final decision

complaint by:	Mr and Mrs K
complaint about:	IFA
complaint reference:	
date of decision:	November 2012

This final decision is issued by me, Tony Boorman, an ombudsman with the Financial Ombudsman Service. It sets out my conclusions in relation to the dispute between Mr and Mrs K and the IFA. Under the rules of the Financial Ombudsman Service, I am required to ask Mr and Mrs K either to accept or to reject my conclusions, in writing, before 5 December 2012.

summary of complaint

This dispute is about the advice given to Mr and Mrs K by the IFA to invest in the Keydata Secure Income Bond Issue 2 ("the Keydata bond") in 2005.

my final decision

I issued a provisional decision upholding this complaint and making a money award requiring the IFA to pay fair compensation. Both parties have responded to my provisional decision.

Mr and Mrs K initially made no further comments and stated that they had already provided this service with all of the documents that they wished to be taken into account.

The IFA did not accept my provisional decision, and made the following points, which I summarise:

affordability

- According to the fact find (which I take the IFA to mean the *"Client Information Form"* dated 18 October 2005), Mr and Mrs K's joint earnings were £1,300 a month and their monthly outgoings were around £1,000, which meant that they had a surplus income.
- Mr and Mrs K had more money available to invest than I had set out in the provisional decision.
- Mr and Mrs K's investment of £60,000 was affordable, given their financial circumstances.

investment objectives

- The IFA described Mr and Mrs K as cautious investors, even though they were attracted to *"the idea of a balanced portfolio"*. In light of their preference for a balanced portfolio, Mr and Mrs K were prepared to take a risk with their capital.
- While there may be no detailed definition of what low risk and no risk could mean in practice, the IFA was required to *"fairly, clearly and not misleadingly point out the risk of loss per se."*
- COB 2.3.3R (*"A firm will be taken to be in compliance with any rule in COB that requires a firm to obtain information to the extent that the firm can show that it was reasonable for the firm to rely on information provided to it in writing by another person."*) and its related provisions are relevant to this dispute.

risk warnings

- Mr K's letter of 10 October 2005 demonstrates that he read the product literature and highlighted areas of concern.
- The IFA informed Mr K that 60% of his funds would be invested in insurance contracts, and as such, he understood that this element of the investment would be exposed to some risk.
- The IFA informed Mr and Mrs K that the bond was not a predominantly cash investment, and that it presented some risk to capital. These risk warnings were given in fair, clear and not misleading terms.
- Mr K understood the risks from the product literature, and he sought further clarity, which was given by the IFA.
- Mr and Mrs K gave informed consent to take on those risks.

FSA Final Notice

- In reaching the conclusions in my provisional decision, I relied upon standards that that the Financial Services Authority ("FSA") set down in 2011. I am penalising a small IFA for actions that were not considered inappropriate by the FSA at the relevant time.
- The FSA Final Notice dated April 2011 should not be relied upon when reaching a view as to what was or should have been apparent to a professional advisor at the relevant time.

HSBC and KPMG involvement

- It was not unreasonable for the IFA to rely on what it was told by Keydata about HSBC's and KPMG's involvement, and to convey that information to Mr and Mrs K.
- Although KPMG and HSBC were involved, the extent of their involvement was not known at the time.
- There was nothing in the product literature that could have led to a reasonable suspicion that HSBC's and KPMG's involvement should have been queried. It is not reasonable for a small IFA to be required to *"expend disproportionate amounts of valuable resources to check out the actual roles of the Banks named in the literature."*
- It cannot be fair and reasonable to state that the firm should have known or ought reasonably to have known that the product literature was inaccurate.
- With regards to the statement *"Although it can not be categorically said that your monies are 100% secure, it would take all the insurance companies with whom*

HSBC buy insurance contracts to default on their obligations to put your capital at risk", the IFA was referring to the strength of cover provided by HSBC. Any inaccuracy about that statement is caused by the fact that Keydata lied about the extent of HSBC's involvement. In any event, this was not the only risk highlighted by the IFA.
- The FSA and the Financial Services Compensation Scheme ("FSCS") have both acknowledged that Keydata made misrepresentations with regards to HSBC's involvement.

Keydata's misrepresentations and the misappropriation of funds

- It cannot be fair and reasonable to conclude that the opaque nature of the bond should have been enough for the IFA to appreciate the risks at the relevant time.
- The misrepresentations by Keydata and the misappropriation of funds caused the material risks to arise.
- The misappropriation took effect after the point of sale, and the firm did not foresee the possibility of such a risk arising. The FSA has made it clear that it was not reasonable for IFAs to have foreseen such a risk, given that the bond had been running smoothly for four years.

On the issue of affordability, as the IFA had questioned the basis of the factual information used, I asked Mr and Mrs K about their recollections from the time.

They provided me with a detailed statement of their circumstances. Including previous savings, and taking into account the fact that they needed to pay tax and intended to make further gifts, Mr and Mrs K had around £200,000 left from the sale of their bed and breakfast – *plus* around £210,000 in previous savings that were held in a deposit account. Together with modest pensions, their savings were planned to cover their retirement needs.

I also exchanged correspondence with the parties on the rate of interest that should be applied to any award. The IFA did not make a material response to this further consideration but for reasons that I will explain in the section of fair compensation I intend to make no material change to the calculations in the provisional decision.

I have carefully considered all the information and evidence submitted by both sides, in order 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 correspondence 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 and Mr and Mrs K in reaching my final decision.

background to complaint

a) events leading up to the complaint

In early 2005, Mr and Mrs K sought investment advice from the IFA. They ran a bed and breakfast business, which they had recently sold. They received £569,885 from the sale (after selling agents' commission). They gave some of this money as a gift to their eldest child, and kept the remainder in bank and building society accounts.

Acting on advice given by the IFA, Mr and Mrs K invested £60,000 in the Keydata bond. The product provider, Keydata Investment Service Limited ("Keydata"), acted as Mr and Mrs K's agent and purchased the bond. The issuer of the bond was SLS Capital S.A., which was a Luxembourg based *"special purpose vehicle"*.

It appears that assets underlying the bond were subsequently "misappropriated" by an unknown party. By misappropriation, I understand the authorities to mean the intentional and illegal use of the property or funds of another person by any person with a responsibility to care for and protect another's assets. After the misappropriation, Mr and Mrs K stopped receiving interest payments in May 2009. Keydata went into administration on 8 June 2009, and it defaulted on 13 November 2009.

As a result of these events Mr and Mrs K have experienced significant losses. They had understood that the investment was guaranteed and were therefore concerned about the advice the IFA had given them to invest in the bond in 2005.

b) the complaint and the IFA's response

Mr and Mrs K complained to the IFA that they made the investment on its advice on the specific understanding that the bond was guaranteed by HSBC. Mr and Mrs K were at a loss as to why HSBC had not stepped in to honour this guarantee.

Mr and Mrs K considered that, if the IFA had misinterpreted the Keydata bond and the bond was not guaranteed by HSBC, the IFA should compensate them for their losses.

The IFA did not agree. It stated that it advised on HSBC's involvement in good faith, relying upon information provided by Keydata. It stated that the product literature made it clear that the bond was not guaranteed by HSBC. It maintained that the real issue was that it had been misled by statements by Keydata and that others should be held responsible for the losses.

Mr and Mrs K 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 recommended that it should succeed, and that Mr and Mrs K should be returned to the position they would have been had they not invested in the Keydata bond.

The IFA did not accept the adjudicator's view. In summary, it stated:

- The IFA was entitled to rely on the product literature when giving advice.
- The IFA's comments on HSBC's involvement were based entirely on the product literature.
- Given that HSBC legally owned the contracts within the bond, the IFA did not misrepresent the nature of the bond.
- Mr and Mrs K should recover any losses through the FSCS.

Mr and Mrs K objected to the IFA's comments. Briefly, they stated:

- The IFA mis-sold the bond to him and his wife.
- They made the investment because of the IFA's assurances to them that it was guaranteed and owned by HSBC.
- Mr and Mrs K held only minimal previous knowledge of investing having been the owners of a bed and breakfast business until its sale in 2005.
- The information contained in the promotional leaflet was unfamiliar to them and they had sought clarification from the adviser. Although they had read the leaflet, important details were unclear. The correspondence from that time showed that security of capital was the cornerstone of any investment policy agreed, and they had only wanted to invest with strong household names.

The IFA decided to employ a representative to make arguments on its behalf but I do not generally distinguish here between those comments made by the IFA itself and those by its representative. The IFA's additional final comments were:

- The complaint was about misrepresentation, rather than unsuitable advice.
- Mr and Mrs K were cautious investors. This caution gave rise to Mr K's questions about the structure of the bond, which Mr K had found unclear based on the product literature.
- Keydata, the product provider, was responsible for mentioning key risks in the key features document which should then be expanded upon, where necessary, by the IFA. The key risks do not extend to default of the bond owner.
- Mr K had read and understood the majority of the key features document, and any misunderstanding was corrected by the IFA.
- The IFA cannot be held liable for the actions of Keydata, which is being investigated by the Serious Organised Crime Agency.

c) application to the FSCS

In November 2009, Mr K submitted a claim against Keydata to the FSCS. He stated that Keydata and the IFA misled him into investing in the Keydata bond.

The FSCS rejected the claim for compensation. Its reasons, in summary, were that:

- The losses were caused by the bond's underlying assets being misappropriated by a third party.
- There was no evidence that Keydata was involved, and the misappropriation was an unforeseeable event.
- Keydata had reason to believe that HSBC would legally own insurance contracts and would be responsible for checking that those insurance contracts were issued by companies with appropriate credit ratings.
- The statements Keydata made regarding the levels of risk were not false.
- Keydata did not make a fraudulent misrepresentation and it had no civil liability towards Mr K.

It is relevant to note at this point that Mr and Mrs K were doubly unfortunate here. Many investors in the SLS related Keydata bonds have been given compensation by the FSCS. But typically this is because they relied on the misstatement in the Keydata brochure that the bond could be placed in an investment ISA.

This statement was untrue and has resulted in compensation payments to those customers who invested in the SLS Keydata bonds within an ISA wrapper. Unfortunately for Mr and Mrs K their own Keydata bond investment was made entirely outside any ISA.

my findings

I have included only a brief summary of the complaint (above), but 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.

a) relevant considerations

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.

The IFA gave Mr and Mrs K advice about a regulated investment in 2005. It is important to note the relevant regulatory regime that applied at the time.

The FSA principles apply to all authorised firms, including the IFA. Of particular relevance to this complaint are:

- Principle 6
  "A firm must pay due regard to the interests of its customers and treat them fairly"

- Principle 7
  "A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading"

- Principle 9
  "A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment".

In addition, where investment advice is given, the more detailed FSA's Conduct of Business rules (which came into force on 1 December 2001) apply. And so it is necessary to take those into account. Of particular relevance to this complaint are:

> *COB 2.1.3R*
>
> *When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading.*
>
> *COB 2.1.4G*
>
> *When considering the requirements of COB 2.1.3 R, a firm should have regard to the customer's knowledge of the designated investment business to which the information relates.*
>
> *COB 5.2.5R*
>
> *Before a firm gives a personal recommendation concerning a designated investment to a private customer, or acts as an investment manager for a private customer, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that customer relevant to the services that the firm has agreed to provide.*
>
> *COB 5.3.5R*
>
> *(1) A firm must take reasonable steps to ensure that, if in the course of designated investment business:*
>
> *(a) it makes any personal recommendation to a private customer to:*
>
> *(i) buy, sell, subscribe for or underwrite a designated investment (or to exercise any right conferred by such an investment to do so); or*
> *(ii) elect to make income withdrawals; ...*
>
> *the advice on investments or transaction is suitable for the client.*
>
> *(3) In making the recommendation or effecting the transaction in (1), the firm must have regard to:*

(a) the facts disclosed by the client; and
(b) other relevant facts about the client of which the firm is, or reasonably should be, aware.

COB 5.4.3R (from 15 November 2001)

A firm must not:

(1) make a personal recommendation of a transaction; ...

with, to or for a private customer unless it has taken reasonable steps to ensure that the private customer understands the nature of the risks involved.

I am also 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).

On the issue of fair compensation, I am further mindful of the law relating to causation and remoteness.

There is no dispute that this was an advised sale of an investment product where the IFA assessed the suitability of the product for these (potential) investors. The IFA argues that Mr and Mrs K did not in their complaint raise *"suitability"* but were concerned about the statements the IFA made about the Keydata bond. The ombudsman service does not require consumers to make *"pleadings"* as a court would (and in my view the financial businesses should not treat complaints on that basis either).

Rather, we will consider the wider background to the dispute to see whether or not the firm has acted fairly. In this case it is clear that there is in addition to any considerations about misrepresentation a dispute about the suitability of the advice the IFA gave.

This service has an inquisitorial remit which means that I will consider all points that are material to the outcome of the complaint – and not necessarily those constrained by the sometimes quite narrow way in which consumers may put their submissions.

In this case, it is clear that in addition to any considerations about misrepresentation, there is a wider dispute about the suitability of the advice the IFA gave. By way of example, Mr K's letter of complaint to us dated 22 May 2010 stated: *"I was mis-sold the Keydata Secure Income Bond by [the IFA] and I am relying on FOS to secure my recompense."*

Therefore, taking the relevant considerations into account, it seems to me that the overarching question I need to consider in this case is whether the recommendation to invest in the fund was a suitable recommendation for the consumers in their individual circumstances.

In deciding this question, I need to take into account the nature and complexity of the investment and the consumers: financial circumstances, needs and objectives; understanding and relevant investment experience; *and* tolerance to investment risk.

If, having considered all the relevant circumstances, I find that the recommendation was unsuitable for the consumers, I then need to consider:

- whether they relied on the recommendation and have lost out as a consequence of that (by considering what the consumers would have done *'but for'* the poor advice); *and*

- if they did, whether it would be fair to award compensation and, if so, how fair compensation should be calculated in all the circumstances of the case.

b) was the investment a suitable recommendation?

In considering this question, I need to take careful account of the investment objectives of Mr and Mrs K at the time this investment was made. I will then consider what the IFA knew (or should have known) as a professional adviser about the product it recommended.

Mr and Mrs K's investment objectives

The IFA recommended Mr and Mrs K invest £60,000 in the Keydata bond.

At the time, according to the information provided to the IFA, and subsequently clarified by Mr and Mrs K:

- Mr K was 58 and Mrs K was 60. Following the sale of their home (which also acted as their bed and breakfast business), a gift, and planned gift to a family member, the purchase of a new family home and money set aside for capital gains tax, Mr and Mrs K were left with a lump sum of just over £200,000.

- Mr and Mrs K held savings of around £210,000 on short term fixed deposits.

- Mr and Mrs K both worked part time for a small local charity. Their total income was around £21,000 per year between them. They both intended to retire at 65. They held modest personal pensions. Their children no longer depended on them for finance.

- The home that Mr and Mrs K had purchased was valued at £235,000.

Mr and Mrs K had a meeting with the IFA in early 2005. The IFA says that, during this meeting:

> *"It was highlighted that producing an income from your monies is important to you both. Although you do require an income you would prefer to keep your monies invested with the bank or building society in cash as opposed to investing these monies in equities whereby the value can fall as well as rise."*

Mr K wrote to the IFA on 27 August 2005 in the following terms:

> *"As you are aware, security is [Mrs K's] and my first priority...I like, in principle, the idea of a balanced portfolio and for the next three months funds are immediately available for any opportunities that might arise. [Mrs K] and I might be interested in low risk 5-7 year commitments that produced 1½% - 2% above bank rate, but nothing longer and nothing with a lower return."*

On 4 October (presumably 2005), the IFA drew Mr and Mrs K's attention to the Keydata bond, and sent them the product literature. Amongst other key features, the IFA letter stated that the key features of the Bond were "*monies are invested in cash and insurance contracts*" and "*full return of your capital after five years*."

Mr K responded by letter dated 10 October 2005. He expressed concerns about being exposed to the insurance market but noted that the bond *"does appear to offer adequate safeguards so long as we have confidence in the companies taking final responsibility for it within the terms and conditions in the leaflet."* Mr K also mentioned that he had a phone conversation with the IFA on 10 October 2005 in which they discussed the structure of the bond, and asked some follow-up questions about the nature of HSBC's involvement.

The IFA says it queried this point with Keydata and then sent Mr and Mrs K a further letter on 14 October 2005, in response to Mr K's queries.

The IFA held a further meeting with Mr and Mrs K on 18 October 2005 during which it completed a Client Information Form. It noted under the savings and investment needs section that:

> *"They are cautious investors who would prefer to stay away from equities."*

The IFA recorded that Mr and Mrs K desired an investment term of five years. Under the risk profile section, the IFA recorded exactly the same answers from Mr and Mrs K to risk attitude questions. For example both when asked to assess the question "*I would feel comfortable if my investments could fall by 20% or more in a year*" said they "*strongly disagree*". Similarly both said they agreed to the statement I prefer the security of bank accounts to stock market related investments. The IFA concluded that *"Mr & Mrs K have a cautious attitude to risk".*

The IFA subsequently wrote to Mr and Mrs K on 26 October 2005 about the bond. The letter is some three pages long and enclosed the Key Features Document. The letter covers the clients' objectives as follows:

> *"During our meeting [on 18 October 2005,] you informed me that your objectives are to receive a higher income than that available from a High Street Building Society account, whilst minimising any risk to your invested capital."*

Under "Attitude to risks", the letter states:

> "*We established that you both have a cautious attitude to risk. This means you are prepared to take only limited risks with your money."*

While risk profiles such as these can provide a helpful indication of the risks a consumer is prepared to take, they are not always of great assistance when considering the actual objectives and wishes of inexperienced investors – especially when as in this case no distinction is made between no risk and limited risk.

The fact that Mr and Mrs K are recorded as being cautious investors is not in itself sufficient to persuade me that they were in fact prepared to take a risk with their capital. On the contrary, Mr and Mrs K made it clear that security of capital was their first priority. After they sold their bed and breakfast business, they wanted to find a secure place to invest these funds, which would supplement the very modest earnings they received from their employment and as they planned for their impending retirement.

The IFA points out that Mr and Mrs K's joint earnings were £1,300 per month and their monthly outgoings were around £1,000, which meant that they had a surplus income. I do not consider this to be material. The small surplus in monthly income which Mr and Mrs K may have recorded, does not affect my conclusion that they had a very modest income. And it remains the case that they needed extra funds to help them with day to day expenses as they moved into retirement.

The IFA further queries how I reached the conclusion in my provisional decision that, after capital gains tax and gifts to their children, Mr and Mrs K were left with around £280,000. At page 16 of the Client Information Form, the IFA stated that:

> *"Mr + Mrs [K] have received a lump sum of around £480,000 following the sale of a local guest house they used to own. After capital gains tax (yet to be decided) and gifts they are giving to their children they will have around £280,000."*

I therefore based my conclusion on the IFA's evidence on this issue. Following my provisional decision, I sought clarification from Mr and Mrs K, and it is now apparent that (at the time of the advice) and when money set aside for a gift to their second son and for capital gains tax is taken into account they had just over £200,000 in cash and around £213,000 on short term fixed deposits.

I note that even based on the £280,000 figure the IFA considers that the investment of £60,000 was affordable. I have carefully considered this matter taking account of the actual sum held in cash and on short term deposit. Having done so, I still remain of the view that the investment of £60,000 was not money that Mr and Mrs K were prepared to take risks with. Mr and Mrs K had a very modest income and were fast approaching the time they wanted to retire. The cash and deposits they held were, in my view, essential to provide for their retirement. They were not in a position to take significant risks with this capital that they needed to fund their retirement.

While I accept that Mr K stated (in his letter dated 27 August 2005) that he liked *"in principle, the idea of a balanced portfolio"*, he also made it abundantly clear that security was both Mr and Mrs K's first priority. He also stated that Mr and Mrs K would be *"interested in low risk 5-7 year commitments that produced 1½ - 2% above bank rate, but nothing longer and nothing with a lower return"*.

I also note here that, in any event, the concept of "balanced" investment is rather unhelpful, especially for inexperienced investors. Who after all wishes to be "un-balanced"? Balance in investment does not automatically suggest a willingness to take significant investment risks.

Having considered the IFA's latest submissions on this point, I remain of the view that Mr and Mrs K's primary objective was for a reasonable return but secure cash investment held over the medium term. Given that security was expressly stated to be their first priority, there is no reason for departing from my conclusions that Mr and Mrs K did not wish to take risks with their money.

In any event, even if Mr and Mrs K could be properly described as balanced investors or investors willing to take a modest investment risk, as I have explained below, I have real doubts as to whether this Keydata bond would have been suitable for all but the most experienced retail investors. Mr and Mrs K plainly do not fall into that category.

So I conclude in respect of Mr and Mrs K's investment objectives at the time that the primary objective was for a reasonable return but secure cash investment held over the medium (five-year) term. They did not wish to take risks with this money – in simple terms they were no risk customers, not limited risk customers.

about the product

I have carefully considered the documentation relating to the bond, much as I am sure the IFA did along with any other information it had access to before making any recommendation.

Turning to the product literature, the front of the brochure produced by Keydata stated

- *"Secure Income Bond*

  Fixed Income with no stock market exposure"

Then in very large print: "*7.5% annual income"*

Below this is the statement:

- *"Benefit from security;*

  *Full return of capital after 5 years**
  Bond invests in cash and assets issued by Institutions rated 'A' or better by Standard & Poor's or equivalent"

Below this (in very small print):

> *" * The return of capital is not guaranteed, it is possible for you to get back less than your original investment at the end of the term or if you cash your investment early."*

The brochure describes the investment approach as *"lower risk than many stock market linked income investments."*

The Key Features document (included with the brochure) explained that:

> *"Your money will be invested in a bond where the assets are a mix of cash and insurance contracts from institutions rated a minimum 'A' by Standard and Poor's or equivalent. The bond will provide you with income or growth payments and maturity proceeds at the end of the investment term. The Issuer of the Bond will have a current Standard and Poor's or equivalent rating of 'A' or better.*
> *...*
>
> *The investment objective of the Bond is to provide regular fixed income payments over a five-year term and a full return of capital at maturity.*

Alternatively investors may elect to roll up income distributions into one final payment."

It included the following amongst its description of *'Risk Factors'*:

- *Predicted Maturity rates*

  The actuarial modelling used to provide the financial models for the Bond is based on recognised industry standards. Whilst these are not subject to rapid change there is a risk that a significant technological or pharmaceutical development could impact on the accuracy of the models and when contracts are likely to mature.

  This is considered to be a small risk due to size of the portfolio and the spread of expected maturity dates across the contracts. Furthermore, any such advance is highly unlikely to affect all contracts and would also be difficult to gain regulatory approval for, within the five year term of the Bond

- *Credit Risk*

  - *Issuing company risk*

    There are 3500 contract issuers in the US and Canada that can be included in the portfolio. Large reserves are carried by these companies to protect against default and, were this to happen the contracts are then assumed by another provider i.e. the book is traded en masse.

    The Keydata Secure Income Bond will form part of a larger portfolio of existing contracts and cash with the following issuer credit rating, which is comfortably in excess of the minimum required:

    ...

    If an issuer's rating drops below 'A' KPMG consider whether it is better value for the Bond to sell the relevant contracts or keep them to maturity if their value is significant.

    ...

- *Valuation of traded insurance contracts*

  The actuarial models used in the Bond have been stress tested by KPMG but there can be no guarantee that they will function as anticipated. This could lead to contracts possibly being mis-priced relative to their future sale value if contracts are still current when the bond matures.

  It is also assumed that the longer a contract is owned by the Bond the greater its market value since it is closer to possible maturity. If the dynamics of the market change this might not be the case and it would therefore be possible for contracts to fall in value. If this were to happen capital might not be returned in full at the end of the term which involves the sale of residual contracts to generate sufficient cash.

This is considered to be a small risk by KPMG because of the spread of risk over a large number of contracts from a range of issuing companies.

- *Past performance IS NOT an indication of future performance and should not be used to assess the risks associated with this investment.*

- *Liquidity*

  There can be no assurances that there will be any continuous market for the eligible assets traded during the investment period. As such, there is a risk that insurance contracts may take longer to be sold or bought than anticipated, particularly if there is insufficient demand from the marketplace, resulting in low or non-existent trading volumes.

- *Eligible Assets*

  Your investment could be at risk if a number of eligible assets do not mature in a way predicted by the Financial Model.

  However, the Financial Model is reviewed every 6 months to ensure that the balance of cash and eligible assets remain on target to meet the Bond's objectives.

In answer to the question "*What about my final capital repayment?*", the Key Features document stated: *"In addition to the income or growth option you have chosen, you should receive your full original investment (plus any interest earned during the offer period)"*.

The brochure gave further information about the bond, including the following:

> *The assets it invests in, cash and insurance contracts, are not linked in any way to the stock market and are issued by insurance companies that are rated 'A' or better by leading rating agencies. This makes it lower risk than many traditional stock market linked income investments (see Generating Income and Capital Security).*
>
> *A lower risk profile and a higher level of income allows you to receive the income you need without the worry of stock market falls.*
>
> *We believe that the balance of cash and insurance contracts within the bond offers an attractive combination of higher levels of income and lower levels of risk.*
>
> *Is there any risk?*
>
> *With the current low interest rate environment, we think the level of income is attractive. However, you should understand that your capital is not guaranteed and that your investment is not instantly accessible without penalty during the term of the Bond.*
>
> *Your capital is at risk in the following circumstances:*
>
> *If the insurance companies issuing the insurance contracts default on their obligations*

If the issuer of the Bond goes into liquidation

If factors change which affect the rate at which insurance contracts mature.

Under the heading *"Please note",* the brochure repeated the following:

- *Past performance IS NOT an indication of future performance and you may get back less than your original investment. If you sell your investments before maturity you may get back less than the amount you originally invested.*

The FSA imposed a financial penalty on Norwich and Peterborough Building Society for failing to give its customers suitable advice in relation to the sale of Keydata products. The FSA's Final Notice in respect of Norwich and Peterborough Building Society dated April 2011 provides a helpful summary in slightly more accessible terms of the same bond (albeit Issue 3, rather than the similar Issue 2):

> *"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."*

Issue 2 was described as investing in a bond *"issued through a special purposes vehicle controlled by MeesPierson Limited in Luxembourg"*.

What might an IFA have concluded from the information that was reasonably available to a professional adviser at the time this investment was made?

Of course 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, I think it is (and was) clear from this description and the other information readily available to the IFA about the bond in 2005 that it was not predominantly a cash investment. The bond presented some risk to capital. The product literature expressly stated that capital was not guaranteed.

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 change which affected the rate at which insurance contracts mature. Investors could also 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. And the assurance provided by household names such as HSBC and KPMG 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. This is a point I return to in the next section.

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 appeared to represent a risk free approach, nor would they have been suitable for investors looking to invest in cash or 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 still 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 investors such as Mr and Mrs K.

Indeed, in my view, the advice that the IFA gave to Mr and Mrs K to invest in the Keydata bond demonstrated a complete disregard for their interests.

It was important for advisers to take these matters into account when assessing the suitability of the product for an individual investor, and for potential investors to understand that the fund presented a significant risk to their funds – certainly far more risk than an ordinary cash fund.

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 Mr and Mrs K.

Accordingly, it is my conclusion that this investment was *not* suitable for Mr and Mrs K. They did not wish to take any significant risk with their *"investments"*. The bond was not a proper alternative to a cash fund or building society or similar cash deposit. It involved risks to capital that were material and made it unsuitable for investors such as Mr and Mrs K.

The IFA has argued that I should not rely on the FSA Final Notice in reaching my view as to what was or should have been apparent to a professional advisor at the relevant time.

On the contrary, my findings are not based upon on the FSA Final Notice. I have reached my findings on the basis of what, in 2005, the IFA knew, or could be expected to find out, about the investment and based on a reasonable expectation of how the bond would operate. Having reviewed the product literature, I consider that a professional financial advisor should have appreciated that the capital was not guaranteed. The product literature gave a host of scenarios in which investors could lose money.

If the IFA had carefully considered the product literature (as it should have done) it would have realised that the bond was not suitable for cautious investors looking to invest in cash, such as Mr and Mrs K. The significant features of the bond (highlighted by the FSA Final Notice), were features that were or should have been apparent to the IFA in 2005.

The IFA urges me to note that it was a modestly sized advisory business that could not make extensive independent research about the funds it recommended. I have some sympathy for this point.

My normal approach is to recognise the practical limitations placed on smaller advisory firms and their need to rely heavily on product literature and other readily available public information in order to make an assessment of suitability. I am not varying this approach in this case.

In my view an IFA without extensive research would and should have been able to identify that this bond was not suitable for its client. The fact that the FSA had not intervened, and that the bond was associated with well known businesses, did not obviate the need for the IFA to make its own reasonable assessment of risk.

risk warnings and assurances

Mr and Mrs K were entitled to rely on the recommendation that the IFA made. But for the sake of completeness I have also considered whether the information that the IFA provided to Mr and Mrs K was sufficiently clear that it should have alerted them to the fact that the investment was not suitable for their needs.

I have already referred to some of the correspondence between the IFA and Mr and Mrs K. Much has been made of this in the subsequent correspondence about this complaint from both Mr and Mrs K and the IFA.

As noted previously, when introduced to the Keydata product Mr K responded by expressing concerns about being exposed to the insurance market. Mr K had queries about the safeguards attached to the bond but noted that the bond seemed to contain adequate safeguards. Mr K referred to a telephone conversation he had with the IFA on 10 October 2005. He said:

> *"I understand from our telephone conversation this morning that the issuing companies of the insurance contracts including the Prudential, and that the bond issuer, Keydata Investment Service Ltd, is a wholly owned subsidiary of HSBC. I understood you to tell me that the issuing companies (i.e. HSBC, the Prudential & others) would themselves have to default for our capital to be at risk. Did I understand you correctly? [Mrs K] and I will need to have a clear understanding of who takes responsibility for the bond before we buy into it and so your clarification in writing would be appreciated."*

The IFA sent a written response on 14 October 2005. It said:

> *"Keydata are the company who promotes and administers the Secure Income Bond. The bond is issued and owned by HSBC and it is HSBC with whom you would have the contract with. HSBC employ the services of KPMG in order to monitor the bond to ensure the investment criteria are adhered to.*
>
> *With the monies you may invest, 40% is held in cash by HSBC and the remaining 60% being used to buy insurance contracts, which are bought in the name of HSBC.*
>
> *…*
>
> *Although it can not be categorically said that your monies are 100% secure, it would take all the insurance companies with whom HSBC buy insurance contracts to default on their obligations to put your capital at risk."*

The IFA wrote to Mr and Mrs K on 26 October 2005 about the bond. It enclosed the Key Features Document. The letter warned about cautious portfolios, as follows:

> *"They are considered a safer investment than shares, although, like shares, their value will also go down as well as up. This means you might get back less than you put in."*

Under the heading *'Recommendation'*, the IFA noted that *"Having conducted research on your behalf I feel the Keydata Secure Income Bond best meets your needs."*

The letter went on to describe the bond in general terms, including the following:

> *"The Secure Income Bond is back by HSBC and has been available to institutional investors for the past four years [sic]."*

The letter warned that there were risks to returns from the insurance contracts, and highlighted mechanisms put in place to *"mitigate other risk factors"*. Under the heading *"Risks"*, the letter stated:

> *"In the unlikely event that the Insurance institutions are unable to meet their financial obligations, you may receive less than you invested.*
>
> *This is a five year plan and encashment prior to this will result in penalties and could result in you receiving less than you invested."*

At the end of the end of the letter, the IFA stated that *"The Key Features Document also provides you with details of any risks and potential disadvantages associated with the contract recommended."*

It is clear from the overall balance of communication that the IFA gave Mr and Mrs K considerable assurance about the security of the Keydata bond. In particular, the IFA placed much emphasis on HSBC's involvement in the structure of the bond.

This emphasis appears to have been in response to Mr K's statement (in his 10 October 2005 letter) that *"the above bond does appear to offer adequate safeguards so long as we have confidence in the companies taking final responsibility for it within the terms and conditions in the leaflet."* Mr K has subsequently told us he thought he was *"buying into the reputation and strength of HSBC"*.

I find that this was a credible and reasonable position for Mr and Mrs K to take. They were inexperienced investors who felt that they could trust HSBC, but were unsure about Keydata's credentials. The IFA knew that Mr and Mrs K had confidence in HSBC, and that they wanted an assurance that HSBC would take final responsibility for the bond.

The IFA gave statements that it ought to have known were not correct (or at best were far from complete) and gave undue assurance to Mr and Mrs K about the relationship between HSBC and Keydata.

The IFA says that it relied on the product literature and its conversation with Keydata when responding to Mr K's letter. I have therefore considered the product literature in detail. Under the heading '*Strong Management*', HSBC is mentioned amongst other businesses in relation to the '*checks and balances*' that structure the investment.

It stated:

> *"**HSBC (AA- rated by Standard & Poor's)** - Trading of the insurance contracts is overseen by HSBC who ensure that contracts carry sufficient credit ratings. Once bought, HSBC own the contracts as trustees for the Bond. Furthermore, HSBC are liable for ensuring that contracts adhere to the investment criteria and are serviced, ie premiums are paid."*

In the Key Features Document, under the heading *'Parties Involved'*, it states:

> ***"HSBC ('AA-' rated by S&P)***

> *HSBC verifies the contracts, purchases them, pays ongoing premiums and transfer maturity proceeds to the bond custodian. It buys the contracts in its own name and holds them for the custodian, MeesPierson Intertrust.*
>
> *It also ensures that contracts are selected according the investment criteria set down by KPMG."*

These statements give a clear impression of security being derived from the relationship with HSBC, although a more detailed analysis shows that the degree of comfort is limited to the holding, purchase and selection of policies all on behalf of the Fund managers.

It also clear from the overall balance of communication that the IFA gave Mr and Mrs K considerable assurance about the Keydata bond's viability as an alternative to cash deposits. This was not an investment that offered a capital guarantee. The bond put all of Mr and Mrs K's invested capital at risk. It was therefore misleading for the IFA to state that the only circumstance in which the capital would be at risk is if *"all insurance companies with whom HSBC buy insurance contracts default on their obligations*." As I have set out above, there were a host of other risks to the invested capital.

It is difficult, if not impossible, to reconstruct the detail of the dialogue between the IFA and Mr and Mrs K about the fund and the extent to which the IFA gave assurances that the bond was *'guaranteed'* by HSBC or otherwise *'secure'*. From the evidence available to me however I can, at a minimum, see why – given the responses they received to their questions – Mr and Mrs K believed that the fund was *'guaranteed'* – even if technically the IFA did *not* provide a binding assurance that I should treat as overriding. Clearly the true factual position in relation to the fund was that no such guarantee existed.

While I might in isolation conclude that some of the statements made by the IFA during the sales process were misleading, given the IFA recommended the investment, I cannot conclude that these (potentially) misleading statements were of themselves the point that encouraged (induced) Mr and Mrs K to agree to invest in the Keydata bond – although it does appear that they were influential.

But they were (in my view) part of a wider process of (unfounded) assurance leading up to a (misplaced) recommendation. And it was this overall package culminating in the recommendation that persuaded Mr and Mrs K to make this ill-fated investment.

In the event, it appears it was not just Mr and Mrs K who had false assurance about HSBC's actual involvement in the Keydata bond. It seems that this was one of the casualties of the relationship between Keydata and SLS. The details of those issues need not detain us here – suffice to say it would emerge after the event that in reality HSBC's actual role was far from the one Mr and Mrs K had hoped for.

Mr and Mrs K sought advice from the IFA and were entitled to rely on that advice. 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 (and taking account of the overall representations made by the IFA) to suggest to inexperienced investors such as Mr and Mrs K that they should act otherwise than on the advice of their professional adviser.

In its latest submissions, the IFA points out that (in its letter dated 14 October 2005) it informed Mr K that 60% of the funds would be invested in insurance contracts, and as such, he understood that this element of the investment would be exposed to some risk.

It is not disputed that the IFA informed Mr and Mrs K that their money would be invested in cash and insurance contracts. I do not, however, consider that this information alone would have put inexperienced retail investors such as Mr and Mrs K on notice about the risks of the Keydata bond. For the reasons I have set out in this decision, I have found that the overall balance of communication that the IFA gave to Mr and Mrs K gave considerable assurance about the bond's viability as an alternative to cash deposits.

overall conclusions on suitability

So overall, having considered the position carefully, I find Mr and Mrs K's representations that they did not wish to take any risk with their capital to be both plausible and persuasive. I do not believe it likely that Mr and Mrs K appreciated the nature of the risks involved in the Keydata bond and I am not persuaded that the investment was a suitable recommendation for them.

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

I have therefore concluded that:

- Mr and Mrs K were inexperienced investors who did not wish to put their newly acquired capital at risk (or at least wished to take the minimum possible risk), but did wish to explore the possibility of finding a better interest rate than a deposit account;

- the Keydata bond was not a fund suitable for such investors and this should have been apparent from the information readily available to a professional financial adviser like the IFA;

- the information provided by the IFA to Mr and Mrs K, who were inexperienced investors, was not sufficient to alert them to the risks they had been advised to take and indeed gave undue assurance.

Put simply, the IFA recommended the fund to Mr and Mrs K and assured them that it would meet their needs for a secure five-year investment of a substantial portion of their overall wealth – funds they clearly would need to assist them with day to day expenses as they moved into their retirement. The IFA was wrong to make that recommendation and wrong to give those assurances.

Accordingly, I conclude that the recommendation made by the IFA to invest in the bond was not a suitable recommendation for Mr and Mrs K. Indeed, the advice demonstrated in my view a complete disregard for Mr and Mrs K's individual circumstances and interests.

c) what would Mr and Mrs K have done if they had not received the unsuitable advice?

I have concluded that the IFA's recommendation to invest in the bond was not suitable for Mr and Mrs K. I therefore need to consider what Mr and Mrs K 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 their needs and circumstances, and I do not think they would have invested had they appreciated the risks.

Overall I think it most likely that Mr and Mrs K would have retained their money in cash deposit or similar accounts or investments (seeking out from time to time the best available rates/returns).

The return that Mr and Mrs K would have achieved in these alternative investments is a matter of further conjecture. My normal approach would be to link the return to the base rate. But in recent years this has not been a good proxy for readily achievable returns from cash deposits/investments. Following a review of reasonably achievable rates/returns, I conclude that Mr and Mrs K's investment would have increased at the rate of 4.0% per year compounded annually until 6 November 2008 (when the base rate was reduced to 3%) and by 2.5% per year compounded annually after this up until 13 November 2009 when Keydata defaulted and the loss crystallised.

d) fair compensation

I have found that the IFA gave unsuitable advice that was relied on by Mr and Mrs K and were it not for that poor advice they would not have invested in the bond. I am satisfied that the IFA exposed Mr and Mrs K to the risk of capital loss which it should not have done.

I therefore need to consider whether it would be fair to award compensation to Mr and Mrs K, and if so, how the compensation should be calculated.

my normal approach

My normal approach in such cases is simply described. I seek to put the consumers back into the position they would have been but for the poor advice. Typically that would involve assessing how the consumers would have invested their money and compensating them with the difference (if any) between the investment they would have made and the actual investment.

special features of this case

But in this case there is a problem with assessing the true value of the investment Mr and Mrs K actually made. That is because assets in the bond they invested in were taken and have not been recovered.

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 Mr and Mrs K in Bond 2 were part of the investments held by SLS Capital SA (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 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*."

What precisely occurred between 2005 and 2009 is not clear. In any event, while I understand some actions are continuing to try to recover funds, 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. In simplistic terms was this in fact a valuable investment destroyed by a theft, or was this already a largely worthless investment where the crime was limited to the last few pounds in the till?

Or was it that investments were never, in fact, made – but *had* they been made, they would in any event have lost substantial value. What, in other words, were the relative contributions of the underlying investment performance, on the one hand, and the misappropriation, on the other, to the overall position that there is no value for holders of these bonds?

my approach to assessing fair compensation in these circumstances

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, and in contrast, 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.

My responsibility is to award what I consider to be *"fair compensation"*. 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.

Mr and Mrs K would not have been in this Keydata product but for the poor advice of the IFA – and they have suffered very significant losses of money that they cannot afford to lose in this way. These losses will have caused Mr and Mrs K significant distress and worry. They were relying on this money for a significant proportion of their comfort and security in their retirement. Mr and Mrs K are the innocent victims here.

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.

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) Mr and Mrs K'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 Mr and Mrs K's losses did not flow directly from the unsuitable advice on the part of the IFA. And on this basis a court might not require the IFA to compensate Mr and Mrs K for the losses they have 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. It might be fair compensation to make an award for all or part of the loss in such cases if I considered that the professional advice given was not merely negligent but there was a complete disregard for the interests of the client.

Similarly I might make an award if the negligent advice pointed the client to an investment where it could be seen at the time of the advice that there were unusual and significant shortcomings in the governance or the controls surrounding the investment or that it was at that time otherwise clear that the investment might be particularly susceptible to fraud or financial crime.

So consider a wholly imaginary case, where an adviser has recommended to a low risk investor exposure to an exotic investment in some part of the world known for financial crime or lawlessness. There is then a theft and the investment is stolen. In such a case a misappropriation of the funds might almost seem a foreseeable outcome of the investment – certainly the client has been put in the way of danger of becoming a victim of financial crime.

In such a case, regardless of any arguments about the position a court would take, my award of fair compensation would cover all of the losses the consumer had incurred.

I might also make an award if it were possible to differentiate between the underlying investment losses and the losses stemming from the misappropriation. At a simple level, if the misappropriation was modest (in comparison with the underlying investment losses) I would not reduce the compensation payable because some misappropriation had taken place. But I might also make a proportionate award to broadly reflect the two contributions even where the misappropriation was more material.

In the present case, I consider that the IFA had a complete disregard for the interests of its clients in giving this advice.

There were also inherent features of the arrangements for the Keydata bond that I find troubling and might have put the IFA on notice of the increased risk of financial crime.

This was a fund with a significant overseas component that traded in unusual and opaque investments. There was also a reliance on a limited and specialist model for the valuation of the assets. However, while troubling, these features were not of themselves sufficient in my view to have put the IFA on notice that the risks of investing in the fund went beyond those normally associated with (significant) investment risks and were such that they exposed Mr and Mrs K to a heightened risk of financial crime.

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. The evidence suggests, but does little more, that the misappropriation was the major contributory factor to the complete loss of value of the underlying investments. But what would have happened to the investment Mr and Mrs K made without that misappropriation is far from clear.

In all the circumstances of this case, however, I cannot lightly ignore the fact that Mr and Mrs K 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 Mr and Mrs K back into the position they would have been had they 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 Mr and Mrs K and of the suitability of the product and it generally paid complete disregard to their interests. This was simply a class of investment that they 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;

- 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.

After I issued my provisional decision, the IFA repeated its submission that the risks materialised because of Keydata's misrepresentations, which the IFA reasonably relied upon. The misappropriation of the funds could not have been foreseen, given that the bond had been running smoothly for four years.

I understand why the IFA would like me to reconsider, but I am particularly mindful of the point that the advice that the IFA gave to Mr and Mrs K to invest in the Keydata bond demonstrated a complete disregard for their interests. I reiterate that this was a class of investment that they should not have been in and would not have chosen but for the IFA's advice.

Having considered the factors that I have set out in this decision, I reasonably conclude that I should assess fair compensation as putting Mr and Mrs K back in the position they would have been in, had they 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 Mr and Mrs K loss crystallised on 13 November 2009. In my provisional decision, I suggested that interest should be added to that sum at a rate of 2.5% a year from 13 November 2009 until the date the award is paid.

I subsequently asked for the views of the parties on whether this was appropriate given that 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.

Neither party provided a substantive response to my letter. 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 they invested their money, Mr and Mrs K were 58 and 60 respectively and were both earning a modest income working part time for a small local charity. The loss crystallised four years later when they were approaching their intended retirement age.

However they had a significant sum of money on deposit. Whilst the crystallised loses will have given rise to distress and potentially inconvenience to Mr and Mrs K I think the extent of their cash deposits at the time, albeit earmarked for retirement savings, suggest that a rate of 8% might be excessive in this case. I have, therefore, retained the original formulation of 2.5% growth following the crystallisation of the loss in November 2009.

e) procedures

I have considered whether any further enquiries and/or an oral hearing with the parties might help me, in reaching a fair conclusion on this matter. After over six years, memories of discussions will be fading and inevitably may be significantly influenced by subsequent events.

However, I understand I have all the relevant written material that has been retained by either party from 2005, and I am satisfied that this provides a reasonable basis for my decision. And an oral hearing with the parties would not in my view draw out any new information about Keydata and SLS. Accordingly, my final view is that further enquiries by our service and/or hearings are not necessary – and would not be appropriate and proportionate in the circumstances of this case.

my final decision

For the reasons set out above, my final decision is that I uphold Mr and Mrs K's complaint. This Keydata bond should not have been recommended to them by the IFA and I have concluded that the IFA acted with complete disregard for its client's interests.

Where I uphold a complaint, I have the discretion to make a money award requiring a financial business to pay fair compensation (of up to £100,000), plus any interest and/or costs that I consider appropriate.

determination and award

I uphold the complaint. 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 a return of 4% until 6 November 2008 and by 2.5% per year thereafter, compounded annually from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised);

C = the residual value of the investment that Mr and Mrs K made in the Keydata bond which I asses to be zero for this purpose.

D = A+B-C

My final decision is that the IFA should pay Mr and Mrs K the amount produced by that calculation (that is amount D) up to a maximum of £100,000. To that sum (D) the IFA should add interest from 13 November 2009 at the rate of 2.5% a 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.

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 Mr and Mrs K 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 Mr and Mrs K to note this carefully. Mr and Mrs K 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.

Tony Boorman
ombudsman