final decision

complaint by:	Mr W
complaint about:	an 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 on the dispute between Mr W, who is represented by his solicitor and the IFA. Under the rules of the Financial Ombudsman Service, I am required to ask Mr W either to accept or to reject my conclusions, in writing, before 11 December 2012.

summary of complaint

This dispute is about the advice given to Mr W by the IFA to invest in the Keydata Secure Income Bond Issue 3 ("the Keydata bond") in 2005.

my provisional decision

I issued my provisional decision on 30 March 2012, and explained that although I was minded to uphold Mr W's complaint, given the very particular circumstances involved I had decided not to make an award.

In brief, I considered that although the IFA was wrong to recommend that Mr W should invest a proportion of his capital in a Keydata bond and Mr W has undoubtedly suffered as a result, the misappropriation of the Keydata SLS funds was a significant material factor. As I found that this is not a case where the IFA had a complete disregard for the interests of his client, and given my view that the misappropriation of the funds was an intervening force that caused (at least part of) Mr W's losses, my provisional conclusion was that it would not be fair or reasonable to require the IFA to make an award.

The IFA did not provide any further material submissions. However, Mr W did not agree with my provisional decision. He noted that I had found he had received unsuitable advice and that I had highlighted that if he had not received that advice, and had not invested in the Keydata funds, he would not have suffered any loss – because there could have been no misappropriation of his funds. He asked me to reconsider my findings.

As requested, I have carefully reconsidered 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 the points raised by Mr W in his most recent correspondence were points made previously or points which had already been adequately addressed in my provisional decision.

That said, where appropriate I have addressed below specific points made by Mr W in reaching my final decision.

background to complaint

a) events leading up to the complaint

In early 2005, Mr W sought investment advice from the IFA. At the time he was employed as a civil servant, approaching retirement and with a modest earned income. Mr W had received a sum of £100,000 as an inheritance from his late mother's estate and after discussion with his solicitor (who had dealt with probate) he arranged to meet with the IFA, to obtain advice on how best to invest the capital to increase his income. His solicitor supported Mr W throughout the process and given Mr W's personal circumstances and particular needs the solicitor was later appointed as Mr W's attorney. Accordingly this solicitor is representing Mr W in bringing the complaint.

Acting on advice given by the IFA, Mr W invested £15,000 in the Keydata bond.
The product provider, Keydata Investment Service Limited ("Keydata"), acted as Mr W'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 from the information publicly available 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 W stopped receiving interest payments in April 2009. Keydata went into administration on 8 June 2009, and it defaulted on 13 November 2009.

As a result of these events Mr W has experienced significant losses. He had understood that the investment was guaranteed and was therefore concerned about the advice the IFA had given them to invest in the bond in 2005.

b) application to the Financial Services Compensation Scheme (FSCS)

In March 2010 Mr W 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.
- 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 W.

It is relevant to note at this point that Mr W is 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 W his own Keydata bond investment was made entirely outside any ISA.

c) the complaint and the IFA's response

Mr W complained to the IFA that he had made the investment on its advice; that the IFA did not understand the product he was selling; and that if Mr W had known the funds were invested in foreign insurance contracts, held overseas, Mr W would not have agreed to invest.

Mr W considered that, if the IFA had misinterpreted the Keydata bond, the IFA should compensate him for his loss.

The IFA did not agree. It said that the structure of the bond was openly discussed at a number of meetings and that each investment recommendation was fully explained to Mr W, with his solicitor in attendance. It stated Keydata was authorised by the FSA, and as such, it was fair for the IFA to assume that the information printed in the literature was correct. It said the fact that the product failed due to a misappropriation of funds could not have been foreseen by the IFA.

Mr W was not satisfied with the IFA's response and, referred his complaint to the ombudsman service.

The complaint was investigated by one of our adjudicators who recommended that it should succeed, and that Mr W should be returned to the position he would have been had he not invested in the Keydata bond.

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

- the solicitor had been intimately involved with the advice process and in ensuring that Mr W understood what was involved;
- the plan was suitable for the level of risk agreed with Mr W and met his requirement for income;
- the Keydata product was advertised as 'lower risk' because it invested in cash and life insurance contracts;
- the life assurance contracts were whole of life protection policies where a detailed assessment of the life assured was carried out prior to purchase; traded life policies were a tried and tested investment choice, and the insurance companies issuing the policies were rated AA or better;
- the actuarial model used was based on recognised industry standards so a reasonable estimate could be made of the prospective payments coming into the fund;
- the IFA was entitled to rely on the product literature when giving advice;

- Mr W had already made an approach to the FSCS and, the FSCS had said that if it had found evidence that the risk level of the fund had been mis-described, it would not have assisted Mr W's claim as the loss occurred because the funds were misappropriated;

- the FSCS had concluded that the misappropriation of funds could not have been reasonably foreseen by Keydata and no Keydata investor had received compensation solely on the basis that their money was misappropriated;

- the FSCS had confirmed that Keydata was correct in assuming that the model developed by KPMG regarding actuarial calculations on life expectancy was sound, and that Keydata was correct in assuming that HSBC USA would legally own, for the benefit of SLS, insurance contracts issued by insurance companies with appropriate credit ratings, and for paying premiums on those contracts on behalf of SLS. This in turn meant that the Keydata brochure was in no way misleading;

- The adjudicator had concluded that Mr W had not been misled; but had concluded that he was mis-sold because of his reported tolerance for investment risk. Keydata marketed its product as a lower risk investment, and the brochure had been confirmed by the FSCS as not misleading. It was only recently that the FSA had decided to class this type of investment as perhaps of higher risk than lower. It should however be remembered that the loss had occurred as a consequence of misappropriation not because the fund failed to deliver its stated lower risk aims.

Mr W objected to the IFA's comments. Briefly, his solicitor stated on his behalf:

- the solicitor had facilitated the obtaining of advice but the decision to invest had been made by Mr W.

- The IFA mis-sold the bond to Mr W and any award made should include consideration of the legal expenses incurred by Mr W in pursuing his claim – both with the FSCS and with the Ombudsman.

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, including those submissions made on my provisional decision, 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 W 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 is:

- 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 unless otherwise indicated 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 the structure of the bond was fully discussed and that the bond was suitable for the level of investment risk Mr W had agreed.

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 consumer in his individual circumstances.

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

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

- if he 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 W at the time this investment was made. I then need to consider what the IFA knew (or should have known) as a professional adviser about the product it recommended.

Mr W's investment objectives

The IFA recommended Mr W invest £15,000 in the Keydata bond.

At the time, according to the information provided to the IFA:

- Mr W was 59. He received a lump sum of £100,000 from his late mother's estate.

- Mr W worked in the Civil Service earning circa £18,000 p.a. He was expecting a local government pension the following year and was considering his retirement options.

- Mr W owned a flat which he had bought in 1988 and which was mortgaged. He was repaying capital and interest on the mortgage debt which was expected to be finished once Mr W reached age 65.

Mr W together with his solicitor had several meetings with the IFA in late 2005.

On 3 October 2005 the IFA wrote to Mr W confirming the discussions which had taken place. This included an assessment of investment risk that had recorded Mr W as having a risk appetite of 4 on a ten point scale (ranging from 'little risk' (1) to very speculative (10) with no intervening descriptors.

The IFA set out his recommendations for investing £100,000. The IFA recommended a significant reduction in Mr W's mortgage, together with the following investments:

- £15,000 in index linked saving certificates;
- £23,000 in a savings account;
- £7,000 in a corporate bond fund (wrapped in an ISA);
- £15,000 in a 6 year capital guaranteed structured product; and
- £15,000 into the Keydata Secure Income Bond (issue no.3).

The letter said.

> *"Invest £15,000 in Keydata's Secure Income Bond for guaranteed income (I suggest £281.25 quarterly over a fixed 5 years period with a full return of your capital at maturity. Just as with the Woolwich plan a brochure is enclosed and again I must suggest we go through the details of the plan at another meeting. The plan, like the Woolwich's will close on 21 October and obtains returns by investing in corporate bonds, gilts, index linked funds and cash."*

The letter included a description of risk profiles covering low risk, low to medium risk, and medium risk and acknowledged that Mr W held little or no experience of these investments and suggested that he should go through the choices again at the next meeting. A copy of the IFA's letter was sent to Mr W's solicitor.

A later correcting letter was also sent by the IFA dated 8 December 2005, and followed on from a meeting held the previous day. This letter explained that the reference to corporate bonds in the earlier document was a mistake.

> "*During yesterday's meeting, we discussed all the products that I have recommended. You now have a brochure for the new Keydata product, the Secure Income Bond issue 3 and as a result I would ask you to note that this is a fixed income product with no stock market exposure. Please read the brochure and*

particularly page 4 as the latter explains where your money is invested … Basically the Keydata bond involves cash and life assurance contracts. Please contact me should you wish to discuss the above paragraph further."

The fact that Mr W was recorded as a "level 4 investor" (on a scale of 1-10) is not in itself sufficient to persuade me that he was in fact prepared to take a risk with his capital. At his stage of life – approaching retirement and with a limited option to earn additional income, I suggested that security of capital was a first priority. Mr W was looking for a secure place to invest his inheritance, which would supplement the modest earnings received from his employment as he planned for a not too distant retirement.

So I conclude in respect of Mr W's investment objectives that at that time the primary objective was for a reasonable return but secure cash investment held over the medium term. Mr W did not wish to take risks with his money – in simple terms he was a no risk or a very low risk customer not suited to moderate or high risk products.

about the product

I have carefully considered the documentation relating to the bond, much as I was 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 traditional 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 ie 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 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 respect of 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.*

Issue 3 was described as investing in a bond "*issued through a special purposes vehicle controlled by MeesPierson Limited in Luxembourg.*"

What might the 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 was important to avoid the benefit of hindsight in the assessment of these matters today.

That said, I think that 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 have real doubts, 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 W.

It is 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 W.

Accordingly, it is my conclusion that this investment was not suitable for Mr W. He did not wish to take any significant risk with his "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 W.

In saying this, I recognise that the IFA in this case had recommended the Keydata bond as part of a wider range of investments. The Keydata bond accounted for £15,000 out of the £100,000 that was being considered. The decision to reduce the mortgage and to make a number of cash investments clearly reduced the overall risk of the portfolio.

Excluding the Keydata bond, I accept that the investments were a thoughtful and appropriate response to Mr W's needs at the time. I also accept that within a portfolio there may (indeed arguably should) be some variation in the precise risk profile of the individual assets. But that does not in my view mean that it is normally satisfactory to include in a low-risk or no-risk consumer's portfolio a significantly higher risk product.

Certainly in this case, I conclude that the risks associated with the Keydata bond were significantly greater than Mr W's risk tolerance. While I acknowledge the low/no risk recommendations made did to some extent balance the picture, the fact remains that Mr W was not in a position to face the real risk of the loss of a significant proportion of his portfolio.

In the event, the original recommendation was not for a variety of reasons entirely followed. In particular, there was some difficulty in arranging the savings account and the structured product investment was altered. But these points did not alter the overall picture of the investments made or my assessment.

risk warnings and assurances

Mr W was 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 W (and his solicitor) was sufficiently clear that it should have alerted him to the fact that the investment was not suitable for Mr W's needs.

I have already referred to some of the correspondence between the IFA and Mr W.
As noted previously, when introduced to the Keydata product the IFA made an error in his summary which was later corrected.

The IFA wrote to Mr W on 8 December 2005 about the bond. It enclosed the Key Features Document. The letter asked Mr W to contact him if there was anything he did not understand. The IFA says that each page of the brochure was discussed with Mr W at the meeting held the day before with Mr W's solicitor in attendance,

Mr W (and his solicitor) says he was misled about the nature of the bond. From the evidence available to me I could, at a minimum, see how some misunderstandings arose. The IFA appeared not to have been very clear himself about the way the Keydata bond was intended to work.

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 could not conclude that these (potentially) misleading statements were of themselves the point that encouraged (induced) Mr W to agree to invest in the Keydata bond.

Mr W sought advice from the IFA and was entitled to rely on that advice. It was clear to me that is precisely what he (and his solicitor) 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 Mr W's solicitor 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 an inexperienced investor such as Mr W that he should act otherwise than on the advice of his professional financial adviser.

The fact that Mr W had the support of his legal adviser during this process did not alter this conclusion.

overall conclusions on suitability

So overall, having considered the position carefully, I find that the representations made on behalf of Mr W, that he did not wish to take any risk with his capital, to be both plausible and persuasive. I do not believe it likely that Mr W appreciated the nature of the risks involved in the Keydata bond and I am not persuaded that the investment was a suitable recommendation for him even as part of a wider and cautious "portfolio" of investments that the IFA recommended.

This was not a view reached with hindsight. I have based my findings on the product's suitability for Mr W 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 W was an inexperienced investor who did not wish to put his 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 an investor 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 W, who was an inexperienced investor, was not sufficient to alert him (or his solicitor) to the risks he had been advised to take.

Put simply, the IFA recommended the fund to Mr W and assured him that it would meet the need for a secure investment as part of the range of investments it recommended. But this was all capital that Mr W could not afford to place at risk as it could not readily be replaced before his impending retirement.

The overall portfolio of recommendations made took into account the requirements for increasing income by reorganising the existing mortgage, satisfying the need for an emergency fund of accessible cash and the use of tax efficient products and wrappers. However, the IFA was wrong to make the recommendation for the Keydata Bond based on an assumption of capital security and wrong to give the assurances of capital return.

Accordingly I conclude that the recommendation made by the IFA to invest in the Keydata bond was not a suitable recommendation for Mr W.

c) what would Mr W have done if he had not received the unsuitable advice?

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

I have not seen anything which suggests to me (and I find it highly unlikely) that Mr W would have invested in the bond, if it had not been recommended to him.

Nor am I persuaded that he would have invested in the bond if things had happened as they should – the investment was not suitable for his needs and circumstances and I do not think he would have invested had he appreciated the risks.

Overall I think it most likely that Mr W would have increased his investments in the other saving and lower investment products that the IFA recommended.

d) fair compensation

I have found that the IFA gave unsuitable advice that was relied on by Mr W and that were it not for that poor advice he would not have invested in the Keydata bond. I am satisfied that the IFA exposed that portion of capital held by Mr W to the risk of capital loss which it should not have been.

I therefore need to consider whether it would be fair to award compensation to Mr W, 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 W 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 W in the Secure Income Bond 3 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 were continuing to try to recover funds it remains 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 these issues caused significant financial damage to Keydata, 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, regardless of the fact 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 W would not have been in this Keydata product but for the poor advice of the IFA. And he has suffered very significant losses of money that he cannot afford to lose in this way. These losses will have caused Mr W significant distress and worry. He was relying on this money for security in his retirement. Mr W is the innocent victim 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 would be able to consider is what a court might 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 W'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 W'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 W for the losses he has incurred, regardless of the unsuitable advice the IFA gave.

But in assessing fair compensation, I am not limited to the position a court would 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 unsuitable but there was a complete disregard for the interests of the client.

Similarly, I might make an award if the unsuitable 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, while the advice the IFA gave to invest in the Keydata Bond was in my view not suitable, overall the IFA gave thoughtful and considered advice to Mr W about the investment of his relatively modest portfolio. Mr W also had the benefit of the support and legal advice of his solicitor throughout the process. This is not a case, therefore, where the IFA had complete disregard for the interests of his client.

There were 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 W to a heightened risk of financial crime.

It is frustrating that in Mr W's case, the evidence available to me from the relevant authorities here and in Luxembourg is not sufficient to make an 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 W made *without* that misappropriation is far from clear.

I cannot lightly ignore the fact that Mr W would not have been exposed to these risks had the IFA carried out its responsibilities properly.

However, I must also consider what is fair to the IFA. I have already said that in my view a court might not make an award in favour of Mr W because of a break in the chain of causation arising because of the misappropriation.

So I needed to think carefully about what is, on balance, fair to both parties. In the particular circumstances of this case I conclude that fair compensation suggests that I should *not* make an award in favour of Mr W in this case. I say this because of:

- the nature of the advice the IFA gave overall was thoughtful about the needs of Mr W. While the Keydata bond was a class of investment Mr W should not have been in, the other recommendations demonstrate that this is not a case where the IFA had little or no regard for the interests of his client;
- while there appears to be an inherent and significant weakness in the investment model used by Keydata, this bond clearly failed following the misappropriation – and I could not be sure what would have happened but for the misappropriation;
- what I consider to be a fair outcome for both parties to this complaint.

Accordingly, I conclude that it would be fair and reasonable *not* to make any award in the particular circumstances of this case notwithstanding the (poor) advice given.

I have a significant amount of sympathy for the situation in which Mr W finds himself. I fully accept he is the innocent party here and I understand why he would like me to reconsider. However, while the advice to invest in Keydata was poor, I need to consider that poor advice not in isolation but in the context of the conduct of the IFA overall.

The misappropriation of the funds is a material intervening factor that has undoubtedly contributed to Mr W's losses. Given my findings on the overall conduct of the IFA, I find on balance that it would not be fair or reasonable to make an award against the IFA.

e) costs

Mr W's solicitor has suggested that as part of any award I make the IFA should compensate Mr W for the legal costs he has incurred. I recognise that in this case because of his personal circumstances Mr W has needed legal advice and support and so I can see merit in the request. However for the same reasons that apply to my finding on compensation for investment loss, I conclude that it would not be fair or reasonable to make an award against the IFA.

my final decision

For the reasons set out above, I uphold Mr W's complaint. The Keydata bond should not have been recommended to him by the IFA.

Where I uphold a complaint, I have the discretion to make a money award requiring a financial business to pay fair compensation, *plus* any interest and/or costs that I consider appropriate. However, for the reasons explained above, I concluded that I should not make an award.

determination and award

My final decision is that I uphold the complaint but I make no award.

Tony Boorman
ombudsman