Financial Ombudsman Service

## complaint

The complaint concerns the advice given to the trustees by Morgans Ltd ("the IFA") to invest £20,000 into Keydata Secure Income Bond issue 3 in 2005. The trustees believe the advice was unsuitable as it exposed the trust monies to more risk than they were prepared to take.

## background

The circumstances leading to this complaint, and my initial conclusions, are set out in my provisional decision of 19 April 2013. In that decision, I explained why I considered the complaint should succeed. In summary, I found that the Keydata investment was not compatible with the risk the trustees wished to take with the trust monies under their care. On balance, I considered that the IFA had shown a complete disregard for its clients' interests, and so the trust should be compensated accordingly. I invited both parties to let me have any further representations by 21 May 2013.

I have now heard from both parties.

The third party, acting on behalf of the trustees, has confirmed they have accepted my provisional decision. It also added that the trustee is not a tax specialist as the IFA keep asserting.

The IFA has not accepted my provisional decision and the adviser who recommended the investment made the following comments:

- The advice was not negligent but rather the adviser was acting in the client's best interests and with the best intentions.
- The stock market had risen dramatically since March 2003 following a more than 50% reduction in equity values from the peak in 1999. The subsequent almost doubling of the market that took place over the next three years meant caution and underlying guarantees were more important at the time of the advice.
- The clients were willing to have a predominantly equity based portfolio as they believed the returns from equities would outperform most other asset classes in the medium to long term.
- The clients were extremely wealthy individuals in their own right and the capital invested into the trust was from the client's father. Although the adviser was not able to take details of his financial circumstances, he believed that he was a very wealthy individual.
- The main conversations regarding the investment were held with the client and subsequently the other trustees and his father were copied in on the recommendations whenever appropriate.
- One of the trustees had a great deal of experience in all forms of investment, including structured investments, with which he had previously had no problems. His co-trustee was an expert in tax law and a very intelligent man.
- The adviser was concerned that the stock market may have risen too far too quickly; so he recommended that a portion be kept in cash to hedge against any volatility and then to be contributed into the market, should a drop take place.
- He also recommended they reduce volatility by contributing into equities by pound cost averaging on a monthly basis and to invest a proportion of the money ie 25% into a structured product, which was effectively based upon the performance of "Impaired Life Annuities".

- The clients would have suffered significant losses if the adviser had invested as they had wanted him to (fully into equities). The concept of investing into “Impaired Life Annuities” cannot be deemed as negligent or inappropriate as in theory only the yields vary.
- The capital loss only took place as a result of misappropriation of the funds. People could have lived longer than anticipated, but there was no chance that they would live forever and therefore there had to be a yield, albeit variable.
- At that time, the adviser anticipated that the variable yield, based upon sick people dying, would not have been worse than the likely fall in equity values (which not so long after amounted to almost 50%).
- The product was marketed as lower risk than high yield corporate bonds, which is where the adviser pitched it in all of his recommendations and discussions with the clients. He never suggested it was a low risk investment and he pointed out that there was a risk of capital loss should the counterparties default on their obligations.
- The adviser has had no complaints in the last 25 years and therefore, if the advice is deemed to be negligent, either he had a commercial/mercenary interest in recommending this product as it was not in the best interests of the client or he did not understand what he was doing. Neither of these were the case.
- The FSA visited the IFA in 2006 and went through the majority of the Keydata files. The FSA had no concerns and did not want the adviser to change the way he was advising his clients at that time.

**my findings**

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

Having done so, I am not persuaded that I should depart from the findings on the merits of this complaint, as set out in my provisional decision. I consider that many of the issues the IFA has raised in its most recent submissions were points made previously or which had already been adequately addressed in my provisional decision. That said, where appropriate I have addressed below specific points made by the IFA in reaching my final decision.

I note what the adviser has said about the experience, wealth and background of the trustees. However, the advice here was in relation to the trust.
Its objectives were not necessarily the same as the trustees may have had with their own monies. I am not persuaded the personal circumstances of the trustees is evidence of the risk they would wish to take with the trust monies under their care.

I do not doubt that the trustees may have been prepared to take some level of risk with the capital within in the trust. However, I am not persuaded that they were prepared to take the degree of risk associated with the Keydata investment.

The IFA also suggests that the Keydata bond was appropriate as part of a larger portfolio. Again, I am not persuaded by this argument. Of course, there are situations where a higher risk element is included in a portfolio of investments so that overall the recommended investment strategy is appropriate. However, if that is what was intended, I would expect to see this approach explained. This would allow the consumer to understand the investment strategy and if necessary query the amount of their capital that was going to be subject to a higher degree of risk.

This of course is not the situation here. On the contrary, the evidence indicates the bond was intended to represent the more cautious element of the monies held within the trust. I consider this is how it was represented to the trustees in the advice they were given.

Having carefully considered the available evidence and having taken account of the circumstances and likely needs of the trust, I find on balance that the trustees would not have wanted to take a significant risk with this proportion the trust's capital.

I have noted the IFA's views on the risks of the Keydata plan, including the reference to counterparty risk. As I have explained previously, the product literature listed a number of different risks that could impact on the capital return at the end of the term. As an example, there could be problems with the predictions used within the modelling. Another example was potential liquidity problems in the second hand policy market. The same literature said that steps had been taken to mitigate these risks. However, it appears there was, and still is, an expectation, whether reasonable or not, that all these various risks would always be managed by all the different parties involved thereby ensuring the right outcome for investors such the trustees.

In my deliberation of the overall risk of the plan in the context of its suitability for the trustees, I have taken into account the nature of the underlying policies themselves and the market that provided the mechanism to be able to sell and purchase such policies. This was a unique and less than mainstream asset class which was based in the US and issued through an investment vehicle in Luxembourg. There were several different parties involved in the overall arrangement and this was not just an open–ended fund but instead it had been structured and packaged in such a way to supposedly generate the required cash flows to provide the relevant returns all within a fixed time frame.

As I said in my provisional decision, the IFA should be exercising professional judgement about the inherent nature of the investment and its suitability for their client's particular investment needs. The IFA should have identified those significant risks inherent in this product and taken them into consideration when recommending the investment to the trustees.

Regardless of any previous investment experienced, the trustees sought advice from the IFA and they were entitled to rely on that advice as appropriate for the trust. It is clear to me that is precisely what they did.
But even if they took care to read all the material that the IFA provided including the product documentation (and I have no reason to doubt that they did so), I do not consider that the warnings and description of the funds were sufficiently clear in the circumstances to suggest to the trustees that they should act otherwise than on the advice of their professional adviser.

The IFA considers that the investment was not a low risk. However, the plan was recommended as such and was supposed to represent the more cautious element of the trust. In my view, notwithstanding the risk warnings which were issued, the trustees would have been entitled to believe that the recommendation was consistent with this requirement.

Even if I were to accept that the trustees were taking a medium risk approach with the trust (which I do not) I would still remain of the view the plan was unsuitable. Further, even if a much smaller proportion of had been exposed to this Keydata plan, it would not alter my view that it was an unsuitable recommendation. Overall, I consider that taking account of the trustees' circumstances, the IFA has demonstrated a complete disregard for their interests.

I note the IFA's comment about the plan failing due to misappropriation. My provisional decision very carefully considered this matter. However, I have found that the trustees would not have been in this class of investment at all had it not been for the negligent advice given by the IFA. I cannot lightly ignore the fact that the trustees would not have been exposed to these risks had the IFA carried out its responsibilities properly. Consequently, for the reasons set out in detail in my provisional decision, I remain of the view that in the particular circumstances it is fair and reasonable to hold the IFA responsible for the unsuitable advice regardless of any arguments about a break in the chain of causation and the remoteness of the loss.

Finally, I note what the IFA says about the FSA visit; however, there is no evidence that this particular case was reviewed by the FSA. In any event, I have reached my own view on the advice given and have explained why I find it was unsuitable for the trustees.

**fair compensation**

As I have concluded that the IFA's recommendation to invest in the bond was not suitable for the trust, I need to consider what fair compensation should be. Usually I seek to put the investor back in the position they would have been in but for the poor advice. In this case, I think it most likely that the trustees would have still invested but into a more cautious investment.

However, there is a problem with assessing the true value of the investment the trust actually made. That is because assets in the bond invested in were taken and have not been recovered. It is not clear what the inherent value of the SLS investments were before the misappropriation. It is therefore not clear what the relative contributions are, of the underlying investment performance and the misappropriation, to the overall position that there is no value for investors.

So I need to decide whether or not the misappropriation from the Keydata bond produces new circumstances where my normal approach to fair compensation should not apply.

It is relevant, therefore, to note the information that is available to me about the circumstances of this Keydata bond and the liquidation of SLS.
As I understand the position, the investments made by the trustees were part of the investments held by SLS registered in Luxembourg. Following its liquidation the Luxembourg based liquidator (Baden and Baden) announced that "At this stage and with all due precaution, it does not appear that there are any remaining assets left."

The UK administrator for Keydata (PwC) explains "The underlying assets in relation to these plans were liquidated and misappropriated. This means that investors will not receive any income payments or return of their capital, unless recovery actions are successful. SLS Capital is now in liquidation."

Following an investigation, the UK Serious Fraud Office (SFO) concluded in April 2011 that "After extensive consideration we concluded that we had insufficient evidence to secure a prosecution in this case. As a result we decided to focus our efforts on tracing the assets of SLS Capital SA rather than attempting to prosecute. We are continuing to do this." In November 2012, the SFO confirmed that despite substantial effort to trace the assets, it has been unable to do so and it was unlikely to do so in the future. As a result, it closed its file.

What precisely occurred between 2005 and 2009 is not clear. However, given the findings of the SFO it seems that there is little (or perhaps more realistically no) hope of any value being recovered from the SLS managed Keydata bonds.

The position, however, is different from that of other Keydata products. The underlying assets associated with other Keydata funds are also seen (at least for the purposes of the Compensation Scheme) as having no value. While the issues with SLS caused significant financial damage to Keydata, I understand that there were also inherent problems with the investments associated with the other Keydata funds.

There is a further complication. As far as I can ascertain from the information available to me, there is no clear view about the inherent value of the SLS investments before the misappropriation. So it follows that is difficult to assess the relative contribution of the underlying investment performance, on the one hand, and the misappropriation, on the other.

My approach to cases such as this is difficult to describe in general terms – much depends on the particular combination of circumstances. But two points can be made:

First, no liability attaches to an adviser who has given satisfactory advice. Second, particular difficulties arise in assessing fair compensation when it seems clear that (as in this case) the customer would not have been in that class of investment at all had it not been for the negligent advice. In such circumstances, I might assess fair compensation to be awarded against the provider of the unsuitable advice to put the customer back in the financial position they would have been in but for the poor advice, notwithstanding that such an award may not be made by a court.

But I would need to be persuaded that such an approach represented “fair compensation” in the individual case. It seems to me that in assessing what represents fair compensation; I should have regard to the applicable legal principles. But I should also take into account the nature of the advice given and the impact of any award on the parties and reach a view on what I consider to be fair in all the circumstances of the case.

The trustees would not have been in this Keydata product but for the poor advice of the IFA – and the trust has suffered a significant loss of money.
But I also need to be conscious of what is fair to the IFA. The IFA is and should be held to account for the poor advice it gave, but it was not responsible for the misappropriation of the funds, or for the fact that insurance was not in place to cover such an eventuality.

The legal principles of causation and remoteness that might be applied to cases such as this are highly case sensitive and I cannot be definitive about how a court might apply these principles. As such, the most I will be able to consider is what a court is likely to find, when confronted with this particular set of facts.

In my view, a court might consider that the available balance of evidence about the sequence of event reveals that there was an intervening force that caused (at least part of) the trust’s losses: namely the misappropriation. I also think that a court might find that there are no reasonable grounds for suggesting that the IFA could, in October 2005, have foreseen that the assets underlying the bond might be misappropriated by a third party.

Accordingly, a court might conclude that not all of the trusts losses flowed directly from the unsuitable advice on the part of the IFA. And on this basis a court might not require the IFA to compensate the trustees for all or any of the losses the trust has incurred notwithstanding the clearly unsuitable advice the IFA gave.

But in assessing fair compensation, I am not limited to the position a court might reach. I think there are other factors in cases such as these, given in particular the specific circumstances of financial investments and advice that I should consider.

In particular, it seems to me that in assessing fair compensation, I should take into account the nature of the advice that has been given. In the present case, I consider that the IFA had a complete disregard for the interests of its clients in giving this advice.

It is frustrating that in the present case the evidence available to me from the relevant authorities here and in Luxembourg is not sufficient to make a wholly reliable assessment of the underlying value of the bonds or the impact the misappropriation had on the value of the investment.

However, in all the circumstances of this case, I cannot lightly ignore the fact that the trustees would not have been exposed to these risks had the IFA carried out its responsibilities properly. Taking all these factors into consideration, I conclude that I should assess fair compensation in this case as putting the trust back into the position it would have been had the trustees not followed the advice to invest in the Keydata bond. I say this because of:

- the nature of the advice the IFA gave was in my view clearly in error;
- its assessment of the needs of trustees and the trust and of the suitability of the product and it generally paid complete disregard to their interests;
- this was simply a class of investment that the trustees should not have been in and would not have chosen but for the IFA’s recommendation;
- the fact that there appears to be an inherent and significant weakness in the investment model used by Keydata. Other very similar Keydata bonds failed largely as a result of factors other than this misappropriation; and
- what I consider to be a fair outcome to this complaint.

Accordingly, I conclude that it would be fair and reasonable to make an award in the particular circumstances of this case – regardless of any arguments about a break in the chain of causation and the remoteness of the loss from the (poor) advice given.

Having considered the factors that I have set out in this decision, I reasonably conclude that I should assess fair compensation as putting the trust back in the position it would have been in, had the trustees not followed the advice to invest in the bond.

I have also considered what award I should make in respect of interest given that as outlined above the trust’s loss crystallised on 13 November 2009. My normal approach is to award 8% simple per year (before tax) on crystallised losses, unless it is clear that another rate would more accurately reflect the costs to the particular consumer for being out of the money concerned.

The 8% figure is not intended to be an interest rate in the way that a bank deposit account pays interest. Rather it is a rate which I consider to be a fair yardstick for compensating consumers for a wide range of possible losses and lost opportunities they may have incurred. The consumer might, for example, have:

- borrowed money, or continued to borrow money, at credit card or loan rates which they would not have done if the money had been available to them;
- saved or invested the money in some way producing a variety or possible returns;
- spent the money on holidays, home improvements, or any number of goods which might have given them an unquantifiable return;
- or any combination of these things.

The 8% simple interest rate is gross and is subject to tax – and is a rate often (but not always) used by the courts in not dissimilar situations.

At the time the trustees invested the money, the vast majority of it was set to remain in the trust for over 15 years (because of the ages of a number of the beneficiaries). The Keydata bond accounted for 25% of the trust and the loss crystallised four years later. So, whilst the crystallised loses will have given rise to distress and potentially inconvenience to the trust, I think the extent of the overall assets at the time, suggest that a rate of 8% might be excessive in this case. I therefore consider that a fair rate of interest is 2.5% simple per year following the crystallisation of the loss in November 2009.

**my final decision**

My final decision is to uphold the complaint and I require Morgans Ltd to pay compensation as follows:

> 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 capital growth equivalent to 1% more than Bank of England base rate compounded yearly from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised);
>
> C= the residual value of the investment that the trust made in the Keydata which I assess to be zero for this purpose.
>
> D= A+B-C

My final decision is that the IFA should pay the trustees the amount produced by that calculation (that is amount D). To that sum (D) the IFA should add interest from 13 November 2009 at the rate of 2.5% simple per year 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 (ie the interest added to D), it must send a tax deduction certificate with the payment. The trustees may be able to reclaim the tax paid from HM Revenue and Customs, according to the circumstances.

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.

In relation to (C), I understand that the fund cannot be encashed. For that reason, as set out above, for the purposes of (C) the investment should be treated as having a nil value. However, this is provided that the trustees agree 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 the trustees to note this carefully. They 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.

Doug Mansell
**ombudsman**

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# PROVISIONAL DECISION

**summary of complaint**

The complaint concerns the advice given to the trustees by Morgans Ltd ("the IFA") to invest £20,000 into Keydata Secure Income Bond issue 3 in 2005. The trustees believe the advice was unsuitable as it exposed the trust monies to more risk than they were prepared to take.

**background to complaint**

In late 2005 the trustees sought investment advice from the IFA in relation to investment of monies placed under trust.

Acting on advice given by the IFA, £20,000 was invested into the Keydata bond. The product provider, Keydata Investment Service Limited ("Keydata"), acted as the trustees' agent and purchased the bond. The issuer of the bond was SLS Capital S.A. (SLS), which was a Luxembourg based 'special purpose vehicle'.

It appears that assets underlying the bond were subsequently 'misappropriated' by an unknown party. Keydata went into administration on 8 June 2009, and it defaulted on 13 November 2009.

Following the failure of Keydata the trustees submitted a claim to FSCS, but I understand the claim was rejected.

The trustees employed a third party to represent them and complained to the IFA that they had made the investment on its advice and therefore it should compensate the trust for its losses.

The IFA did not agree. It stated that:

- Attitude towards risk was discussed in detail and was demonstrated by the deviation from the original recommendation following the trustees' wish for equity-based investment.
- With regard to establishment of attitude to risk, this was discussed in great detail with the two trustees and it was at their request that the IFA deviated from the original, cautious recommendations made.
- One of the trustees was a long-standing client of the IFA and had himself considerable experience in both equity investments and structured products. The other trustee is a barrister and specialist in taxation matters.
- The spread of investments (56% equities, 19% cash and 25% in the Keydata bond) provided a balanced approach. An additional monthly amount has been invested in unit trusts since June 2006.
- The monies were diversified quite considerably; the Keydata investment was only a small element of total monies invested.
- The Keydata key features document restates several times that the bond did not expose the investor to stock market risk; if this was not the case surely responsibility lies with Keydata for misrepresentation of its product.

The trustees were not satisfied with the IFA's response and referred the complaint to this service.

The complaint was investigated by one of our adjudicators, who expressed the view that it should be upheld. Briefly, she concluded that the plan was not a suitable recommendation and represented more risk than the trustees might reasonably have understood.

The business did not agree with the adjudicator's findings. In addition, to the points raised above, it said that:

- If there was misrepresentation by Keydata, then this is a matter for Keydata or the regulator who approved the product for sale. The adviser was reliant on the information provided by Keydata. It appears this information was misleading.

- The original recommendation was based on a more cautious model. It was the consumers who requested a more diversified/higher risk portfolio. A significant proportion of monies have been invested directly into equity-based funds.

- One trustee is a taxation barrister and therefore qualified to understand complex investment issues. It considers he would reasonably be expected to understand and appreciate the risk involved.

- The other trustee and his wife held a number of identical holdings for which it has not received any complaint.

It considers the consumers are acting with hindsight in making this complaint. The real reason money has been lost is due to the actions of Keydata, the regulator and the subsequent failure of the company.

As the complaint has not been resolved, it has been passed to me for a decision. I must decide this case on its individual merits. However, we have considered complaints about Keydata funds before and published a decision which sets out our general approach to such complaints on our website here: http://www.financial-ombudsman.org.uk/publications/technical.htm

**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 the trust. 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 FSA principles and rules on how a business should conduct itself.

The IFA argues that the bond was suitable for the level of investment risk the trustees were prepared to take on behalf of the trust. Therefore, I have considered whether the recommendation to invest in the fund was a suitable recommendation in the circumstances. In doing so I have taken account of the nature and complexity of the investment and the trustees' needs and objectives.

The trustees had several meetings with the IFA in late 2005 during which various recommendations were made. In the end, the money was invested as follows:

- £45,000 in units trusts in a variety of funds.
- £15,000 in cash deposits.
- £20,000 in Keydata Secure Income Bond

The IFA drew the trustees' attention to the Keydata bond and sent them the product literature. Amongst other key benefits, the IFA's report stated:

"*This makes the Secure Income Bond a lower risk investment than investments that invest in high yield corporate bonds or equities*".

The IFA also outlined:

"*it falls somewhere in the middle of the cash within the Trust, and the Unit Trusts recently applied for*".

Whilst I have noted the points made by the IFA about the trustees' attitude to risk, I have not seen evidence of what measures it took to assess this matter. Whilst it may be the case that one of the trustees was also a customer of the IFA in his own right, and may have been advised on his own investments, I am not persuaded that this is evidence of the risk the trustees would wish to take with the trust monies under their care.

However, having carefully considered the available evidence and having taken account of the circumstances and likely needs of the trust, I find on balance that the trustees would not have wanted to take a significant risk with this proportion the trust's capital.
Whilst part of the capital within the trust was placed on deposit, as noted above a significant proportion was subject to the risk posed by equity investments within unit trusts.

I am mindful that when explaining the recommendation to the trustees in the letter dated 15 November 2005, the IFA stated that the Keydata bond was a lower risk than investments in higher yield corporate bonds or equities. Further, the IFA commented that the bond should fall somewhere in the middle of the cash and unit trust elements of the trust monies. It therefore seems that the IFA was presenting the Keydata bond as being a lower risk than the capital in the unit trusts and so to essentially represent a cautious element of the trust monies.

I turn now to consider whether the Keydata bond represented a higher risk investment than the trustees were willing to take. 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 Financial Services Authority (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 products. The FSA's final notice in relation to Norwich and Peterborough Building Society dated April 2011 provides a helpful summary in slightly more accessible terms of the same bond:

> *"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") … 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 … SLS 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 potential problems with these types of investments are now well known. So it is important to avoid the benefit of hindsight in the assessment of these matters today. That said, in my view, it was clear from the description and the other information reasonably available to the IFA at the relevant time that the bond was not a secure investment and presented some considerable risk to capital.

Investors could lose money if the insurance companies issuing the insurance contracts defaulted on their obligations, or if the issuer of the Bond went into liquidation, or if factors changed which affected the rate at which insurance contracts mature. There was also the possibility that investors could lose money if the traded insurance contracts fell in value, or if certain assets did not mature in a way predicted by the financial model.

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.*

I agree. Moreover, although certain documentation included mention of HSBC and KPMG, any assurance provided by these household names was largely illusory. Their roles were strictly limited and provided no real assurance about the controls over or quality of the investments or fund management arrangements.

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 these bonds. Accordingly in my view, to a professional financial adviser, these investments would not and should not have been suitable for a cautious investor.

Indeed, thinking about the Keydata investments, and given only what was known (or should have been known) to the adviser 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 retail investors, and certainly not for the trust/trustees even if I was persuaded (which I am not) that a balanced approach was appropriate.

It was important for advisers to take these matters into account when assessing the suitability of the product for the trust, and for the trustees to understand that the fund presented a significant risk to the trust's funds.

It is not sufficient for the adviser to simply assert that they relied on the headline description of the investment when making their assessment of suitability. Rather, they should be exercising professional judgement about the inherent nature of the investment and its suitability for their client's particular investment needs. And the IFA should have identified those significant risks inherent in this product and taken them into consideration when recommending the investment to the trustees. Accordingly, it is my conclusion that this investment was not suitable for the trust.

This is not a view reached with hindsight. I have based my findings on the product's suitability for the trust 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.

Accordingly, I conclude that the recommendation made by the IFA to invest in the bond was not a suitable recommendation for the trustees. Indeed, the advice demonstrated in my view a complete disregard for the individual circumstances and interests of the trust.

I have concluded that the IFA's recommendation to invest in the bond was not suitable for the trust. I therefore need to consider what the trustees would have done "but for" the advice they received.

I have not seen anything which suggests to me (and I find it highly unlikely) that they would have invested in the bond, if it had not been recommended to them. Nor am I persuaded that they would have invested in the bond, if things had happened as they should. The investment was not suitable for the needs and circumstances of the trust, and I do not think the trustees would have invested had they appreciated the risks.

Overall I think it most likely that the trustees would still have invested into an investment suitable for a cautious investor. On balance, I consider that a fair benchmark to indicate the investment return on the investment is 1% more than the Bank of England base rate compounded yearly from the date of investment until the date the loss crystallised.

**fair compensation**

As I have concluded that the IFA's recommendation to invest in the bond was not suitable for the trust, I need to consider what fair compensation should be. Usually I seek to put the investor back in the position they would have been in but for the poor advice. In this case,
I think it most likely that the trustees would have still invested but into a more cautious investment.

However, there is a problem with assessing the true value of the investment the trust actually made. That is because assets in the bond invested in were taken and have not been recovered. It is not clear what the inherent value of the SLS investments were before the misappropriation. It is therefore not clear what the relative contributions are, of the underlying investment performance and the misappropriation, to the overall position that there is no value for investors.

So I need to decide whether or not the misappropriation from the Keydata bond produces new circumstances where my normal approach to fair compensation should not apply.

It is relevant, therefore, to note the information that is available to me about the circumstances of this Keydata bond and the liquidation of SLS.

As I understand the position, the investments made by the trustees were part of the investments held by SLS registered in Luxembourg. Following its liquidation the Luxembourg based liquidator (Baden and Baden) announced that "At this stage and with all due precaution, it does not appear that there are any remaining assets left."

The UK administrator for Keydata (PwC) explains "The underlying assets in relation to these plans were liquidated and misappropriated. This means that investors will not receive any income payments or return of their capital, unless recovery actions are successful. SLS Capital is now in liquidation."

Following an investigation, the UK Serious Fraud Office (SFO) concluded in April 2011 that "After extensive consideration we concluded that we had insufficient evidence to secure a prosecution in this case. As a result we decided to focus our efforts on tracing the assets of SLS Capital SA rather than attempting to prosecute. We are continuing to do this." In November 2012, the SFO confirmed that despite substantial effort to trace the assets, it has been unable to do so and it was unlikely to do so in the future. As a result, it closed its file.

What precisely occurred between 2005 and 2009 is not clear. However, given the findings of the SFO it seems that there is little (or perhaps more realistically no) hope of any value being recovered from the SLS managed Keydata bonds.

The position, however, is different from that of other Keydata products. The underlying assets associated with other Keydata funds are also seen (at least for the purposes of the Compensation Scheme) as having no value. While the issues with SLS caused significant financial damage to Keydata, I understand that there were also inherent problems with the investments associated with the other Keydata funds.

There is a further complication. As far as I can ascertain from the information available to me, there is no clear view about the inherent value of the SLS investments before the misappropriation. So it follows that is difficult to assess the relative contribution of the underlying investment performance, on the one hand, and the misappropriation, on the other.

My approach to cases such as this is difficult to describe in general terms – much depends on the particular combination of circumstances. But two points can be made:

First, no liability attaches to an adviser who has given satisfactory advice. Second, particular difficulties arise in assessing fair compensation when it seems clear that (as in this case) the customer would not have been in that class of investment at all had it not been for the negligent advice. In such circumstances, I might assess fair compensation to be awarded against the provider of the unsuitable advice to put the customer back in the financial position they would have been in but for the poor advice, notwithstanding that such an award may not be made by a court.

But I would need to be persuaded that such an approach represented "fair compensation" in the individual case. It seems to me that in assessing what represents fair compensation; I should have regard to the applicable legal principles. But I should also take into account the nature of the advice given and the impact of any award on the parties and reach a view on what I consider to be fair in all the circumstances of the case.

The trustees would not have been in this Keydata product but for the poor advice of the IFA – and the trust has suffered a significant loss of money.

But I also need to be conscious of what is fair to the IFA. The IFA is and should be held to account for the poor advice it gave, but it was not responsible for the misappropriation of the funds, or for the fact that insurance was not in place to cover such an eventuality.

The legal principles of causation and remoteness that might be applied to cases such as this are highly case sensitive and I cannot be definitive about how a court might apply these principles. As such, the most I will be able to consider is what a court is likely to find, when confronted with this particular set of facts.

In my view, a court might consider that the available balance of evidence about the sequence of event reveals that there was an intervening force that caused (at least part of) the trust's losses: namely the misappropriation. I also think that a court might find that there are no reasonable grounds for suggesting that the IFA could, in October 2005, have foreseen that the assets underlying the bond might be misappropriated by a third party.

Accordingly, a court might conclude that not all of the trusts losses flowed directly from the unsuitable advice on the part of the IFA. And on this basis a court might not require the IFA to compensate the trustees for all or any of the losses the trust has incurred notwithstanding the clearly unsuitable advice the IFA gave.

But in assessing fair compensation, I am not limited to the position a court might reach.
I think there are other factors in cases such as these, given in particular the specific circumstances of financial investments and advice that I should consider.

In particular, it seems to me that in assessing fair compensation, I should take into account the nature of the advice that has been given. In the present case, I consider that the IFA had a complete disregard for the interests of its clients in giving this advice.

It is frustrating that in the present case the evidence available to me from the relevant authorities here and in Luxembourg is not sufficient to make a wholly reliable assessment of the underlying value of the bonds or the impact the misappropriation had on the value of the investment.

However, in all the circumstances of this case, I cannot lightly ignore the fact that the trustees would not have been exposed to these risks had the IFA carried out its responsibilities properly. Taking all these factors into consideration, I conclude that I should assess fair compensation in this case as putting the trust back into the position it would have been had the trustees not followed the advice to invest in the Keydata bond. I say this because of:

- the nature of the advice the IFA gave was in my view clearly in error;
- its assessment of the needs of trustees and the trust and of the suitability of the product and it generally paid complete disregard to their interests;
- this was simply a class of investment that the trustees should not have been in and would not have chosen but for the IFA’s recommendation;
- the fact that there appears to be an inherent and significant weakness in the investment model used by Keydata. Other very similar Keydata bonds failed largely as a result of factors other than this misappropriation; and
- what I consider to be a fair outcome to this complaint.

Accordingly, I conclude that it would be fair and reasonable to make an award in the particular circumstances of this case – regardless of any arguments about a break in the chain of causation and the remoteness of the loss from the (poor) advice given.

Having considered the factors that I have set out in this decision, I reasonably conclude that I should assess fair compensation as putting the trust back in the position it would have been in, had the trustees not followed the advice to invest in the bond.

I have also considered what award I should make in respect of interest given that as outlined above the trust’s loss crystallised on 13 November 2009. My normal approach is to award 8% simple per year (before tax) on crystallised losses, unless it is clear that another rate would more accurately reflect the costs to the particular consumer for being out of the money concerned.

The 8% figure is not intended to be an interest rate in the way that a bank deposit account pays interest. Rather it is a rate which I consider to be a fair yardstick for compensating consumers for a wide range of possible losses and lost opportunities they may have incurred. The consumer might, for example, have:

- borrowed money, or continued to borrow money, at credit card or loan rates which they would not have done if the money had been available to them;

- saved or invested the money in some way producing a variety or possible returns;

- spent the money on holidays, home improvements, or any number of goods which might have given them an unquantifiable return;

- or any combination of these things.

The 8% simple interest rate is gross and is subject to tax – and is a rate often (but not always) used by the courts in not dissimilar situations.

At the time the trustees invested the money, the vast majority of it was set to remain in the trust for over 15 years (because of the ages of a number of the beneficiaries). The Keydata bond accounted for 25% of the trust and the loss crystallised four years later. So, whilst the crystallised loses will have given rise to distress and potentially inconvenience to the trust, I think the extent of the overall assets at the time, suggest that a rate of 8% might be excessive in this case. I therefore consider that a fair rate of interest is 2.5% simple per year following the crystallisation of the loss in November 2009.

**my provisional decision**

For the reasons set out above, I am presently minded to uphold the trustees' complaint. The Keydata investment should not have been recommended to them by the IFA and I have concluded that the IFA acted with total disregard for its clients' interests.

I am minded to uphold the complaint and I consider that fair compensation should be calculated as follows:

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 capital growth equivalent to 1% more than Bank of England base rate compounded yearly from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised);

C= the residual value of the investment that the trust made in the Keydata which I assess to be zero for this purpose.

D= A+B-C

My provisional decision is that the IFA should pay the trustees the amount produced by that calculation (that is amount D). To that sum (D) the IFA should add interest from 13 November 2009 at the rate of 2.5% simple per year 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 (ie the interest added to D), it must send a tax deduction certificate with the payment. The trustees may be able to reclaim the tax paid from HM Revenue and Customs, according to the circumstances.

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.

In relation to C, I understand that the fund cannot be encashed. For that reason, as set out above, for the purposes of C the investment should be treated as having a nil value. However, this is provided that the trustees agree 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 the trustees to note this carefully. They 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 now invite the parties to let me have in writing any further submissions they may wish to make within one month, after which time I will issue my final decision.

Doug Mansell
**ombudsman**