Financial Ombudsman Service

complaint

Mr F complains Lloyds Bank PLC (Lloyds) wrongly advised him to invest in a structured investment, the Scottish Widows Protected Capital Solutions Fund 1 (PCSF1).

background

Mr F was retired and had an income of just over £11,200 in 2009. He had over £200,000 in secure and balanced funds and savings accounts, with £20,000 in speculative shares.

The advisor recorded Mr F was happy to invest for the short term as he sees this as a last chance to invest for growth but keeping access to his funds was key. He recommended Mr F invest £90,000 in the PCSF 1 fund, but after three meetings Mr F decided to invest £50,000. The advisor's note said "a cautious investment approach is acceptable as long as any product has a built-in capital guarantee at maturity".

The investment

The PCSF 1 was a structured investment in which the returns were linked to the performance of the FTSE 100. It had a 'cliquet' structure, which meant the 3.5 year term of Mr F's investment was divided into chunks of six months (called index valuation periods, or 'IVPs'). The performance of the index in each IVP was measured, with any gain or loss being capped at 3.5%. At the end of the term, these values were aggregated and the return on the sums invested would be equal to the aggregate gain in the index over the period.

If this formula did not return a gain, investors got back their initial investment (plus interest earned while the funds were invested in cash before the first IVP commenced).

Over the term of the investment, the FTSE 100 grew by about 40%. But the index fell in four of the seven IVPs giving a capped negative figure of -9.16% while the capped gains in the three periods where the index grew (totalling 10.5%) were reduced to 1.34%. So on a three and a half year investment of £50,000 Mr F received interest of £724.09.

The adjudicator's view

An adjudicator at this service felt Mr F's complaint should be upheld.

She said Mr F was looking to invest some money but keeping access to those funds was important to him. Yet this structured product would lose its capital protection if any mid-term withdrawals were made. That said, she recognised Mr F was left with £128,000 in deposit accounts and other investments after this sale.

On balance, she felt a capital protected structured product was a reasonable option for Mr F to propose, particularly as the sum invested was about 23% of his cash assets (some of which were already invested in equities).

But she wasn't convinced Mr F was given sufficient information to be able to take an informed decision about whether this 'cliquet' product was suitable for him.

She noted the Financial Conduct Authority ('FCA') said the pay-offs in these products are based on the value of an index or benchmark over successive short periods within the investment's term. These periods usually have a cap on the maximum return (and minimum loss) for each short period.

She said products with 'cliquet' structures tended to be among the most complex of all capital protected structured products. She noted the FCA had said, in a recent enforcement notice, that potential customers required a high level of sophistication and experience in order to understand the likelihood of achieving anything above the minimum return.

The FCA's concern is that 'cliquet' products tend to be difficult for the average retail consumer to understand, especially when it comes to the likely return. So if one is recommended to an unsophisticated or inexperienced investor, the business must make sure the consumer clearly understands how the product works, so they can make an informed choice about investing.

She said Mr F was not a sophisticated investor, hadn't invested any structured products before, and had no prior experience of how a complex investment like the PCSF 1 worked.

She therefore considered the steps Lloyds took to ensure Mr F understood how the PCSF 1 worked and the risks involved. In particular, the capping of positive investment performance at various valuation dates and the averaging out of these against negative performance and the impact of this on the ultimate return.

She felt the explanation of the mechanics of the product was particularly important as Mr F didn't have the capacity to absorb little or no returns on maturity.

She said the recommendations' letter didn't explain how the product worked. Rather, it referred Mr F to a personal illustration and key features document, saying "It is essential that you read these documents in conjunction with this Financial Planning Report".

She noted Mr F had no recollection of the advisor explaining how the PCSF 1 worked. She also said when she explained the IVPs and their impact on calculating the overall return on the investment he said that this was not familiar to him.

She felt the advisor ought reasonably to have known Mr F was not sophisticated, or experienced enough to understand how a complex product like the PCSF 1 would work simply by reading the literature alone.

Mr F said he'd looked at the product literature, but felt you'd need to be a 'money specialist' to fully understand it. She agreed with this, and didn't consider it adequate for the advisor to simply refer Mr F to the product literature.

She also noted Lloyds had approached Mr F unsolicited, and he was reliant upon its advice in deciding whether or not to invest in the PCSF 1.

She further noted the advisor recorded one reason for recommending the product as, "this will help protect you against severe, short-term market falls by 'locking-in' performance returns at set intervals throughout the term".

She said this statement was confusing at best, and potentially misleading. The PCSF 1 did not 'lock-in' performance. Instead, capped positive performance was offset by capped negative performance. If negative performance across the aggregated periods exceeded positive, a negative result would be the outcome – thus wiping out any positive gains. This could not fairly be described as 'locking-in' performance returns.

In conclusion, she felt if Mr F had been made aware of all these issues, he would have been unlikely to agree to this investment.

Lloyds did not agree, and said:

- The fund was suitable for a cautious investor looking for a capital guarantee and the prospect of a higher return that that available on interest bearing accounts
- The FCA didn't conclude that 'cliquet' products were intrinsically inappropriate, rather that the features should be clear so consumers could see how gains were deliverable
- Mr F was an experienced investor, if not a sophisticated one, who was aware that stock market-exposed investments didn't have the same guarantees as a deposit account
- Mr F had three meetings with the advisor, and it's most likely the nature of the investment was fully explained
- Mr F received all the relevant documentation, and Lloyds cannot be held responsible if he didn't' read it thoroughly
- This documentation said that no growth was guaranteed, and could be higher or lower than that on offer via a savings deposit account
- Mr F, after consideration, chose to invest a lower sum than that recommended by the advisor – this suggests he had sufficient knowledge and time to choose to make this investment decision

my findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

In this case, I agree with the adjudicator and for all the same reasons.

In essence, Mr F was not a sophisticated investor and I'm not persuaded he would have understood how PCSF worked by simply reading the documentation. The adviser ought to have sufficiently explained the risks inherent in a complex product like PCSF. I've not seen persuasive evidence to conclude that this happened.
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Overall, I believe if Mr F had clearly understood how the product worked he would probably not have gone ahead this investment.

The fact that Mr F chose to invest a lower sum than the advisor recommended does not, in my view, affect the overall merits of this case.

compensation

In assessing what is fair compensation, I consider my aim should be to put Mr F 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 F 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 F's circumstances and objectives when he invested.

what Lloyds should do?

To compensate Mr F fairly Lloyds should:

- Compare the performance of Mr F's investment with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

- Lloyds should also pay interest as set out below.

- Provide the details of the calculation to Mr F in a clear, simple format.

Income tax may be payable on any interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
Protected Capital Solutions Fund 1	matured	average rate from fixed rate bonds	date of investment	date of maturity	8% simple per year 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. Apply those rates to the investment on an annually compounded basis.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mr F 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 F's circumstances and objectives. It does not mean that Mr F 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.

further information

The information about the average rate can be found in the 'Statistics' section of the Bank of England website under 'Interest and Exchange Rates Data' / 'Quoted household interest rates' / 'Deposit rates' / 'Fixed rate bonds' / '1 Year'.

Some examples of how the calculation should be carried out are available on our website under 'Publications' / 'Online Technical Resource' / 'Investment' / 'Calculating compensation in investment complaints'.

my final decision

I uphold this complaint and instruct Lloyds Bank PLC to pay Mr F compensation as set out in the formula above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr F to accept or reject my decision before 8 April 2016.

Tony Moss
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