

## **complaint**

Mrs S's complaint about Bay Associates Limited concerns the advice she received to cash in her existing investment bonds and reinvest the proceeds in a new bond. She does not believe this advice was suitable, particularly in view of the costs associated with switching bond providers.

## **background**

Since 2003, Mrs S had held two investment bonds, both of which were invested in property funds. She had been making regular withdrawals from these bonds to supplement her income. Mrs S met an adviser representing Bay Associates in 2007 and recent issues with property funds, including changes to the basis of unit pricing, were discussed. The adviser recommended that cashing in these bonds and switching her money to a new bond would '*address this loss*' and also '*diversify*' Mrs S's holdings. Following this advice, Mrs S invested in a Canada Life bond split between the Canada Life UK property (60%), Investec cautious managed (20%) and Invesco Perpetual income (20%) funds.

I have previously issued my provisional decision on this complaint explaining why I considered Mrs S's complaint should be upheld.

In summary, I was not satisfied the advantages of switching investment providers outweighed the disadvantages, including the exit charges on the original investments and the set-up charges for the new investment. Had the adviser fully considered and explained the advantages and disadvantages of switching investment providers, I felt it was more likely Mrs S would have retained her existing bonds and simply switched funds. I was also concerned that the advice to invest 60% of the new bond in a property fund did not necessarily achieve the adviser's stated objective of diversifying her holdings.

Following comments received in response to my provisional decision, I have since arranged for letters to be sent to both parties proposing an amendment to my proposed approach to calculating compensation. Both parties have now responded to my original provisional decision and the subsequent correspondence.

Bay Associates made a number of comments in response to my provisional decision, raising the following key points:

- The surrender penalties paid on the original bonds were lower than the amount quoted in my provisional decision.
- Mrs S kept a small amount of the money she received from the surrender of her original bonds (not all of it was reinvested) and would have paid exit penalties on this amount anyway.
- Switching to a new bond increased the tax-deferred withdrawals Mrs S could make as this was based on the amount invested in the new bonds rather than the amount invested in the originals.
- The annual charges on the Canada Life bond were lower than the annual charges on the original bonds.
- The Canada Life bond also included an additional loyalty bonus if held for ten years.

- The Canada Life property fund invested in actual property. Unlike the property funds Mrs S switched out of, which held a proportion of property shares.
- Mrs S switched advisers in September 2011 and has made fund switches since that time. Bay Associates does not believe it should be held responsible for any losses resulting from advice given by another adviser.

Mrs S made a number of comments in response to my provisional decision, raising the following key points:

- I had mentioned that she held another bond, in addition to the two she surrendered, at the time of sale. Mrs S says she did not actually make this investment until 2010.
- But for the advice she received from Bay Associates, the main purpose of which she believes was to secure a sale, she would probably have left her money in the original bonds and in the same funds.
- In hindsight, she believes she should have been advised to retain more money on deposit as she has had to withdraw money from the bond to pay bills.
- My recommendation that compensation be calculated partly by reference to the APCIMS income index is not appropriate as the bond is not an income paying asset, with the withdrawals she has taken instead representing a return of capital.
- My proposed approach to calculating compensation does not mention the set-up charges and commission she paid when investing in the new bond, or the ongoing charges and exit charges.

### **my findings**

To decide what is fair and reasonable in this complaint, I have carefully considered everything Mrs S and Bay Associates have provided. Having reconsidered the case, including all responses to my provisional decision, my conclusions remain as set out in my provisional decision for essentially the same reasons.

In response to the points raised by Bay Associates:

I note Bay Associates says the surrender penalties on Mrs S's original investments were lower than I have previously quoted. But the difference is fairly small and does not alter my view on the merits of the advice to switch from one bond provider to another.

I am aware Mrs S did not invest quite all of the money received on surrendering her original bonds, although the amount she retained was very small. After reviewing the sales documentation, I have seen nothing to suggest she had any particular requirement for the amount that was not reinvested and I have no reason to believe she would have withdrawn this amount if she had not been advised to encash her bonds.

I appreciate the switch increased the amount of tax-deferred withdrawals available to Mrs S, but the increased amount available to her was relatively small. Either way, annual regular withdrawals from the original bonds were not limited to 5% of the amount invested if Mrs S was willing to accept the tax consequences of exceeding this amount.

My provisional decision acknowledged that the annual charges on the new bond were slightly lower than those that applied to the originals. But on balance, I was not persuaded this benefit justified the advice to switch bond providers given the disadvantages involved.

The loyalty bonus will only apply to the Canada Life bond if it is held for ten years and Mrs S is still some way from achieving this. But again, and while I recognise the benefit the loyalty bonus could bring, I am not persuaded it justified the advice to switch bond providers given the disadvantages involved.

I have reviewed the fund factsheets for the property funds in which Mrs S's original bonds were invested provided by Bay Associates. These show that shares made up less than 10% of one of the funds. While the proportion of shares in the other fund is not as clear from the factsheet, I note that direct property accounts for about 70% of the fund and no equities appear in the top ten holdings. With this in mind, I do not believe property shares formed a particularly significant part of either fund and I remain unclear about how the advice to reinvest 60% of her money back into property funds really achieved the diversification (at least for that part of her money) that the adviser said he was targeting for Mrs S.

I accept that Bay Associates should not be responsible for advice provided by another adviser, but I had not previously been told that Mrs S had switched advisers and subsequently arranged fund switches. I addressed this issue in the correspondence that followed my provisional decision and set out that I now believe any loss should be calculated up to the date of the first fund switch after Mrs S transferred to another adviser.

In response to the points raised by Mrs S:

The sales documentation records that Mrs S held a third investment bond that was not cashed in and this is what I referred to in my provisional decision. Whether this was held at the time of the advice in 2007 or taken out at a later date does not alter my decision on the advice Mrs S received in connection with the Canada Life bond.

Without the benefit of hindsight, it is very difficult to know exactly what Mrs S would have done but for the advice she received from Bay Associates. But the evidence from the time of sale does indicate some dissatisfaction with the recent performance of her existing investments and it is certainly true that the economic situation at that time caused many property funds to experience problems. In the circumstances, I do not believe it is unreasonable to think Mrs S may have had concerns about her original investments. And even if she had not been advised to cash them in, I think there is every chance she would have switched at least some of her money into alternative funds within the original bonds.

I note that with hindsight, Mrs S now believes she should have been advised to retain more money on deposit. But the evidence from the time of sale does appear to show the adviser discussed how much she needed as an emergency fund and that she was left with more than this amount on deposit.

The intention of my proposed approach to calculating compensation is to put Mrs S back into the position she would have been in had she not cashed in her existing bonds and reinvested the proceeds. As explained previously, I think it is likely that she would have switched funds with at least some of her money. And without knowing which funds would have been selected, I must make some assumptions about the returns she would have earned. For the reasons previously outlined in my provisional decision, and while I am aware

that withdrawals from the bond are classed as a return of capital rather than income, I believe a combination of the average returns on fixed rate bonds and the APCIMS income index is a reasonable basis for comparison as it gives a portfolio broadly consistent with Mrs S's aims and risk profile.

With regard to the charges Mrs S incurred as a result of the advice she received, I have accounted for the surrender penalties on the original bonds by adding this amount to the amount reinvested in the hypothetical or '*fair value*' element of the calculation. And using the surrender value of the Canada Life bond in the '*actual value*' element of the calculation will take account of the set-up charges Mrs S paid when she reinvested, the ongoing management charges and any surrender penalties that would apply if she cashes it in. While I do appreciate her concerns about commission, it is my understanding that this was an arrangement between Canada Life and Bay Associates and not something that Mrs S paid directly. As such, I am satisfied it does not need to be taken into account separately in calculating the compensation that is due.

### **fair compensation**

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

I take the view that Mrs S 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 S fairly, Bay Associates must compare

- the performance of Mrs S's investment

with

- the position she would now be in if 50% of the amount she invested in the Canada Life bond (plus the total of the early surrender penalties paid on cashing in her original bonds) 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 APCIMS Stock Market Income Total Return Index ('APCIMS income index')

If there is a loss, Bay Associates should pay this to Mrs S.

I have decided on this method of compensation because Mrs S wanted income with some growth with a relatively low level of risk to her capital. Mrs S was prepared to invest for a longer period of time – but with some flexibility.

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 her capital. It does not mean that Mrs S 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 APCIMS income index, which is a combination of diversified indices of different asset classes, mainly UK equities and government bonds would be a fair measure for a consumer

who was prepared to take some risk to get a higher return. I consider that Mrs S's risk profile was in between, as she was prepared to take a relatively low level of risk. I take the view that a 50/50 combination is a reasonable compromise that broadly reflects the sort of return Mrs S could have obtained from investments suited to her 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 Mrs S into the position she would have been in had she received appropriate advice.

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

The compensation payable to Mrs S 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 surrender value of Mrs S's investment at the date of the first fund switch after she transferred her investment to another adviser.

The *fair value* is what the amount invested (plus the total of the early surrender penalties paid on cashing in her original bonds) would have been worth if it had obtained a return using the method of compensation set out above.

To arrive at the *fair value*, Bay Associates should work out what 50% of the original investment (plus 50% of the total of the early surrender penalties paid on cashing in her original bonds) 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 of the first fund switch after she transferred her investment to another adviser and apply those rates to that part of the investment, on an annually compounded basis.

Bay Associates should add to that what 50% of the original investment (plus 50% of the total of the early surrender penalties paid on cashing in her original bonds) would be worth if it had performed in line with the APCIMS income index from the date of investment to the date of the first fund switch after she transferred her investment to another adviser.

Any additional sum that Mrs S 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 Mrs S 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 Bay Associates 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 of the first fund switch after Mrs S transferred her investment to another adviser to the date of settlement. Income tax may be payable on this interest.

If Bay Associates considers it is legally obliged to deduct income tax from the interest, it must provide Mrs S with a tax deduction certificate so she can reclaim any overpaid tax from HM Revenue and Customs if she is eligible to do so.

***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.

**my final decision**

My final decision is that I uphold this complaint.

I direct Bay Associates Limited to pay Mrs S compensation calculated using the method set out above.

Jim Biles  
**ombudsman**