

complaint

Mrs A has complained that advice she received from The Prudential Assurance Company Limited ("the business") in 2000 to invest in the Balance Trust fund of an Individual Savings Account (ISA) was unsuitable for her. She is represented in her complaint by a third party adviser.

Specifically, her representative has said that:

- Mrs A was an inexperienced investor whose available capital savings were all held on deposit;
- Her recorded attitude to investment risk did not match her personal and financial circumstances at the time;
- She surrendered the ISA after approximately three years when its value was almost £1,000 less than the original capital sum she invested. The fund selected by the adviser was not a cautious-rated fund;
- Mrs A should have been advised to consider reducing her existing debts (and hence her interest payments) rather than investing in a risk-based product with charges;
- The advice was completed at one appointment which was insufficient for Mrs A fully to appreciate and understand the product she was being recommended.

background

Mrs A's complaint was investigated by one of our adjudicators, who concluded that it should be upheld because she noted that Mrs A was a first-time investor and disclosed that she was prepared to take a *cautious* degree of risk with her capital. The adjudicator also considered that Mrs A was financially inexperienced at the point of sale and that the risk profile of the fund did not match her approach to investment.

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

- Mrs A disclosed that she was prepared to take a 'cautious' approach to investment (being '3' on a scale of '1' to '4'). Its risk profile system at the time allowed Mrs A to select a more cautious attitude to risk and she did not do so;
- The fund selected matched her recorded attitude to risk at the time and presented a moderate risk to her capital by investing in a range of assets, including fixed interest securities and equities;
- The adjudicator's basis of redress assumes that Mrs A should have received a return on her investment using an index that was similar in risk to the fund that was considered unsuitable.

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 of Mrs A's financial circumstances at the time is that she earned a modest income from employment, held a joint mortgage with her husband covered by an endowment policy and some capital savings. Although these savings were held in capital-secure deposit accounts, it was recorded that Mrs A was prepared to adopt a 'cautious' attitude to risk for investment.

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

Indeed, it is noticeable that the only risk profile category Mrs A could have selected above 'cautious' was 'adventurous' and therefore, the range of funds that matched a 'cautious' approach could have been so widespread as to include any fund above 'very cautious' as long as it did not present a highly 'speculative' degree of risk. As it was, the Balance Trust fund included an exposure to significant holdings in UK and overseas equities and fixed interest securities that, in my view, represented a degree of risk that Mrs A should not have been asked to consider.

The ISA was recommended to Mrs A on the understanding that she would hold it over the medium to long term for capital growth. That she took a significant loss by surrendering this investment after approximately three years would indicate that she was not prepared to adopt an approach to investment that required some tolerance of capital erosion and that her risk attitude was probably consistent with that of a much more cautious investor. An investor who is prepared to take a degree of risk would tend to persist with an investment even if it begins to show a capital loss in the short term.

While the business has said that the risk profile of the investment fund matched her attitude to risk, I am not satisfied that Mrs A should have been regarded as a 'cautious' investor (as defined by the business), if she could be regarded as an investor at all, given her lack of any previous experience of risk-based products.

I agree with the adjudicator that this investment was inappropriate for Mrs A in her circumstances at the time.

With regard to the redress formula set out by the adjudicator, a comparative return based on 50% fixed rate bonds and 50% of the APCIMS index provides a 'benchmark' measure of the performance of a range of assets, including cash, fixed interest securities, corporate bonds and property, as well as equities. Collectively, these two indices do not represent the same level of risk as the Balance Trust fund, which invested significant holdings direct in UK and overseas equities.

I do not agree, therefore, that the redress calculation compares the return from the investment Mrs A was recommended and the return from an index which bears the same degree of risk.

fair compensation

To compensate Mrs A fairly, The Prudential Assurance Company Limited should put her as close to the position she would probably now be in if she had not been given unsuitable advice.

I think Mrs A would have invested differently. It is not possible to say *precisely* what she would have done differently.

However, I am satisfied that what I set out below is fair and reasonable given her circumstances and objectives when she invested.

what should the business do?

To compensate Mrs A fairly, The Prudential Assurance Company Limited should:

compare

- the performance of Mrs A' investment

and

- the position she would be in if 50% of her investment 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') over the same period of time

If there is a loss, the business should pay this to Mrs A and pay interest on this loss at 8% per annum simple from the date the investment was surrendered to-date.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mrs A wanted growth with a small risk to her 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 her capital and the APCIMS index for someone who was prepared to take some risk to achieve a higher return.
- I consider that Mrs A' risk profile was between capital secure and 'cautious', in the sense that she was prepared to take a small level of risk to attain her investment objectives. So, the 50/50 combination would reasonably put her in that position.

- It does not mean that Mrs A would have invested 50% of her money in a fixed rate bond and 50% in some kind of index tracker fund. Rather, I consider this is a reasonable compromise that broadly reflects the sort of return Mrs A could have obtained from investments suited to her objective and risk attitude.
- The interest on the loss from the date the ISA was surrendered is for being deprived of redress since that date.

how to calculate the compensation

The compensation payable to Mrs A is the difference between the *total fair value* and the *actual value* of her investment. If the *actual value* is greater than the *total fair value*, no compensation is payable.

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 the interest.

actual value

This means the actual value of the investment at the date 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 the ISA was surrendered;
- 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 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 surrendered.

APCIMS index element

To arrive at this value the business should:

- Work out what 50% 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 the ISA was surrendered.

additional capital

Any additional sum that Mrs A 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.

withdrawals and income payments

Any withdrawal or income payment that Mrs A 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 will 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.

my final decision

My final decision is that I uphold Mrs A's complaint.

I require The Prudential Assurance Company Limited to pay Mrs A redress, if any, based on the redress formula set out above.

Kim Davenport
ombudsman