complaint

Mr and Mrs K's complaint is that the investments recommended to them by Square Mile Wealth Ltd ("SMW"), as appointed representatives of The On-Line Partnership Limited, were unsuitable as they were not compatible with their attitude to risk.

background

Mr and Mrs K's complaint covers four different investments recommended to them in 2004 and 2005.

An adjudicator considered the complaint and concluded that it should be upheld. In summary, the adjudicator stated that when they first accepted advice in November 2004 to invest into an investment bond, Mr and Mrs K's attitude to risk had been recorded by the business as being "*very cautious*". When they accepted further advice, in September 2005, to encash two existing with-profit bond investments in order to invest predominantly in three property funds, Mr and Mrs K's attitude to risk was described as being "*cautious*".

The adjudicator noted the fund recommended in September 2004 to be held within Mr and Mrs K's investment fund was an Unregulated Collective Investment Scheme ('UCIS'), but that there was no evidence that this point had been drawn to Mr and Mrs K's attention.

He added that none of the regulatory exemptions allowing for the promotion of a UCIS appeared to apply in this case, and that there was no indication in the case file that the business took reasonable steps to ensure the suitability of recommending what could be considered a higher risk investment to Mr and Mrs K.

It was acknowledged by the adjudicator that, following an earlier meeting with SMW, their adviser wrote to Mr and Mrs K in February 2005 to confirm that the UCIS held within their investment bond did not match their attitude to risk as recorded in the November 2004 fact find. The reason given by the adviser for this was that because jurisdiction for the UCIS was the Cayman Islands, "*there would be no capital protection if the fund was to go into liquidation as the normal UK investor protection would not apply*".

Accordingly, the adviser said the business was prepared to switch Mr and Mrs K into one of two other cash based funds he named, both "*offering 100% capital guarantee",* without them incurring any early surrender or other costs. The adviser's letter also stated that: "*If you decide to leave the funds invested* [in the UCIS]*, I need to fully document that you are aware of the inherent risks and carefully document your reasons for this decision*".

Mr and Mrs K wrote back to the adviser to say that:

"*After careful consideration we have decided to keep the funds invested in the plan. We understand that because of the jurisdiction of the* [UCIS] *being in the Cayman Islands, there would be no capital protection if the company was to go into liquidation as the normal UK investor protection would not apply….We also realise that this does not match the attitude to risk that we stated on the fact find we completed with you …. However, we have studied the literature provided and are comfortable with the Fund forming part of our overall investment portfolio*".

The adjudicator considered that, in style and layout, this letter showed strong signs of having been drafted by the adviser for Mr and Mrs K to sign. He also commented that, despite the

statement in the adviser's letter: "*If you decide to leave the funds invested* [in the UCIS]*, I need to fully document that you are aware of the inherent risks and carefully document your reasons for this decision*", nothing in the case file indicated Mr and Mrs K's reasons for retaining the UCIS were documented. In addition, given Mr and Mrs K's recorded attitude to risk, he considered it improbable that - in answer to the adviser's letter – they would not have taken up the opportunity to switch at the business' expense into another investment with a 100% capital guarantee, unless they had been given further and compelling reassurances about the future of the UCIS.

The adjudicator therefore concluded that the UCIS had been mis-sold to Mr and Mrs K.

As regards the business' September 2005 recommendation to Mr and Mrs K that they should invest a substantial proportion of their investment capital in property funds, the adjudicator stated he could not see how this exposure to a single sector could reasonably be viewed as compatible with a cautious attitude to risk. This is especially so given Mr and Mrs K's sizeable existing UCIS holding within the investment bond. The adjudicator therefore concluded that the three property funds had been mis-sold to Mr and Mrs K.

The business rejected the adjudicator's assessment. In its response it made the following points:

- The three property fund investments had been entered into in October 2005 and, like the UCIS, were held within the investment bond. The adviser subsequently left the business to work for another firm, taking Mr and Mrs K with him as clients, and the investment bond provider informed The On-Line Partnership of the change of agency in January 2006.

  Therefore the business said that its responsibility for the investment advice taken up in October 2005 ceased in January 2006, and it calculated that two of the three property funds complained of showed a small rise in value over this period. The third fund was suspended in January 2008, making it hard to obtain past performance figures for the fund, but based on two year performance figures issued in December 2007, the business considered it likely that Mr and Mrs K would have made a gain on their investment by January 2006.

- The redress proposed by the adjudicator, i.e. comparing the performance of the investments complained of "*with the fixed rate deposit average and the APCIMS Stock Market Income Total Return Index, with interest applied at 8% to any redress payment*", was not reasonable.

  The business commented that interest at 8% per year would have been unlikely to have been achieved in cash accounts at the time Mr and Mrs K's investments were made and was "*entirely unrealistic*" in relation to later years. Use of the APCIMS (now WMA) index was criticised by the business on the basis that Mr and Mrs K had clearly expressed a wish to reduce equity exposure. It considered that the average monthly interest rate of UK monetary financial institutions' sterling fixed rate deposits over the period of advice (October 2005 to January 2006), i.e. 4.35%, would constitute a *"realistic alternative to the investments made and an alternative to a cash investment*". On this basis the business calculated that Mr and Mrs K had suffered no financial loss.

- Any advice given to Mr and Mrs K regarding their holdings after January 2006, including the encashment and retention of these, was completed under the adviser's new agency and was not the responsibility of The On-Line Partnership Limited.

- As regards the UCIS investment, the adviser had subsequently alerted Mr and Mrs K to the risks it had realised applied to this fund, and had offered a free transfer to either of two other investment recommendations. The business therefore considered that Mr and Mrs K's decision to retain the UCIS was an informed one, and that their March 2005 response to the adviser's February letter (after the adviser had sent a chase up letter early in March) "*provides sufficient documentation of the retention of the fund at this time*". Although it acknowledged that the original recommendation of the UCIS may have been unsuitable, it had done all that it could do to rectify this situation, and at the time when the agency was transferred away from it "*Mr and Mrs K had suffered no financial detriment*" in relation to their investments.

  Finally, the business strongly objected to the adjudicator's statement, in relation to Mr and Mrs K's March 2005 letter to the adviser confirming they wished to keep the UCIS, that *"…in style and layout, this letter shows strong signs of having been drafted by* [the adviser] *for* [Mr and Mrs K] *to sign*". It asked that this statement either be retracted or the evidence to support it be provided.

In December 2013, Mr K sent us further evidence in the form of copies of letters written to Mr and Mrs K by the adviser in December 2004 (talking about the stability of the UCIS) and March 2005 (reminding Mr and Mrs K of the need to set out for him their reasons for holding on to the UCIS despite his advice that they move into another fund). In relation to this later letter, Mr K said that: "*When I received this letter, I telephoned [the adviser] asking him how he would like this letter written, he answered that he would have the letter typed for us and on receipt, all I need to do, should we both agree with it, is myself and* [Mrs K] *to sign the letter and return to him …which upon receipt of same, is what I did*".

The adjudicator forwarded copies of all these letters to the business, which made no further submission to us.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. Having done so, I agree with the conclusions arrived at by the adjudicator and for essentially the same reasons

UCIS recommendation

In SMW's fact find, Mr and Mrs K's attitude to risk was assessed as "*very cautious*", the most conservative possible category, defined by SMW as "*People in this category set as their main priority the guaranteed safety of their capital/investment and accept a low rate of investment return in doing so*."

SMW's November 2004 suitability letter, which includes the recommendation to invest in the UCIS, confirms that Mr and Mrs K "*have chosen to provide full information of your financial circumstances*." It says that "*You have a very conservative attitude to risk and as a result have decided to move out of equity backed investments…This fund meets with your attitude to risk profile of 'very cautious' as the capital is protected and the returns can only be*

upwards." There is no mention of any risk at all in relation to the fund and therefore no reason for Mr and Mrs K to consider it as anything other than a very conservative choice.

The adviser then wrote to Mr and Mrs K in February 2005 to inform them that the fund did not, in fact, match their attitude to risk, thereby effectively saying that the advice given in November 2004 was unsuitable.

SMW has argued that this February 2005 letter effectively corrected the original error. Having considered the letter carefully, I note that the adviser's warning was solely on the basis that "*although the fundamental principles of the fund are capital security*" the fund (which he did not identify as a UCIS) would not benefit from "'*normal UK investor protection"*. I consider this warning needs to be seen in the context of the adviser's earlier statement that "*There are some funds…such as* [the UCIS] *and cash deposits that by their very nature do not fall in value. The only way they can decline in value is if the annual management charges were higher than the growth. There would have to be an exceptional fall in annual returns from* [the UCIS] *for this to happen*". I consider that this portrays the fund as similar to a cash deposit in risk terms, whereas the warning is in my view described more as a technicality.

This letter was also sent following a conversation with the adviser. I agree with our adjudicator that it is difficult reasonably to believe that Mr and Mrs K would not have taken the opportunity to switch into another investment with a 100% capital guarantee had they not been advised that the risk to their capital, despite the absence of investor protection, was negligible.

I have seen no evidence that any mention was made by the adviser at any point of any other risks, such as the illiquidity, volatility and gearing risks often applicable to UCIS. I consider that if a more complete picture of the risks had been drawn to Mr and Mrs K's attention, then they would neither have bought nor agreed to retain this UCIS.

For the reasons set out above, I am not persuaded that this letter and any associated conversations remove the responsibility for the original advice. The letter still suggests that there is minimal risk of loss and fails to give a full picture of the risks of the UCIS. I therefore consider that this was unsuitable advice.

the three property investments

At the time of the advice to invest in the three property investments, a new fact find was completed and Mr and Mrs K's attitude to risk was reassessed as "*cautious*", defined as "*You set your main priority as a high level of safety of your capital/investment but are also looking for a higher rate of investment return than is associated with being very cautious. In doing so they accept that return of their original investment /capital is not fully guaranteed*."

The suitability letter confirms that "*We have conducted a detailed discussion on your attitude to risk*" before recommending the three property funds. The reasons given for this recommendation are that it reduces Mr and Mrs K's equity exposure and offers better returns than their existing with-profits funds. The letter informs them that "*this asset class can demonstrate good consistent performance combined with low volatility over the medium to long term*". The recommendation hence appears to be based on the past performance of the sector without regard to whether this is a reliable guide to future performance. There is no mention of why these three specific funds are suitable or of the link between higher returns and higher risk. There is also no mention of how this recommendation fits into the overall

portfolio, of why all three funds are in the same sector or any discussion of the desirability of diversification.

I consider the adjudicator was correct in his reasoning that this recommendation to make substantial investments into the property sector when classified as *"cautious*" investors was also unsuitable. I also note that The On-Line Partnership, in its response to our adjudicator's view, has focused its arguments on when responsibility ceased and how redress should be calculated. It has not attempted to justify the original advice.

I therefore find that Mr and Mrs K's complaint should be upheld.

The business says that its responsibility for the investments recommended to Mr and Mrs K ceased when its adviser moved elsewhere. I am not persuaded by this argument. The business has produced no evidence that advice was given to Mr and Mrs K about their existing investments after January 2006 by the new firm to which the adviser had moved. I note that The On-Line Partnership's earlier advice appears to have been given in relation to stand-alone investments made as a result of individual sums of money being available to Mr and Mrs K, and not as the result of an ongoing investment programme for which the business was paid a retainer. I take the view that the investments complained of were not of a type that would ordinarily need to be the subject of subsequent investment advice unless the consumers' financial objectives or circumstances changed significantly.

The business has also made some comments regarding our adjudicator's recommendation that simple interest at the rate of 8% per year be added to the redress to be paid to Mr and Mrs K. This is in accordance with our usual policy which is set out on our website which includes the following:

> 'The current low rates paid on deposit accounts are not an appropriate yardstick. The rates of interest consumers have to pay in order to borrow are much higher. So the 8% interest rate (which is also the rate generally used by the courts) reflects the fact that:
>
> - the rate is gross before tax is deducted;
> - it often applies to historic losses at times when different base-rates applied;
> - it takes account of current interest rates being charged on overdrafts and loans - which have not reduced in line with the base rate'.

In relation to the business' comments about the use of an APCIMS (now WMA) index in calculating overall redress, I note that the adjudicator stated clearly of his proposed redress methodology that: *"It does not mean that* [Mr and Mrs K] *would have invested 50% of their money in a fixed rate bond and 50% in some kind of index tracker fund. Rather, I consider this a reasonable compromise that broadly reflects the sort of return* [Mr and Mrs K] *could have obtained from investments suited to their objective and risk attitude*".

Redress should therefore be in line with that recommended in the adjudicator's assessment, as follows:

fair compensation

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

I take the view that Mr and Mrs K would have invested differently. It is not possible to say *precisely* what they would have done differently. But I am satisfied that what I set out below is fair and reasonable given their circumstances and objectives when they invested.

To compensate Mr and Mrs K fairly, The On-Line Partnership must

compare

- the performance of Mr and Mrs K's investment

with

- the position they would now be in if 50% of their 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 and 50% had performed in line with the FTSE WMA Stock Market Income Total Return Index ('WMA income index')

If there is a loss, The On-Line Partnership should pay this to Mr and Mrs K.

I have decided on this method of compensation because Mr and Mrs K wanted income with some growth but with small risk to their capital.

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 their capital. It does not mean that Mr and Mrs K 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 WMA 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 Mr and Mrs K's risk profile was in between, as they were prepared to take a small level of risk. I take the view that a 50/50 combination is a reasonable compromise that broadly reflects the sort of return Mr and Mrs K could have obtained from investments suited to their 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 Mr and Mrs K into the position they would have been in had they received appropriate advice.

how to calculate the compensation?

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

I understand that two of the investments have been sold but two have not and are currently suspended.

funds still in force

If the other funds cannot currently be sold or encashed, the current *actual value* should be assumed to be nil for the purpose of arriving at fair compensation. Therefore redress calculated to the date of my final decision will be the *fair value* as calculated below.

If the business requires it, Mr and Mrs K should assign their remaining holdings in the complained of funds to it. Any costs associated with this process should be borne by the business.

To arrive at the *fair value,* The On-Line Partnership should work out what 50% of the original investment 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 my decision and apply those rates to that part of the investment, on an annually compounded basis.

The On-Line Partnership should add to that what 50% of the original investment would be worth if it had performed in line with the WMA index from the date of investment to the date of my decision.

Any additional sum that Mr and Mrs K 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 Mr and Mrs K 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 the business totals all such payments and deducts that figure at the end instead of periodically deducting them.

If my award is not paid within 28 days of The On-Line Partnership Limited receiving notification that Mr and Mrs K have accepted my decision, simple interest is to be added at a rate of 8% gross a year from the date of my decision to the date of settlement. Income tax may be payable on this interest.

the surrendered funds

For the two property unit trusts which I understand have been sold, the *actual value* is the amount Mr and Mrs K received at the date surrendered.

To arrive at the *fair value,* The On-Line Partnership should work out what 50% of the original investment 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 my decision and apply those rates to that part of the investment, on an annually compounded basis.

The On-Line Partnership should add to that what 50% of the original investment would be worth if it had performed in line with the WMA index from the date of investment to the date of my decision.

Any additional sum that Mr and Mrs K 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 Mr and Mrs K 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 the business totals all such payments and deducts that figure at the end instead of periodically deducting them.

For the surrendered funds, simple interest should be added to the compensation amount at 8% each year from the date surrendered to the date of my decision. Income tax may be payable on this interest.

my final decision

I uphold the complaint. My decision is that The On-Line Partnership Limited should pay Mr and Mrs K the amount calculated as set out above.

Louise Bardell
ombudsman