

complaint

Mrs F, supported by her husband, has complained about the advice she received to invest in a Keydata investment. She says the risks of the investment were not correctly described and that it exposed her capital to a greater degree of risk than she was willing to accept.

background

In 2006, Mrs F invested in the Keydata secure income plan. The product provider, Keydata Investment Services Limited (Keydata), acted as Mrs F's agent and purchased the plan. The issuer of the plan was Lifemark, which was a Luxembourg based special purpose vehicle. Keydata went into administration on 8 June 2009 and defaulted on 13 November 2009. I understand that Mrs F has received compensation from the Financial Services Compensation Scheme (FSCS) but that her rights to the bond have since been reassigned to her.

Our adjudicator recommended the complaint be upheld. In summary, he identified the IFA had a responsibility to ensure any recommendation made was suitable for Mrs F's circumstances and requirements. Rather than simply relying on the headline description of the investment, he said the IFA should be exercising professional judgement about its inherent nature to assess its suitability for her needs. Based on the information that was available at the time of sale, he felt a financial professional should have been able to identify the Keydata investment included a number of significant distinctive features and risks. And that these features and risks meant it was not a suitable recommendation for Mrs F, principally because it exposed her capital to a greater degree of risk than she was willing to accept.

But for the unsuitable advice, the adjudicator concluded Mrs F would not have invested in Keydata and proposed a method of calculating compensation designed to return her to the financial position she would now be in if she had invested in a way that was consistent with her requirements.

The IFA disagreed with the adjudicator's conclusions, raising the following key points:

- It provided an email from after the sale in 2006 that it believes shows Mr F was an experienced and sophisticated investor.
- The Keydata investment was not presented as being capital secure and the associated risks were set out in the documentation provided at the time of sale, including the adviser's suitability report.
- It has seen evidence from an independent expert who says the Keydata investments could easily be classed as low-medium risk.
- The Keydata investments were the subject of misappropriation, misrepresentation and mismanagement and it was these factors that resulted in a complete loss of capital. When the adjudicator commented that there has been no evidence of misappropriation in respect of investments in Lifemark bonds, the IFA responded that it may well yet come to light that these were also the subject of fraud.
- Some of the risks identified by the adjudicator apply to other investments also and were not unique to Keydata.

- The Financial Services Authority (FSA) visited the IFA in 2007 about Keydata sales. The FSA made no mention of any concerns at that time.
- The adjudicator is meant to consider each case on its own merits but quoted extensively from a previous published decision relating to Keydata investments.
- In respect of Mrs F's investment, the IFA commented that the money invested represented a small proportion of her and her husband's overall portfolio and provided them with additional diversification.
- With regard to redress, the IFA questioned what type of investment would have provided a return of 1% above Bank of England base rate between 2006 and 2009. It also questioned why the adjudicator was awarding interest at 8% on the crystallised loss since Keydata defaulted in 2009.

Following further consideration, the adjudicator amended his view on redress and concluded that interest since Keydata defaulted should be calculated at 2.5% per year instead of the 8% previously quoted.

Mrs F was passed a copy of the correspondence between the adjudicator and the IFA. She and her husband made the following comments:

- Although Mr F had a general level of financial knowledge from his business background, this did not extend to personal investments and should not be used by the IFA to avoid any responsibility for the advice given.
- The comments in the email provided by the IFA relate to a hedge fund product. Mr and Mrs F said this product was a small investment recommended by the IFA and taken out while they were still working.
- The key point that influenced Mrs F's decision to invest in Keydata was the adviser's reassurances about the involvement of a leading high street bank. These assurances have subsequently proved not to be correct.
- They also explained that their initial claim included an amount for the costs of pursuing their complaint and for the worry and anxiety caused.

We have considered complaints about Keydata life settlement funds before and published decisions which set out our general approach to such complaints on our website. The decisions are in the *investment* section of our *online technical resource* which can be found by clicking the *publications* tab. I have referred to this purely for information purposes as it may provide some useful background. But I can reassure the parties that I have considered Mrs F's complaint on its own merits as I am required to do.

my findings

To decide what is fair and reasonable in this complaint, I have carefully considered everything Mr and Mrs F and the IFA have provided.

When considering what is fair and reasonable, I am required to take into account relevant: law and regulations; regulator's rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

I am therefore mindful of the general legal position including: the law relating to negligence, misrepresentation and contract (including the express or implied duty on professional IFAs to give advice with reasonable skill, care and diligence); and the law relating to causation and foreseeability.

There is no dispute that this was an advised sale of an investment product where the IFA assessed the suitability of the product for Mrs F. As the IFA gave advice about regulated investments, I have taken account of the regulatory regime that applied at the time which includes the relevant FSA principles and rules on how a business should conduct itself.

Taking the relevant considerations into account, it seems to me that the overarching question I need to consider in this case is whether the recommendations given were suitable for Mrs F in her particular circumstances. In doing so I need to take into account the nature and complexity of the investments and Mrs F's financial circumstances, needs and objectives; understanding and relevant investment experience; and tolerance to investment risk.

The adjudicator has already set out Mr and Mrs F's circumstances in detail and I agree with his assessment that they appear to have needed the income generated from the Keydata investment to supplement their income in retirement and presumably, over the longer term. It appears this need would have been particularly important given they did not own their own home and had to pay rent. While I am aware the amount invested in Keydata was a fairly small (but not insignificant) part of their overall capital, previous sales documentation indicates Mr and Mrs F may have been planning to draw on their capital at some stage to purchase a property. If they did this, the proportion of their available capital invested in Keydata would presumably have increased significantly.

In their circumstances, I do not believe Mr and Mrs F would have been willing or were in a position to expose this part of their capital to any significant degree of risk. The adviser's assessment of their attitude to risk as '*low-medium*' in the fact find completed at the time of sale seems likely to be about right in my view. This attitude to risk was described as follows:

Most capital placed in secure investments, in the knowledge this limits the potential for future growth or loss in capital and/or income.

I appreciate that documentation completed at earlier and subsequent meetings with the IFA recorded Mr and Mrs F's attitude to risk as '*medium*', but this fact find was completed prior to the advice to invest in Keydata and was presumably the document on which that recommendation was based.

The adjudicator also set out the risks associated with the Keydata investment and I agree with his assessment that these risks meant that it was not suitable for Mrs F. I appreciate some of these risks would also have applied to other types of investment, but many were distinctive to Keydata. As an overall package, I also believe these risks were significant.

While I am aware of how the investments were widely viewed at the time, my conclusion is not based on hindsight and I believe it should have been apparent to an IFA at the time that

the investments were not suitable for an investor like Mrs F who was not willing to expose her capital to a significant degree of risk.

In response to the remaining points raised by the IFA:

It does seem clear that Mr F had some investment knowledge, but I do not believe this somehow discharges the IFA of its responsibility to provide suitable advice. If Mr F had genuinely been a sophisticated investor, I believe it is questionable that he would have required advice at all. Either way, Mr and Mrs F received advice and the adviser had a responsibility to make sure any recommendation made was suitable for them. While some of the risks associated with the investment may have been set out in the product literature and the adviser's recommendation report, the provision of explanatory documentation alone is not sufficient to demonstrate that suitable advice was given.

I understand the IFA's comments regarding misappropriation and I agree that could not reasonably have been foreseen. But the adjudicator was right to say that at this stage at least, the only evidence of misappropriation relates to Keydata bonds issued by SLS and not Lifemark. I note the IFA believes further evidence may come to light in respect of Lifemark, but this statement is not supported by any evidence. Either way, I believe Mrs F's investment was unsuitable and should not have been recommended in the first place. I do not therefore believe it is unreasonable to hold the IFA responsible for any losses incurred as a result of being in that investment – whether or not it subsequently turns out to have been the subject of misappropriation.

I am not able to comment on the FSA's visit to the IFA in 2007 as I am unaware of its purpose and have not seen details of the conclusions that were ultimately reached. Either way, as I have said previously, I believe it should have been apparent to a professional IFA that the Keydata investment was not suitable for Mrs F.

I am aware the investment represented a small proportion of Mr and Mrs F's overall portfolio, although it was possible that this could become a much more significant proportion for the reasons set out above. But my concerns relate to the general nature of the investment and its suitability for Mrs F. My concerns would stand regardless of the amount invested. While I appreciate the investment provided a degree of diversification, but I do not believe that justifies the recommendation of an investment that was otherwise unsuitable.

In short, it is my view that the Keydata plan was not suitable for Mrs F. The IFA had a responsibility to ensure any advice provided was suitable and, by failing to do so, I consider he acted with complete disregard for her interests. This is not a view reached with hindsight. I have based my findings on the product's suitability for Mrs F 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 reasonable expectations of how the plan would operate.

Having reached the view that the recommended investment was unsuitable, I now need to consider what Mrs F would have done 'but for' the advice she received.

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

Overall I think it most likely that Mrs F would have invested this capital into another investment consistent with her circumstances and attitude to risk. On balance, I consider a fair benchmark to indicate the investment return on her investments is 1% more than the Bank of England base rate compounded yearly from the date of investment until the date the loss crystallised when Keydata defaulted. This is not based on the performance of any particular investment as I do not believe it is possible to now know exactly what Mrs F would have done. But I believe it is a reasonable estimate of the return she might have been able to achieve with suitable advice.

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

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

- borrowed money, or continued to borrow money, at credit card or loan rates which they would not have done if the money had been available to them;
- saved or invested the money in some way producing a variety of 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.

In this case, I have taken into account that the money invested was part of a much larger amount Mr and Mrs F had access to. So while the crystallised losses will have given rise to distress and potentially inconvenience to Mr and Mrs F, I think the extent of their assets at the time suggest a rate of 8% would be excessive in this case. I therefore consider that a fair rate of interest is 2.5% simple per year on the crystallised investment loss.

I have noted Mr and Mrs F's claim for additional compensation, but we do not normally make awards in respect of the normal costs incurred in pursuing a complaint, including time, postage and telephone calls. The principal aim of any compensation we award is instead to return consumers to the financial position they would otherwise be in but for the inappropriate actions of the business involved.

my final decision

My final decision is that I uphold this complaint. I believe the Keydata plan was unsuitable for Mrs F and that the IFA acted with complete disregard for her interests.

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation plus any interest and/or costs that I consider appropriate. My aim is to put

Mrs F in the position she would now have been in but for the IFA's poor advice. In deciding how to assess fair compensation I consider it fairest to assume;

- with reasonable advice, Mrs F would have had the original capital intact plus a reasonable rate of return;
- the rate of return on the original capital would have been equivalent to 1% more than Bank of England base rate from time to time compounded yearly; and
- the rate of return would have been by capital growth, rather than income, and may be taxable in Mrs F's hands as a capital gain.

I consider that fair compensation should be calculated as D, where:

- A = the capital invested in the Keydata plan, 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 the Bank of England base rate plus 1% per annum, compounded annually from the date of investment until 13 November 2009 (when Keydata defaulted and the loss crystallised) or until the date that the last income payment was made if later;
- C = the residual value of the investment that Mrs F made in the Keydata plan, which I assess to be zero for this purpose.
- $D = A + B - C$

My decision is that the IFA should pay Mrs F the amount produced by this calculation (that is the amount D). To that sum the IFA should add interest from 13 November 2009 (or from the date that the last income payment was made if later) at the rate of 2.5% per year simple until this award is paid.

For clarification, A and B above should work as follows. Any sum paid into the investment should be added to the calculation from the point in time when it was actually paid in so it accrues the 'reasonable rate of return' within the calculation from that point on. Any reduction to the investment (excluding the final encashment payment) should be deducted from the calculation at the point in time when it was actually deducted so it ceases to accrue the 'reasonable rate of return' within the calculation from that point on.

I understand that in some cases, consumers have received income payments after Keydata defaulted. It is only fair that such payments are taken into account in my award and I have allowed for this possibility in the award formula. It should be noted that the income payments do not include any distributions made following the Bondholder Notice dated February 2013 which is discussed further below.

As it is my understanding that on payment of this compensation the FSCS will require repayment of its compensation to Mrs F, no allowance should be made for any sum received from the FSCS in the calculation of the investment loss. However, Mrs F has had use of this money since it was paid. Accordingly, although the amount D should not be reduced, the sum used to calculate the interest payment should be reduced by the amount of compensation paid by the FSCS from the date of its redress calculation onwards. Mrs F

should provide evidence of the date at which the calculation took place and the amount received.

In relation to C, I understand that the fund cannot be encashed. For that reason, as set out above, for the purpose of C the investment should be treated as having a nil value. However, that is provided Mrs F agrees 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 Mrs F to note that carefully. She will need to co-operate with the IFA to enable it to make the necessary calculations and in order for it to take ownership of the investment if it wants to.

I am aware that a recent Bondholder Notice dated February 2013 indicates that there may be a further distribution to bondholders. I consider that as part of any arrangement to pay the award and to take ownership of the investment it would be reasonable for the IFA to make appropriate provision for it to receive any future distribution whenever paid. This would cover a situation where the consumer receives the distribution before the award has been paid and/or before transfer of ownership to the business has been completed. It would also cover a situation where the distribution is incorrectly paid directly to Mrs F even though ownership has been transferred.

If the IFA considers it is legally obliged to deduct income tax from the interest (i.e. the amount to be added to part D only), it must provide Mrs F with a tax deduction certificate so she can reclaim any overpaid tax from HM Revenue and Customs if she is eligible to do so.

It is my understanding that HM Revenue and Customs has made certain provisions so it may be possible for compensation paid in relation to a Keydata fund that involved an ISA/PEP to be transferred into an ISA wrapper. I am unable to give any more information or advice about this matter. However, information can be found on the HMRC.gov.uk website by entering '*ISA reinstatement*' in the search box on the home page. I can only suggest that if Mrs F would like to explore this further she contacts HM Revenue and Customs directly or seeks appropriate independent advice.

Jim Biles
ombudsman