how would you describe your level of investment knowledge experience?* rings 'minimal' which says *I know very little about investments.* Of course between the date of filling in the tolerance form and the sale of the product Mr B's knowledge may have increased. Nevertheless I think that this supports my view that Mr B's knowledge of investment was not sufficient for him to understand the nature of the risks posed by this product.

In addition, even if I were persuaded that Mr B did have a greater knowledge of different types of investment this does not justify the provision of unsuitable advice to Mr B. It is entirely understandable in my view that Mr B acted upon the recommendation of a professional adviser and was entitled to rely on that advice. The adviser had an obligation to ensure that the recommendation was suitable for Mr B's needs and objectives. To my mind, it failed to do so.

The IFA has highlighted that this service seems to be reaching a different view on the funds to that of the regulator and the FSCS. However, I am not persuaded that I am reaching a view that is inconsistent with these organisations. Certainly, they have not reached any view on this particular case. Needless to say, I am required to undertake my own independent and impartial assessment of the complaint, based on its individual merits. That is what I have done and that is the basis on which I have determined whether or not the advice given by the IFA was suitable or not.

I have carefully considered the IFA's view on the risks associated with the funds, but on balance I am not persuaded that they were suitable for Mr B. Moreover, I do not consider that the warnings and descriptions of the fund were sufficiently clear to suggest to Mr B that he should act otherwise than on the advice of the IFA.

I am of the opinion that the IFA should have carefully considered the impact of all the risks in their entirety prior to recommending the product to Mr B. Further, I consider that the risks inherent in the investment were foreseeable and these should have been carefully considered by the IFA before any recommendation was made to invest.

This is not a view reached with hindsight. I have based my findings on the product's suitability for Mr B based on what the IFA knew or could be expected to find out about the investment at the time the advice was given and based on a reasonable expectation of how the bond would operate.

In all the circumstances of this case, I cannot lightly ignore the fact that Mr B's monies would not have been exposed to these risks had the IFA carried out its responsibilities properly.

I note the IFA has said that at the time of the sale there was nothing to undermine the perceived low risk nature of the investment from the information publicly available. However, it is my view that the investment contained the significant risks identified above, and that should have been apparent to the IFA.

Furthermore, the IFA has highlighted that the plan had the involvement of highly respected household names. Nevertheless, for the reasons I have explained above, I remain of the view that the recommendation was unsuitable for Mr B. The involvement of household names does not alter that fact, nor justify an unsuitable recommendation to invest.

Additionally, although certain documentation included mention of household names any assurance provided by their involvement was largely illusory. Their roles were strictly limited and provided no real assurance about the controls over or quality of the investments or fund management arrangements.

Similarly, I have carefully considered whether the intervention of the regulator should have a bearing on whether or not the IFA should be held responsible for the unsuitable advice they gave to Mr B. In relation to the action of the FSA, I make no comment other than to note that any action taken – or not taken - does not alter my view that the investment was unsuitable for Mr B for the reasons I have already given. Moreover, the risks inherent in the investment were in my view foreseeable and these should have been carefully considered by the IFA before any recommendation was made to invest. As a result, I am not persuaded that the actions of the regulator (or for that matter any other party) should mean that the IFA is not held responsible for any loss that flows from the unsuitable advice it has given.

Having reached the view that the recommended investment was unsuitable, I now need to consider what Mr B would have done 'but for' the advice he received.

I have not seen anything which suggests to me (and I find it highly unlikely) that Mr B would have invested in the plan, if it had not been recommended to him. Nor am I persuaded that Mr B would have invested in the plan if things had happened as they should. The investment was not suitable for his needs and circumstances, and I do not think he would have invested had he appreciated the risks. Given that finding I do not believe it is unreasonable to require the IFA to compensate Mr B for any investment loss and so it is now necessary to consider how to calculate fair compensation.

Overall I think it most likely that Mr B would have invested this capital into another investment suitable for his circumstances and needs. On balance, I consider that a fair benchmark to indicate the investment return on his investments is 1% more than the Bank of England base rate compounded yearly from the date of investment until the date the loss crystallised when Keydata defaulted in November 2009 or until the date that the last income payment was made if later.

I have also considered what award I should make in respect of interest on the crystallised loss. Our normal approach is to use an 8% simple interest figure from the date the loss crystallised until the date of settlement.

This is not intended to be an interest rate in the way that a bank deposit account pays interest. Rather it is a rate which I consider to be a fair yardstick for compensating consumers for a wide range of possible losses and lost opportunities they may have incurred. For example, the may have:

- Borrowed money, or continued to borrow money, at credit card or loan rate which they would not have done if the money had been available to them;
- Saved or invested the money in some way producing a variety or possible returns;
- Spent the money on holidays, home improvements, or any number of goods which might have given them an unquantifiable return;
- Or any combination of these things.

The 8% simple interest rate is gross and is subject to tax – and is a rate often (but not always) used by the courts in not dissimilar situations.

Bearing this all in mind and taking account of the particular circumstances – I consider that the 8% simple rate is fair and reasonable.

my provisional decision

For the reasons set out above, my provisional decision is that I currently intend to uphold this complaint.

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £100,000, plus any interest and/or costs that I consider appropriate.
If I consider that fair compensation exceeds £100,000, I may recommend the business to pay the balance.

My aim is to put Mr B in the position he would now have been in but for IFA's poor advice. In deciding how to assess fair compensation I consider it fairest to assume;

- With reasonable advice, Mr B would have had the original capital intact plus a reasonable rate of return;
- The rate of return on the original capital would have been equivalent to 1% more than Bank of England base rate from time to time compounded yearly.

determination and award

I currently intend to uphold this complaint. I consider that fair compensation should be calculated as D, where:

A = the capital invested in the Keydata plan, less any amounts paid out by way of withdrawals, distributions of capital or before-tax income;

B = a return on the amount from time to time of A, by way of a return of the Bank of England base rate plus 1% per annum, compounded annually from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised) or until the date that the last income payment was made if later;

C = the residual value of the investment that Mr B made in the Keydata plan, which I assess to be zero for this purpose.

D = A + B – C.

My provisional decision is that HFM Columbus Partners LLP should pay Mr B the amount produced by this calculation (that is the amount D) up to a maximum of £100,000. To that sum the IFA should add interest from 13 November 2009 (or from the date that the last income payment was made if later) at the rate of 8% per year simple until this award is paid.

As it is my understanding that on payment of this compensation the FSCS will require repayment of its compensation to Mr B, no allowance should be made for any sum received from the FSCS in the calculation of the investment loss. However, Mr B has had use of this money since it was paid.

Accordingly, although the amount D should not be reduced, the sum used to calculate the interest payment should be reduced by the amount Mr B received from the date of the FSCS payment. Mr B should provide evidence of the date at which the payment was made and the amount received.

If the IFA considers it is legally obliged to deduct income tax from the interest (ie the amount to be added to part D only), it must provide Mr B with a tax deduction certificate so he can reclaim any tax from HM Revenue and Customs if he is eligible to do so.

For clarification, A and B above should work as follows. Any sum paid into the investment should be added to the calculation from the point in time when it was actually paid in so it accrues the ‘reasonable rate of return’ within the calculation from that point on. Any reduction to the investment (excluding the final encashment payment) should be deducted from the calculation at the point in time when it was actually deducted so it ceases to accrue the ‘reasonable rate of return’ within the calculation from that point on.

I understand that in some cases, consumers have received income payments after Keydata defaulted. It is only fair that such payments are taken into account in my award and I have allowed for this possibility in the award formula. It should be noted that the income payments do not include any distributions made following the Bondholder Notice dated February 2013 which is discussed further below.

In relation to C, I understand that the fund cannot be encashed. For that reason, as set out above, for the purpose of C the investment should be treated as having a nil value. However, that is provided Mr B agrees to the IFA taking ownership of the investment if it wishes to. The IFA would then be able to obtain any value of the investment as and when that value can be realised plus any distributions made from it.

I am aware that a Bondholder Notice dated February 2013 (and some later notices) indicate that there may be further distributions to bondholders. I consider that as part of any arrangement to pay the award and to take ownership of the investment it would be reasonable for the IFA to make appropriate provision for it to receive any distributions whenever paid

This would cover a situation where Mr B receives the distribution before the award has been paid and/or before transfer of ownership to the IFA has been completed. It would also cover a situation where the distribution is incorrectly paid directly to Mr B even though ownership has been transferred. I would ask Mr B to note that carefully. He will need to co-operate with the IFA to enable it to make the necessary calculations and in order for it to take ownership of the investment if it wants to.

Similar to the situation with the FSCS payment, in the event that Mr B has already received any distribution payments but these were paid after 13 November 2009 they should not be deducted from the amount D, but the sum used to calculate the interest payment should be reduced by the amount Mr B received from the date he received any distribution payment. Again, Mr B should provide evidence of the date at which any payment was made and the amount received.

I understand that this case may involve an award that would exceed our limit of £100,000. If so, the amount of any distribution that should be paid to the business will depend on whether the business decides to pay the full award or not and the extent to which any distribution exceeds the amount the consumer is entitled to receive. To cover this situation, I make a recommendation as follows:

recommendation

If the compensatable loss (figure D in the above calculation) exceeds £100,000, I recommend that the IFA pays Mr B the balance. Interest at the rate specified above would then be added to this figure. This recommendation is not part of my determination or award. It does not bind the IFA. Whether Mr B can accept my decision and go to court to ask for the balance is uncertain. Mr B may want to consider getting independent legal advice before deciding whether to accept this decision.

If the compensatable loss exceeds £100,000 and the IFA does not agree to pay this in full, any reassignment of ownership referred to above should only concern itself with any amounts which are in excess of the full compensatable loss. To identify this amount, the IFA should deduct £100,000 from the compensatable loss. The resulting figure is the amount Mr B is entitled to retain by way of any future value and/or distributions. Any value or distributions that might be made over and above this amount may be assigned to the IFA, if the IFA decides to take a transfer of those rights.

If the compensatable loss exceeds £100,000 and the IFA decides to pay the entire amount, the IFA is entitled to take an assignment of the rights to all future value and distributions of the investment if it wishes.

Simon Rawle
ombudsman