



Welcome to the latest edition of our Hindsight publication.

The effect of the credit crunch on property and stock market prices caused an increase in complaints against IFAs last year, which we are now seeing reflected in the number of Ombudsman cases coming through the system. We have decided to concentrate this issue of Hindsight on looking at a number of cases and exploring why the Ombudsman reached the decision they did, either to reject or uphold the complaint.

There has been a lot of press comment in recent weeks concerning proposals to increase the maximum limit for Ombudsman claims from £100,000 to either £150,000 or even £200,000. We have been party to discussions with the FSA on this and have told them of our concerns. We have included a brief introduction on how the Ombudsman process works and our objections to the proposals put forward.

These articles have been produced in collaboration with Mark Gibbon, Managing Director and Martin Archer, Legal Director.

We hope that you will find these articles informative and useful.

If you have any comments on the content, or suggestions for future issues, please write to us or e-mail us at newsletter@collegiate.co.uk



Richard Turnbull
Underwriting Director
Collegiate Underwriting

Financial Ombudsman Service

Cases go to the Financial Ombudsman Service ('FOS') because either, the IFA has issued a final outcome letter not upholding the complaint and the customer is dissatisfied with the decision, or redress has been offered but the quantum of this is disputed.

The 'FOS' process involves an initial decision by an Adjudicator. This can be appealed by either party for a final decision by the Ombudsman. If that decision is in favour of the customer it is binding on the IFA if accepted. There is no compulsion on the consumer to accept the decision and they can at this stage decide to

seek compensation through the legal process. There is no appeal against the Ombudsman's decision but there can be a judicial review. The Ombudsman is required to make decisions 'by reference to what is in the opinion of the Ombudsman, fair and reasonable in all the circumstances of the case'. To win a judicial review the litigant would need to prove that the entirety of the Ombudsman's decision was so unfair that no right minded person would have made a similar decision.

The basis for an Ombudsman decision can be more beneficial to a consumer than the



legal process through the courts because of the requirement to make a decision that is fair and reasonable rather than the need to prove legal liability.

In particular, the Ombudsman rarely agrees to have an oral hearing although there is provision for this to be requested. In addition

one cannot compel full disclosure of the client's documents or documents in the possession of third parties and neither is it possible to join in third parties who may have a responsibility.

It is because of these limitations to the Ombudsman process that we have recently expressed

our opposition to the proposed increase in level of Ombudsman award. There have been some suggestions that the limit will be increased to either £150,000 or even £200,000. It is our view that compensating such a large sum of money without applying the full rigour of the legal system is not compatible with an IFA's

human rights. For sound public policy reasons the Ombudsman offers cheap and relatively quick access to justice, but necessarily that comes at a cost to rigor and detailed scrutiny. The FSA needs to recognise the limitations of the service. The courts are the correct forum for high value claims to be resolved.

Unregulated Collective Investment Schemes ('UCIS')

'UCIS' were the subject of an article in our previous edition of Hindsight. The FSA have produced a factsheet on 'UCIS' as they are concerned about complicated investment opportunities being unlawfully promoted and sold to members of

the general public. This is currently a hot topic at the FSA and any firm involved in these activities should ensure they are properly authorised and only advising suitable clients.

We had a complaint upheld where the customer had been advised to invest in a fund that was not regulated. This was based on the fact that 'UCIS' cannot be promoted to the general public, although they can be promoted to

certified high net worth individuals, sophisticated investors, self certified sophisticated investors and existing investors in 'UCIS'. As the customer did not fall into any of these categories the investment was deemed to be mis-sold.

Execution only

The complaint was about an investment bond, which the IFA stated was sold on an execution basis. The letter to the customer at the time of sale stated 'When making recommendations to our customers we would normally provide them with a letter explaining why we believe the transaction to be suitable, but as this transaction has been arranged at your own explicit request no such letter will be issued. All aspects of this contract have been selected by you, with no advice being given or requested.'

There was a third party involved who assisted the client with their finances and was not employed by the business. He confirmed that he had acted as a friend.

The complaint was dismissed.

In a previous decision the Ombudsman stated 'It would be fair to say that these transactions bear the hallmarks of an execution only transaction; that is, investments sourced by the investors themselves, discounts provided on the commission paid to the firm and then the application merely processed through a regulated firm.'

In summary for a transaction to be execution only the customer should have:

- Identified the product and product provider
- Determined the level of premium
- Selected the fund
- Selected the term of the contract

The IFA should have:

- Confirmed the basis of the transaction in writing
- Provided no advice
- Discounted commission/fees to reflect the execution only basis



Property investment bond

The customers were retired in their late fifties. They were advised to invest in excess of £150,000 in a property fund. This represented 90% of their available assets.

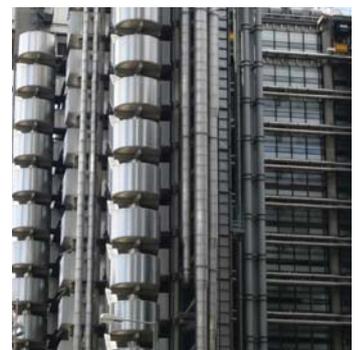
The Adjudicator on examining the case found:-

- There was an inadequate analysis of the customer's personal circumstances in order to arrive at a meaningful risk rating
- There were two distinct and different definitions for the risk levels. It was unclear whether the customer was low/medium or low/cautious
- The customers were retired with limited means to replace lost capital
- A risk rating of low would have been appropriate
- The responsibility to give advice extended to ensuring their overall portfolio was well balanced and appropriate for their general circumstances
- Following the advice their portfolio was not sufficiently balanced

- The investment was funded by selling their with profits bond. There was no explanation of the increased risk associated with an investment into a property fund as compared to a with profit fund

The Adjudicator found that had the customers understood the risks involved in investing in the property fund they would have retained their investment in the with profits fund. Compensation was recommended as the difference between the surrender value of the property bond and the value of the with profit bond if it had remained in force.

The problems were the over concentration and the poor quality risk assessment.



Fall in value of investment bond

The complaint concerned an investment which was not commensurate with attitude towards investment risk as the customer could not afford to take risk.

The investment represented 1/6 of the total portfolio, the balance being invested in cash and premium bonds. The following were extracts from the suitability letter:

- The fund in which your money is invested will invest primarily in equities this will provide a good degree of security while offering the potential for modest growth.
- The investments will meet your required degree of risk

which we have agreed to be balanced. Although as stated your attitude to risk is balanced you have decided to invest in slightly more cautious areas and will review in the future.

- The key features document is attached. If you make withdrawals from this bond which exceed the net growth rate achieved by the underlying investments its value will fall.
- It is important that you are aware that the value of units in a unit-linked investment, as well as any income they generate, can fall as well as rise and past performance is not a guarantee of the future.

The Adjudicator stated that it is reasonable to expect policyholders to read the information they are given. After reviewing this information, he believed the nature of the investment was described in understandable terms and was sufficiently clear. This was with particular regards to the fact that the value of the bond could fall as well as rise and that its performance was not guaranteed.

In addition to providing an explanation of the way the investment would work, the adviser also had a responsibility to ensure that it was consistent with the client circumstances and requirements.

The fact find recorded that

the customer had a balanced attitude to risk and this was confirmed in the suitability letter. The Adjudicator considered the recommended funds were consistent with the level of risk the customer was prepared to accept. The amount invested was a small proportion of their overall holdings and it was reasonable to conclude that the client was prepared to accept some risk with this investment.

The complaint was rejected.

This case showed the benefit of a well documented suitability letter and a risk assessment that was in tune with the Adjudicator's assessment of the customer's circumstances.

Investment bond in Eastern European commercial property

The customer was taking a sabbatical from work for six months. The attitude to risk was assessed as low-medium and access would be required to the money on return to the UK in six months to purchase a property. The Ombudsman found that the investment was inappropriate for the following reasons:

- The investment was one that needed to be held for the medium to long term, that is five years or more. This was inconsistent with circumstances, short term needs and a balanced portfolio.
- Penalty free access was required

- Growth over one year was required
- Customer was risk averse as the investment represented substantially all the assets and could not afford to lose it

The Ombudsman ordered redress based on a return of capital intact plus interest.

Compensation payment to client

The customer had been paid compensation to provide financial security for the rest of their life due to their inability to work. The customer was very reliant on this capital and it was important to ensure that there was no unnecessary risk. The Adjudicator made the following comments about investment risk:

- Simply because the sales documentation is available does not demonstrate that a detailed explanation of the funds was made.

- Prior to these investments, there is no real evidence that the customer had any investments to support they were willing to take a risk with capital or to suggest he had any financial awareness
- Some of the investments were notably high risk investments that the customer would not be prepared to take
- The customer did not come from a financial background and was reliant on the adviser

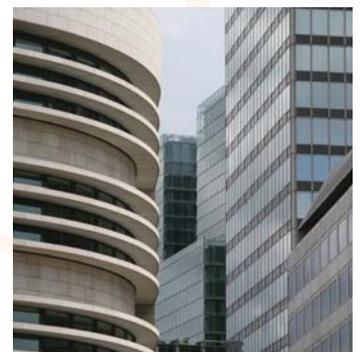
On this basis an award was made returning the original capital intact plus interest at base rate plus 1%.

The Ombudsman reviews each case on its merits and draws different conclusions depending on individual circumstances. In this case the customer had little financial knowledge and experience. There is a different expectation on the advice that should be given to such a customer compared to an experienced investor.

Transfer of pension from with profits to a SIPP

The customer was advised to transfer pension benefits at age 57. These were transferred 25% into a bank account to pay the tax free lump sum due in three years and 75% in a cautious income and growth portfolio.

The Ombudsman found the advice unsuitable because of the customer's cautious attitude to risk, her proximity to retirement, the high cost involved in the transfer, the fact the transfer was from a with profits arrangement and that no comparison with the benefits of the ceding scheme were carried out. Suitable advice would have been for the client to remain with the existing provider but to make appropriate fund switches to protect the value of her pension fund, in view of her cautious attitude to risk, and her intention to retire in three years.



Transfer of pension

At the time of advice the client was less than two years away from when they wanted to take pension benefits. Although the client would then be 50, the pension fund had been secured as part of a divorce settlement and was the main source of income. The client was exposed to investment risk and the fund lost value.

The client's attitude to risk as

cautious was not in dispute. The Ombudsman accepted that the asset allocation proposal could be considered reasonable if the intention had been to invest for the long term. However there was always an intention to take benefits at age 50. The advice should have reflected this objective. The asset allocation was wrong for the short timescale. The Ombudsman considered that

a mix of cash, corporate bonds and gilts would have been more appropriate. However as the loss was clearly in excess of the maximum the Ombudsman could award of £100,000 this was not resolved.

Investing for the wrong timescale is a common cause of problems. This can also happen when a client has a mortgage which is

subject to penalties if paid off. Instead of investing money which is earmarked for repaying the mortgage securely it is exposed to investment risk. At the wrong time this can cause losses. Invariably a complaint will be forthcoming which will be very difficult to defend.

Drawdown v Annuity

The customer was aged 62 and had a mostly cautious attitude to risk. The Ombudsman considered that the annuity deferral and investment in potentially volatile funds did not meet the customer's attitude to risk. He decided that

the customer should have been advised to take an annuity and ordered compensation on the basis that an annuity had been purchased at the time of the advice. This involved taking an annuity on the remaining benefits in the plan

and purchasing a further annuity to cover the shortfall. The past loss was calculated by comparing what had been withdrawn from the fund against what would have been taken had an annuity been purchased.

Where a client is assessed as having a cautious attitude to risk it is unlikely that the Ombudsman is going to accept that an income drawdown contract is best advice.

Keydata

This was an investment into a Keydata Secure Income investment bond. The IFA wrote to the customer stating that whilst the Keydata Secure Income Fund does not provide an absolute guarantee of full capital return at maturity, the implicit aim of the investment is indeed to protect the original capital value at maturity. In 2009 Keydata Investment Services Ltd went into administration and the Serious Fraud Office began an investigation.

The complaint was that this was not a suitable investment. The findings of the adjudicator were:-

- Investment was affordable
- The customer had some experience of investments
- The customer was prepared to accept some degree of risk to capital
- The investment was consistent with the degree of risk that the

customer was prepared to accept. On this basis the adjudicator was not persuaded that the investment was unsuitable and commented that he could not hold the IFA responsible for any fraud that may have occurred at Keydata.

£100m was invested in Keydata Secue Income Bonds one, two and three. This money was invested in bonds issued by Luxembourg company SLS Capital and used to

purchase life policies relating to individuals in the USA. SLS was under the control of Mr Elias. Funds were misappropriated to meet other business needs. The Serious Fraud Office are tracing where these funds have gone. They are now investigating a company called Lifemark SA, which carried on the same business as SLS but under different ownership.

Kaupthing Singer & Friedlander Isle of Man

The customer sought advice on investing cash held in a SIPP. They did not want to take risks and were looking for a very secure approach. The cash was invested in an offshore bond, this was spread in the deposit accounts of four offshore banks.

The Adjudicator found:

- The bond recommended was not a 'no risk' investment.

- The IFA had explained that by depositing in banks via an offshore bond the client could not benefit from the banking compensation scheme
- KSF was rated A1 for long term strength by Moody's
- KSF had a guarantee from its parent company, lodged with the Isle of Man Financial Services Authority

- The customer had previously invested pension monies in property funds.
- The customer was not a 'no risk' investor, they were a low risk investor
- The bond was suitable for a low risk investor

The complaint was not upheld.

The crucial factors in this decision were that the client's attitude to risk was low, the IFA had explained that the Banking Compensation Scheme did not apply and the money was spread across four deposit holders.

The latest information on KSF is that the administrator is expecting to pay creditors between 80%-90% of their investments.

Collegiate Underwriting is a trading name of
Collegiate Management Services Limited
Registered Office:
Mint House
77 Mansell Street, London E1 8FE

Telephone: 020 7459 3456
Facsimile: 020 7459 3455
E-mail: cms@collegiate.co.uk
www.collegiate.co.uk

Registered in England No. 02065041



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