

complaint

Mr C's complaint concerns the advice given to him by Positive Solutions (Financial Services) Limited (IFA) to invest £230,000 in the Keydata Secure Income Plan issue 4 (of which £7,000 was wrapped as an ISA).

background

The circumstances leading to this complaint, and my initial conclusions, are set out in my provisional decision sent in May 2013, a copy of which is attached and forms part of this final determination.

I invited both parties to let me have any further comments they wished to make. The IFA has not responded to my provisional decision. Mr C's representatives responded to say that Mr C accepted the provisional decision on the proviso that he is not excluded from pursuing the IFA for the balance of his claim over and above our financial award limit.

my findings

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

As neither party has raised any additional points regarding the actual merits of the case, I see no reason for me to depart from the conclusions set out in my provisional decision.

In relation to Mr C's concern about being able to pursue the balance of his claim over and above our financial limit, the case review adjudicator has explained that the issue of whether such a balance can be successfully pursued in court following the acceptance of a final decision is unclear. My provisional decision also contained information on this issue. I would suggest that Mr C obtains independent legal advice on this matter

my final decision

My final decision is that I uphold Mr C's complaint and I direct Positive Solutions (Financial Services) Limited (IFA) to pay him compensation in accordance with the calculation of redress as detailed in my provisional decision.

Philip Miller
ombudsman

PROVISIONAL DECISION

summary of complaint

Mr C's complaint concerns the advice given to him by Positive Solutions (Financial Services) Limited (IFA) to invest £230,000 in the Keydata Secure Income Plan issue 4 (of which £7,000 was wrapped as an ISA).

background to complaint

In September 2006, Mr C sought investment advice from the IFA. It was noted that Mr C was seeking to receive the maximum income from his investment, but that he was only prepared to take a low amount of risk with his money.

Acting on advice given by the IFA, Mr C invested £230,000, (including £7,000 in an ISA), into the Keydata plan. The product provider, Keydata Investment Service Limited ("Keydata"), acted as Mr C's agent and purchased the bond. The issuer of the bond was Lifemark SA.

Keydata went into administration on 8 June 2009, and it defaulted on 13 November 2009.

Mr C submitted a claim with the Financial Services Compensation Scheme (FSCS). As a result, he was paid compensation. As this did not fully compensate his losses, Mr C employed a third party representative to subsequently raise a complaint with the business.

In its final response issued in September 2011, the business stated that as Mr C had transferred his legal rights against any relevant third parties over to the FSCS, it was unable to consider his complaint.

Unhappy with the response received, Mr C's representative brought his complaint to this service.

In November 2011, the FSCS reassigned the rights to the policy back to Mr C. As a result, we have been able to consider his complaint.

The complaint was investigated by one of our adjudicators, who expressed the view that it should be upheld. Briefly, he concluded that the plan was not a suitable recommendation and exposed Mr C to a level of risk which he was not willing to accept. Mr C was not a particularly knowledgeable or experienced investor, it was stated, and the complexities of the product would have been difficult for a layperson to understand.

The IFA did not agree with the adjudicator's findings, however, stating that the redress proposed was not reasonable and that, as Mr C had already received compensation from the FSCS, the recommended method of calculating redress would overcompensate Mr C.

The adjudicator explained that the terms of the reassignment allowed Mr C to pursue his complaint against the business and that, if the complaint was upheld and an award made, he would need to repay the FSCS any compensation already received.

As the case could not be resolved informally, it has been passed to me for my consideration.

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.

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 advisers to give advice with reasonable skill, care and diligence); and the law relating to causation and foreseeability.

There is no dispute that this was an advised sale of an investment product where the IFA assessed the suitability of the product for Mr C. 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 Financial Services Authority (FSA) (now Financial Conduct Authority) 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 given was suitable for Mr C in his particular circumstances.

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

According to the fact find from the sale of the Keydata bond, Mr C's circumstances at the time the Keydata bond was sold were as follows:

- He was 67 years of age, retired and in good health
- His total income was £12,000 gross per annum
- He had net monthly income of £900 per month and monthly disposable income of £230.
- He held £290,000 in a savings/current account
- He was married but no joint details were recorded.

It was also noted that Mr C had a 'low' attitude to investment risk and it was recorded that:

"Your preference is for a plan which is relatively low-risk, and which offers the prospect of a higher return than a typical high-rate Building Society or Bank Deposit account. You would like to have a high degree of security for your capital. And would not like the investment to be linked to any type of stock market performance."

So, it is necessary for me to decide whether the Keydata bond represented a higher risk investment than Mr C was willing to take. In considering this issue, I have carefully considered the documentation relating to the bond, along with any other information the IFA had access to before making any recommendation.

It is helpful to set out a description of the investment. I note that 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 the same 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 (i.e. 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 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 5 or 7 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 Secure Income Plan. Accordingly in my view, to a professional financial adviser, these investments would not and should not have been suitable for an investor like Mr C, who required a low risk investment with a high degree of security for their capital.

Indeed, given only what was known, or should have been known about the Keydata investments by the IFA at the relevant time, I have real doubt – given the opaque nature of the investments and the significant uncertainty around accurate valuation and liquidity – whether such a fund would have been suitable for all but the most experienced of retailer investors and certainly not for investors such as Mr C.

It is not sufficient for the IFA to simply assert that it relied on the headline description of the investment when making their assessment of suitability. Similarly, it would not be fair or reasonable for the IFA to rely on the list of bullet points which set out circumstances where a consumer may receive less than the amount they invested. Rather, they should be exercising professional judgement about the inherent nature of the investment and its suitability for their client's particular investment needs. Importantly, the adviser should have identified those significant risks inherent in this product and taken them into consideration when recommending the investment to Mr C.

Having reviewed the plan literature, I consider that a professional adviser should have appreciated that capital would be placed at significant risk. It is material that Mr C wanted his capital to have a high level of security, and to take only a low risk with the investment. This is hardly surprising, given his age at the time and that he wanted an income to supplement a fairly modest existing income in retirement. Having carefully considered the available evidence, I find on balance that the IFA's recommendation to invest in the Keydata bond was entirely at odds with Mr C's objectives. I also consider that too much of Mr C's money was exposed to Keydata.

In short, it is my view that the advice demonstrated a complete disregard for Mr C's individual circumstances and interests. This is not a view reached with hindsight. I have based my findings on the product's suitability for Mr C based on what the IFA at the time of the advice knew or could be expected to find out about the investment and based on a reasonable expectation of how the bond would operate.

Having reached this view, I now need to consider what Mr C 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 C would have invested in the bond, if it had not been recommended to him. Nor am I persuaded that he would have invested in the bond, 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.

Overall I think it most likely that Mr C would have taken out an investment suitable for someone who had a low or cautious attitude to risk. On balance, I consider that a fair benchmark to indicate the investment return on his investment is 1% more than the Bank of England base rate compounded yearly from the date of investment until the date the loss crystallised.

I note that the loss crystallised in November 2009. Mr C has been deprived of a significant proportion of his money since that date. This is money which Mr C was relying on to provide an income in retirement. I am satisfied that being deprived of this money will have caused significant financial detriment at a time when Mr C should have been enjoying his retirement. As a result, I am satisfied that it is appropriate to award an interest rate of 8% simple on this sum from the date the loss crystallised until the sum is paid.

I have also noted that Mr C has received compensation from the FSCS, but the amount paid seems significantly less than the total loss he had suffered. In the circumstances, it does not seem unreasonable for Mr C to pursue any other business he believes may be responsible for his losses. Ultimately, there is nothing to prevent Mr C from pursuing a complaint against the IFA and that is his choice to make. The IFA provided the advice to invest in the Keydata plan and was responsible for ensuring its suitability. Where a complaint is upheld about unsuitable advice and a loss has resulted from this, we can require the business to pay compensation.

The FSCS is designed to provide a safety net for those consumers where an IFA or product provider is unable to meet its financial obligations - perhaps because it has ceased to trade previously or has reported itself in default because it is in financial difficulty. In the circumstances of this complaint, the IFA is still trading, and so it should be expected to meet its redress obligations in full. Crucially, we are in the position, and have the authority, to investigate the complaint which has been brought to us. I understand that, under the agreement between Mr C and the FSCS, upon payment of redress awarded by this service, the FSCS would require repayment of the redress it has paid Mr C.

my provisional decision

For the reasons set out above, my provisional decision is that I uphold the complaint. I am of the view the Keydata plan should not have been recommended to Mr C.

My aim is to put Mr C in the position he would now have been in but for the Positive Solutions (Financial Services) Limited's (IFA) advice. In deciding how to assess fair compensation I consider it fairest to assume;

- With reasonable advice, Mr C 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.

I therefore intend to award compensation on the following basis.

A= the capital invested, 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 C made in the Keydata plan which I assess to be zero for this purpose.

$$D = A + B - C$$

My provisional decision is that the IFA should pay Mr C the amount produced by that calculation (that is amount D) up to a maximum of £100,000. To that sum the IFA should add interest from 13 November 2009 at the rate of 8% pa simple until this award is paid.

If the IFA considers that it is legally obliged to deduct income tax from the interest element of my award (i.e. the interest added to D), it must send a tax deduction certificate with the payment.

As it is my understanding that, on payment of this redress, the Financial Services Compensation Scheme (FSCS) will require repayment of its compensation to Mr C, no allowance should be made for any sum received from FSCS in the calculation of the investment loss. However, Mr C 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 received from the FSCS from the date it was paid onwards.

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 that Mr C 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 would ask Mr C to note that carefully. He will need to cooperate 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.

I am aware that a recent Bondholder Notice dated February 2013 indicates that there may be a further distribution 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 business to make appropriate provision for it to receive any future distribution whenever paid. This would cover a situation where the consumer receives the distribution before the award has been paid and/or before transfer of ownership to the business has been completed. It would also cover a situation where the distribution is incorrectly paid directly to Mr C even though ownership has been transferred.

Recommendation: As the amount I consider to be fair compensation may exceed £100,000, I am minded to recommend that, in this situation, the business pays Mr C the balance.

This recommendation is not part of my determination or award. It does not bind the business. Whether Mr C can accept my decision and go to court to ask for the balance is uncertain. Mr C may want to consider obtaining independent legal advice before deciding whether to accept this decision.

Mr C should also read our factsheet “compensation over £150,000”, which explains our current award limit and the lower limit of £100,000 for complaints referred to this service before 1 January 2012. It also explains certain implications of accepting our ombudsmen’s decisions. The factsheet can be found in the consumer factsheets section of our online technical resource which can be found by clicking the publications tab.

If the compensatable loss exceeds the limit an ombudsman can award and the business does not adopt the recommendation to pay the award in full, any assignment should only concern itself with any amounts in the distribution which are in excess of the full compensatable loss as calculated.

To identify this amount, the business should deduct £100,000 from the compensatable loss. The resulting figure is the amount that the consumers are entitled to receive (e.g. retain) by way of future value and/or distributions (including any money received following the February 2013 Bondholder Notice). Any value or distributions that might be made over and above this amount may be assigned to the business, if the business decides to take a transfer of those rights.

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

It is my understanding that HMRC has made certain provisions so that it may be possible for compensation paid in relation to a Keydata fund that involved an ISA/PEP to be transferred into an ISA wrapper. I am unable to give any more information or advice about this matter.

However, information can be found on the HMRC.gov.uk website by entering “ISA reinstatement” in the search box on the home page. I can only suggest that if Mr C would like to explore this further he contacts HMRC directly or seeks appropriate independent advice.

Philip Miller
ombudsman