complaint

Mr W has complained that advice he received from N D Toy & Partners Ltd ("the business") in 2006 to invest a capital sum equally between a cautious managed fund and a property fund within an investment bond was unsuitable for him. He wished to make provision in around seven years' time for his retirement when he would require income from this investment.

Mr W is represented in his complaint by a third party adviser, which complained to the business that:

- The adviser did not correctly establish Mr W's attitude to risk;
- He was not told that the capital investment was at risk;
- The adviser failed to discuss other, more suitable, products;
- The adviser did not explain the effect that drawing an income would have on the capital investment;
- The adviser led the investor to believe that a greater income would be generated through the investment.

In response, the business rejected the complaint it was asked to consider and Mr W was advised to refer his complaint to this service.

background

The business has expressed dissatisfaction to this service that, when referring Mr W's concerns, his representative has reformulated the complaint to include a number of points it had not previously made, together with Mr W's recollection of events from the point of sale that should have been submitted to it in the first instance.

Mr W's representative has made additional statements that:

- The investment bond appears to have taken priority over the option of supplementing his existing personal pension policies since his objective was to make provision for retirement. This resulted in a loss of tax relief for any pension contributions;
- The disclosure of risk factors is reliant on a suitability letter and the key features document that are "sparse and uninformative" which do not cover market value adjusters, capital erosion, illiquidity of property funds, commissions and charges;
- The reasons for not recommending ISAs or pension enhancement are erroneous and inaccurate, with no comparison of benefits;
- Mr W could not be considered a 'medium' risk investor based on a demutualisation share issue and some national savings;
- The income from the bond was limited to 5% of the original capital investment and not any growth within the funds. To release further funds, the bond would need to be surrendered and the proceeds reinvested, with potential tax implications;
- The after-sales service was non-existent and Mr W was deprived of more appropriate investment opportunities for his retirement needs.

Mr W's complaint was investigated by one of our adjudicators, who concluded that it should be partly upheld because he did not believe that Mr W was an experienced investor who would have been prepared to take this degree of risk with such a large capital sum. At the point of sale, he held 95% of his capital in secure areas, with the remaining 5% held in demutualisation shares and national savings. Following the recommendation, the investment bond represented approximately 43% of his savings.

Given it was Mr W's first experience of investing a lump sum, the adjudicator did not believe it was reasonable for such a large part of his capital to be exposed to this degree of risk. Although he felt that a low/medium risk approach to investment was not wholly inappropriate for Mr W, he thought it would have been more prudent to expose less of his capital to this degree of risk.

He therefore recommended, as a means of settling the complaint, that Mr W should receive redress as if he had invested half of the capital sum he actually did place in the investment bond, split equally between both funds.

In response, the business disagreed with his assessment and said that:

- It feels strongly that Mr W's representative has reformulated his complaint after it had issued its final response letter to him addressing the main issue that he did not realise that, in taking an income from the investment bond, he was risking capital erosion. Mr W never actually made an income withdrawal, although he did take two capital withdrawals in 2012 and 2013;
- The complaint made to this service raised new areas of concern it had not been given the opportunity to address. This was unfair as it had spent time and expense investigating a complaint that had now changed;
- Mr W could not be considered a risk-averse client because he owned shares and invested in a personal pension policy. He approached the representative for advice on investing a capital sum from his deposit account;
- The suitability report confirms that Mr W agreed to invest by adopting a 50% low risk and 50% medium risk approach, not a no risk approach, over seven years to supplement his retirement fund;
- The redress recommendation assumes a return from one to two-year short term bank bonds, which would not be suitable for Mr W's longer term objective and his risk attitude. He did not wish to invest with no risk to capital. After 5 years, the investment bond was penalty-free, thus allowing Mr W access to his funds;
- The inheritance Mr W received was not made known to the adviser at the point of sale;
- It sent Mr W an annual review 'pack' with a view to providing ongoing advice and he did not respond to this offer. In any event, he received annual valuations showing him the investment performance which made him fully aware that his bond was penalty-free after 5 years when he could have moved or switched funds. As it was, he took two large capital withdrawals without taking advice.

In response, the adjudicator was not persuaded to change his view. He was still not comfortable with Mr W exposing such a large amount of capital to his chosen degree of risk.

With regard to the redress recommendation, the adjudicator was not advising that Mr W would have invested in 12 to 17 month fixed rate bonds. They represent a 'benchmark' return if Mr W had left 50% of his capital in interest-earning, secure accounts.

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.

First, I do sympathise with the business's point that Mr W's representative has raised a number of new issues the business was not given the opportunity to address in its final response letter to Mr W.

However, this service would, in any event, adopt an 'inquisitorial' approach to assessing the suitability issues raised in the first instance by Mr W's representative, and the business is consulted on all subsequent points that emerge during our assessment of his case before a decision is made.

My understanding of Mr W's position at the point of sale is that he was a basic rate taxpayer and held a significant amount of capital on deposit, including a recent inheritance. He owned a cash ISA and some shareholdings. He agreed to invest part of his capital savings with a 'low' and 'medium' approach to risk for his future retirement in approximately seven years' time (although it is recorded that he intended to retire at a later age). Mr W also owned two personal pension policies whose combined value he had transferred to another provider, to which he also paid a regular contribution of £60 per month.

Given Mr W's objective was to build up a capital sum for retirement income, I am persuaded by his representative's point that he should have considered increasing his contributions to his personal pension policy through single contributions on which he would obtain tax relief. He could then have taken some of the eventual pension fund as a tax-free cash sum when he "retired".

I also appreciate that, if he wished to adopt a low and medium approach to investment risk, he could have considered ISAs and unit trusts, which offered certain tax advantages over an investment bond and imposed little restriction on the amount of capital he could access at any time. There could also be liquidity issues for a property fund when Mr W came to access his capital from the bond.

On the other hand, his contributions to his personal pension policy and to an ISA would be restricted each year.

On balance, I am inclined to agree with the adjudicator that Mr W needed to adopt a risk-based approach to investing some of his capital savings for retirement in seven years' time. However, I believe that he did invest too much capital in the investment bond without being recommended to consider supplementing his personal pension policy and investing in an appropriate fund of an equity ISA or a unit trust for diversification and tax-efficiency.

Having said that, it is not possible to know precisely how much Mr W might have invested in any alternative investments, which funds would have been chosen and how those funds might have performed since 2006.

I have, therefore, decided that Mr W's complaint should be upheld in part and that he should receive redress, as the adjudicator recommended, assuming he had invested 50% of his capital in the investment bond across the two funds.

I note the business's point that the 'benchmark' rate equivalent to the return available from 12 to 17 month fixed rate bonds does not correspond with Mr W's intended investment term or his attitude to risk. However, this comparison rate does not assume that the remaining 50% of Mr W's capital had been invested in a risk-based product; it assumes that he retained it in an interest-earning deposit account providing a reasonable rate of return.

fair compensation

To compensate Mr W fairly, the business should put him as close to the position he would probably now be in if he had not been given unsuitable advice.

I think Mr W would have invested 50% of his capital differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I set out below is fair and reasonable given Mr W's circumstances and objectives when he invested.

what should the business do?

On the understanding that Mr W has retained the investment bond to-date, to compensate him fairly, the business should

compare

- the performance of 50% of Mr W's investment across the two funds

with

- the position Mr W would now be in if 50% of his capital investment, split equally across both funds, had produced a return matching the average rate for fixed rate bonds with 12 to 17 months maturity as published by the Bank of England

If there is a loss, the business should pay this to Mr W.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mr W wanted to achieve a reasonable return without risking any of this part of his capital.
- The average rate would be a fair measure given Mr W's circumstances and objectives. *It does not mean that Mr W would have invested in a fixed rate bond. It is the sort of investment return a consumer could have obtained with no risk to this capital sum.*

how to calculate the compensation

The compensation payable to Mr W is the difference between the *fair value* and the *actual value* of 50% of his investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

actual value

This means the value of the 50% of his investment if surrendered on the date of calculation.

fair value

This is what 50% of the investment would have been worth if it had obtained a return using the method of compensation set out above. 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 of calculation
- 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
- the calculation should be carried out on an annually compounded basis; that is, with the return added to 50% of the investment at each anniversary
- work out the value to the date of calculation

additional capital

50% of any additional sum that Mr W paid into the investment should be added to the calculation from the date it was actually paid.

withdrawals and income payments

50% of the capital withdrawals or income payments Mr W took from the investment should be deducted from the calculation at the point it was actually paid so that it ceases to accrue any return in the calculation from that date.

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 *fair value* instead of periodically deducting them.

further information

- This redress guidance assumes that Mr W has retained the investment bond to-date. Otherwise, the parties should notify me if that is not the case and I shall provide further guidance in calculating redress.
- 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.

decision

My final decision is that I uphold Mr W’s complaint in part and I require N D Toy & Partners Ltd to pay him redress, if any, on the basis set out above.

Kim Davenport
ombudsman