complaint

Mr and Mrs C have complained that advice they received from Bank of Scotland plc ("the business") in March 2004 to invest £25,000 in a capital-protected product, the 'Guaranteed Investment Plan', over five years was unsuitable. They are represented in their complaint by a third party adviser, which has said that:

- The adviser did not accurately establish Mr and Mrs C's appetite or capacity for risk;
- The underlying assets in the fund do not match their approach to investment;
- The nature of the fund was unsuitable for risk-averse and inexperienced investors;
- The capital sum invested represented 83% of their total available savings;
- The proportion of assets in the same investment fund did not meet diversification requirements;
- No recommendation was made for the clients to maximise tax-efficiency through ISAs. Providers did offer capital protected products within an ISA "wrapper";
- Mr and Mrs C should have been advised to consider repaying their outstanding mortgage, which was not due to be repaid until after Mr C retired.

background

Mr and Mrs C's complaint was investigated by one of our adjudicators, who recommended that the complaint should be partially upheld. While he considered that the 'Guaranteed Investment Plan' ("the Plan") was suitable with regard to investment risk and the inclusion of the capital guarantee, he believed that they had invested too much of their available capital.

Accordingly, the adjudicator recommended that the business should offer redress on the assumption that Mr and Mrs C should have invested £20,000 in the Plan and retained an additional sum of £5,000 on deposit for unforeseen contingencies. Redress should compare the return this sum of £5,000 would have accrued which matched the average return from fixed rate bonds (with 12 to 17 months maturity) as published by the Bank of England on its website and the return it actually achieved in the Plan.

He also noted that the business had failed to inform Mr and Mrs C of an offer that had been extended to other investors in this plan to surrender the Plan before it matured and place the proceeds in a deposit account earning 4.1% per annum for 2 years. The adjudicator, therefore, recommended that, after taking into account the adjustment to the amount he felt Mr and Mrs C should have invested, the eventual value of this investment at maturity should be treated as if they had taken advantage of this offer.

While the business accepted the adjudicator's assessment, Mr and Mrs C's representative did not, and said that:

- The basis of redress still left Mr and Mrs C in a position of having almost 66% of their capital invested in this plan, with the potential of returning only the original capital invested. Their history of investing in one-year fixed rate bonds meant that it was inappropriate to recommend a product that exposed their returns to risk;
- The complaint is not one of 'affordability' but 'suitability', and more weight should be given to their previous experience of investing in fixed rate bonds;
- Therefore, appropriate redress for Mr and Mrs C should be based on the whole capital sum invested from the start date to surrender, with interest at 8% per annum simple on any loss from surrender to the date of settlement;

- The offer only seems to calculate the potential loss suffered by Mr and Mrs C since December 2009, rather than from the start date of March 2004 when the unsuitable advice was given.

As no agreement has been reached in this complaint, it has been referred to me for review.

findings

To decide what is fair and reasonable in this complaint, I have considered everything that the business and Mr and Mrs C's representative have provided. Having done so, I find that I have reached the same conclusions as the adjudicator, and for broadly the same reasons.

In reviewing this complaint, I have taken note of a customer questionnaire Mr and Mrs C completed for the business of the actual concerns they held about this investment. Among other things, they confirmed that the investment was intended as a 'nest egg' for their retirement, and not to repay their mortgage. They also accepted that a risk to the return did exist as the investment was linked to the stock market and believed that the longer the investment term, the greater the return. However, they did not appreciate from the illustrations they were provided that the value of the investment could fluctuate during the five year term.

My understanding of Mr and Mrs C's financial position in March 2004 is that they were both in paid employment, enjoyed a healthy monthly disposable income and were due to retire in around five years' time. While they had an outstanding mortgage which was due to be redeemed in approximately eight years' time, they were satisfied that this liability was affordable in retirement. Their objective was not to repay their mortgage early, but to achieve growth on this capital sum over the five years to retirement for which they were prepared to adopt a 'cautious/medium' attitude to investment risk.

As this investment offered security of their capital and the potential to achieve a better return than their existing deposit-based savings, I believe that this product was suitable for them.

The nature of the product provided that Mr and Mrs C's capital would be secure if the investment was held to the 'guarantee date' after five years. In the meantime, its ongoing value fluctuated in accordance with the performance of the underlying fund. I can find no evidence that Mr and Mrs C were given the impression that this return would increase progressively over the five year term. However, they were right to believe that the investment could provide a greater return over the longer term than if they had continued to hold this capital on deposit.

As it was, the investment guaranteed their capital and did provide them a return after five years, and I am satisfied that the information Mr and Mrs C received at outset did not confirm that the product promised more than this. It guaranteed their capital after five years but it did not guarantee the return it could achieve.

I am also satisfied that the annual charge applied to the unit price of the fund to manage the investment and provide the 'guarantee' is prominently displayed in the product information they were provided at outset. There were no initial charges applied to the original capital sum they invested and no exit charges.

However, while I am satisfied that this product was appropriate for Mr and Mrs C, I do share the adjudicator's concern that their financial commitment to this investment may not have left them sufficient available capital for emergencies, notwithstanding their healthy disposable income.

Therefore, while it is not possible to be precise about this, I am inclined to agree that it would have been more appropriate to invest a capital sum of £20,000 in this product.

I also note that Mr and Mrs C deferred taking the proceeds of the investment beyond the ‘guarantee date’ of March 2009, until March 2010.

In December 2009, the business wrote to all investors who took out this product between December 2004 and September 2008 which had not yet reached the ‘guarantee date’. Due to the economic climate prevailing since 2008, almost the entire fund was switched away from equities to fixed interest assets to protect the ‘guarantee’. As the return from these assets was then very low, the fund no longer offered the same growth prospects as was anticipated when the investment was taken out.

Investors were offered the option to surrender their investment at no cost before the ‘guarantee date’ to a savings account which provided an annual return of 4.1% gross for two years. Mr and Mrs C’s Plan had already ‘matured’ in March 2009, and they were therefore not made this offer at the time.

However, as they deferred surrendering their investment until March 2010, the business is prepared to settle their complaint also on the understanding that they had been offered, and taken up, this option in December 2009 until they finally surrendered the investment in March 2010, even though it was not obliged to do so.

Therefore, as the adjudicator set out in his assessment, this offer made by the business should be accommodated by offering redress in two parts, as follows.

loss of investment opportunity since December 2009

On the understanding that Mr and Mrs C should have invested £20,000 in this product, for the period between December 2009 to March 2010, when they deferred receiving the proceeds of the investment, Mr and Mrs C should receive compensation of ‘D’ + ‘E’, where:

- A = The actual value of the investment on 19 December 2009, reduced by 20% (i.e. £25,846.61, less £5,169.32);
- B= Interest at the rate of 4.1% per annum gross from 19 December 2009 to the date Mr and Mrs C surrendered the investment on 24 March 2010;
- C = The value of the investment at the date of surrender on 24 March 2010 reduced by 20% (i.e. £25,996.02, less £5,199.20);
- D = A + B – C;
- E = interest on ‘D’ at the rate of 8% per annum simple from the date of surrender on 24 March 2010 to-date.

investment loss arising from the original advice in March 2004

As above, I consider it fair and reasonable to recommend redress based on Mr and Mrs C being advised to place £5,000 less than they originally invested in this product in March 2004.

fair compensation

To compensate Mr and Mrs C fairly, Bank of Scotland plc should put them as close to the position they would probably now be in if they had not been given unsuitable advice.

I think Mr and Mrs C would have invested differently. It is not possible to say *precisely* what they would have done differently. However, I am satisfied that what I set out below is fair and reasonable given Mr and Mrs C's circumstances and objectives when they invested.

what should the business do?

To compensate Mr and Mrs C fairly, the business should

compare

- the performance of £5,000 (20%) of Mr and Mrs C's total investment from the start date to the date the investment was surrendered on 24 March 2010;

and

- the position Mr and Mrs C would be in if this investment 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 on its website over the same period of time.

If there is a loss, the business should pay this to Mr and Mrs C

and

pay interest at the rate of 8% per annum on this loss from 24 March 2010 to-date.

why is this remedy suitable?

I have chosen this method of compensation because:

- Mr and Mrs C wanted to achieve a reasonable return without risking any of their capital.
- Mr and Mrs C were prepared to invest for a longer period of time – but with some flexibility.
- The average rate would be a fair measure given Mr and Mrs C's circumstances and objectives. It does not mean that they 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 interest on the loss from the date surrendered is for being deprived of the compensation money since that date.

how to calculate the compensation

The compensation payable to Mr and Mrs C is the difference between the *fair value* and the *actual value* of their investment. If the *actual value* is greater than the *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 this interest.

actual value

This means 20% of the actual value of the investment at the date of surrender on 24 March 2010.

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. 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 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
- 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 of surrender.

additional capital

Any additional sum that Mr and Mrs C paid into the investment should be added to the calculation from the date it was actually paid in.

withdrawals and income payments

Any withdrawal or income payment that Mr and Mrs C received from the investment should be deducted from the calculation at the point it was actually paid so 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

- 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 and Mrs C's complaint in part.

I require Bank of Scotland plc to pay Mr and Mrs C redress on the basis set out above.

Kim Davenport
ombudsman