Ombudsman response to comments on provisional determination
CIFO Reference Number: 15-000018
Complainant: [The complainants]
Respondent: [Investment Company D]

> It is the policy of the Channel Islands Financial Ombudsman (CIFO) not to name or identify complainants in any published documents. Any copy of this determination made available in any way to any person other than the complainant or the respondent must not include the identity of the complainant or any information that might reveal their identity.[1]

I have considered the additional representations made by both [the complainants] and [Investment Company D]. [the complainants] have asked me to consider further compensation for the £3523.75 in legal costs incurred when they engaged a lawyer to pursue their complaint in 2013.

[Investment Company D] accepted the method of calculation in principle, but have questioned the use of a 'Low/Moderate' risk benchmark to calculate opportunity costs, and suggest a 'Low' risk benchmark should be used.

Compensation for legal costs

CIFO does not generally compensate for legal costs incurred by complainants when pursuing their complaint. This is because CIFO was created to be a free and informal alternative to the courts, and complainants are not expected to have legal representation through our process.

However, I do acknowledge that CIFO was established relatively recently and, while expected to commence operation sometime in 2015, was therefore not yet available to [the complainants] at the time of their complaint.

I have therefore considered whether compensation for the legal costs, above the amount of compensation for investment losses set out in my provisional determination, would be fair and reasonable.

I note that at the time of the legal action in 2013, the losses incurred by [the complainants] had not yet crystallized because the fund remained suspended and several distribution options were to be made available. It is therefore arguable that legal action was premature.

I also note that immediately prior to the legal expenses being incurred in late 2013, the complainants had opted, with the advice of their daughter, to exchange their [X] Fund units for the Run-off Shares which offered the prospect of recovery of their losses both through anticipated redemptions, subject to sufficient funds being available, as well the

[1] Financial Services Ombudsman (Jersey) Law 2014 Article 16(11) and Financial Services Ombudsman (Bailiwick of Guernsey) Law 2014 Section 16(10)

potential upside of additional participation in the investment recovery as the underlying life policies matured. This further confirms my view that the incurring of legal expenses was, on the balance of probabilities, premature.

I am also influenced by significant evidence that [the complainants] were ably supported throughout by family members, in particular their daughter, possessed of sophisticated insight into the investment issues involved in this complaint. I am therefore of the view that, on the balance of probabilities, the incurring of the legal expenses was more of a pressure tactic against [Investment Company D] than necessary support in the articulation of their complaint to [Investment Company D].

I have also considered the basis on which the legal action was taken. The letters sent by [[the complainant's] lawyer argued that the investment into the [X] Fund was unsuitable for [the complainant's] risk profile, rather than over-concentrated as we concluded.

My own decision on the complaint does not concur with the legal position taken by [the complainants] through their lawyer. It would therefore not be reasonable for me to award compensation for legal advice and a legal challenge that I consider to have been without merit.

On the basis of the above, I do not consider that further compensation, beyond that set out in my provisional determination, is warranted.

Appropriate performance benchmark

[Investment Company D] have disagreed with my usage of a low/moderate risk benchmark to calculate the opportunity cost payable to [the complainants]. They have argued that a low risk benchmark should be used, as this is the risk profile [the complainants] claimed to possess in their claim that the investment was unsuitable. I note that this differs from the 'Low/Moderate' risk profile ascribed to [the complainants] by their own adviser from [Investment Company D].

In my decision I was satisfied that, based on their particular circumstances, [the complainants] could reasonably be considered low/moderate risk investors. This was the risk profile that both [Investment Company B] and [Investment Company D] had ascribed to them in their respective investment reviews.

It would not therefore be fair and reasonable for me to apply the low risk benchmark in determining the opportunity costs payable to [the complainants].

Conclusion

On the basis of the above I am satisfied that there was no additional information which prompts me to change my provisional determination which is now repeated as a final determination below.

Please note that the calculations in my provisional determination accounted for a third redemption from the [X] Fund which was expected shortly following the issuing of that provisional determination. It has now been confirmed that this payment was £2,559 and 25.391 shares have been redeemed. The calculations and compensation amounts have been amended to reflect this.

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Background

In 2009 the complainants obtained investment advice from [the adviser], a financial adviser working for [Investment Company B].

Between January and February 2009 the adviser conducted an assessment of the complainant's investment requirements and recommended the [X] Fund, a Traded Life Policy Investment ("TLPI"). The complainants were classified as 'Low/Moderate' risk investors with a score of 4 out of 10 on [Investment Company B's] scale.

The complainants subsequently invested £65,000 into the [X] Fund in March 2009. In May 2009 the adviser notified them that she was leaving [Investment Company B] to work for [Investment Company D]. The complainants completed the paperwork to transfer to [Investment Company D] in July 2009 in order to continue their advisory relationship with the adviser.

A meeting was held in January 2010 to provide an update on the current valuation of the [X] Fund. In March 2010 the adviser conducted a substantial review and prepared a financial assessment. However, the complainants' current investments were not reviewed, with the adviser noting in the file that they were content with the performance of the [X] Fund so far.

In October 2011 a further investment review was held after the complainants identified a further cash sum of £20,000 for investment. To avoid having too much invested into the one investment, the adviser advised against investing further into the [X] Fund, despite its good performance. She recommended an investment into the [Y] Bond instead, in order to diversify their portfolio.

The [Y] Bond required potential investors to be risk assessed prior to acceptance. Following their meeting the adviser reassessed the complainants as 'Moderate' risk investors in an Investment Risk Profile dated 28th October 2011.

[1] Financial Services Ombudsman (Jersey) Law 2014 Article 16(11) and Financial Services Ombudsman (Bailiwick of Guernsey) Law 2014 Section 16(10)

In November 2011 the UK's Financial Conduct Authority ("FCA") released a statement branding all TLPI's as 'toxic' high risk investments that are suitable only for sophisticated investors.

Almost immediately afterwards in December 2011 the [X] Fund suspended trading due to a large volume of redemption requests.

In 2013 the [X] Fund sent a circular to investors advising them of the options available to them, namely to remain in the Continuing Share class, or switch to a different category called Run-Off Shares.

Continuing shareholders would remain invested in the fund, with the first opportunity to fully redeem expected at the beginning of 2016. Run-Off shareholders would enter a different share class, with the potential for twice yearly redemption payments if sufficient funds were available until the underlying life policies had all been paid out.

For investors opting for the Run-Off class of shares, while there was no guarantee that funds would always be available for these redemptions, it meant investors may have been able to realise their investments earlier.

The complainants chose to switch to the Run-Off Shares. In September 2014 they received a redemption of £2,011.24, with a further £15,229.62 paid in December 2015. A further redemption of £2,559 was paid on 31st August 2016.

On 1st September 2013 the complainants raised a formal complaint against [Investment Company D], arguing that the [X] Fund was unsuitable for them, and that the adviser ascribed to them an incorrect risk profile when she originally recommended the investment to them in 2009.

[Investment Company D] declined responsibility for the original advice, which was provided while the adviser was still employed by [Investment Company B]. The complainants acknowledged this but argued that the adviser had a continuing responsibility to review the suitability of the investment while she was employed with [Investment Company D].

[Investment Company D] ultimately rejected the complaint, and a legal challenge by the complainants was abandoned after the cost became unsustainable for them. The complaint was therefore referred to CIFO for review.

Following discussions with both parties, CIFO prepared an initial proposal for resolving the complaint. This was rejected by the complainants. I reassessed the complaint in light of their response and have detailed my conclusions below.

Analysis – [Investment Company D's] Period of Responsibility

The initial advice to invest into the [X] Fund was provided in 2009. This is prior to our statutory maximum reach-back date, which means we have been unable to review it. In addition, responsibility for this advice lies with [Investment Company B], a different financial services provider, which is now defunct.

On this basis I have not reviewed the claim that the [X] Fund was mis-sold to [the complainants] in 2009. I have instead reviewed any further advice provided by [Investment Company D] from 1st January 2010 until the fund's suspension in December 2011, and their actions following this date until the present day.

January 2010 Meeting

The complainants have asked me to consider using a meeting in January 2010 as the date from which [Investment Company D] should be responsible for identifying issues with their portfolio and taking steps to rectify them.

I have reviewed the circumstances of this meeting, which appears to have been an update on the performance of the [X] Fund. There is no evidence that any broader review of the complainants' investments or assets took place at this meeting and I therefore do not consider that time as the appropriate starting point for our analysis.

March 2010 Review

The March 2010 review took place a year after the [X] Fund investment with [Investment Company B] in March 2009, nine months after the complainants transferred their account to [Investment Company D]. This is in line with [Investment Company D's] standard approach to meet with clients on a yearly basis. While I note that [Investment Company B] offered the complainants six-monthly reviews, I consider that this was an arrangement specific to [Investment Company B] and not [Investment Company D].

While the complainants decided not to discuss their investments at this review, I consider it to have been sufficiently in-depth to be considered the appropriate opportunity for [Investment Company D] to have assessed their portfolio and be held responsible for its ongoing suitability.

On the basis of the above, I consider this March 2010 meeting date to be the starting point for our analysis of [Investment Company D's] responsibility for the complainants' investment portfolio.

Analysis - Risk Profile of [The complainants]

While working for [Investment Company B] in 2009, the adviser assessed the complainants as having a risk tolerance of 4 out of 10, or 'Low/Moderate', which was confirmed in her letter of 19th February 2009. The adviser considered the [X] Fund to be suitable for investors of this risk profile.

Later in 2009, while working for [Investment Company D], the adviser produced a portfolio analysis which listed the complainants as 'Cautious', which I understand to be 2 out of 5 on the scale used by [Investment Company D]. The lowest risk profile used by [Investment Company D] is 1 out of 5, or 'Conservative'. The complainants had previously been rated 4 out of 10 at [Investment Company B], or 'Low/Moderate'.

After reviewing both definitions, I consider that 'Cautious' on the [Investment Company D] scale and 'Low/ Moderate' on the [Investment Company B] scale are comparable risk profiles.

In October 2011 the adviser assessed the complainants as 'Moderate' risk prior to their investment into the [Y] Bond. They say this risk assessment was conducted without their input, and they were not aware of the risk profile the adviser had ascribed to them. In addition, they say that their risk profile has always been 'Low'.

On the basis of the above, and after reviewing the complainants circumstances, I conclude that it was reasonable for [Investment Company D] to consider the complainants to have had a 'Low/ Moderate' risk profile at the time of the March 2010 review and throughout the period to the date of this determination.

Analysis - Risk Profile of [X] Fund

I have acknowledged the statement released by the FCA in November 2011, which stated that TLPIs are 'toxic' investments suited only for sophisticated investors with high risk tolerances. It is noted that these comments were not directed at any fund in particular, but the entire class of investment products in general.

It would not be fair and reasonable in this case to apply the benefit of hindsight to the suitability of the [X] Fund. I have therefore considered what [Investment Company D] knew or ought to have known about the suitability of the investment when the March 2010 review was conducted.

A copy of the [X] Fund fact sheet from 2009 describes the fund as 'lower risk' with an annual performance benchmark of 8%. Historic performance showed that the fund had consistently achieved annual returns of between 7% and 10%. In the complainants' case, their investment rose by 8.69% between the time of the original investment in March 2009 and the first review in March 2010.

I consider the Private Client Indices ("PCI") to be an appropriate comparative benchmark. The PCI has 68 contributing portfolio managers, of which a large number are based in the Channel Islands. I consider that this affords it a particular relevance as opposed to one predominantly focused on UK-based firms.

In 2009, the 'Cautious' PCI returned an average annual return of 7.60%. The 'Balanced' portfolio returned an average annual return of 12.78%. In 2010 the same portfolios achieved 6.81% and 9.81% respectively. For the avoidance of doubt, I consider that the PCI definition of 'Cautious' could be considered synonymous with 'Low', and 'Balanced' with 'Moderate'. I therefore consider that the mean between the 'Cautious' return and the 'Balanced' return to be a reasonable performance benchmark for a 'Low/Moderate' portfolio.

With a return of 8.69% between the March 2009 investment and the March 2010 review, the [X] Fund was performing broadly in line with a 'Low/Moderate' risk portfolio, consistent with the risk profile originally attributed and communicated to the complainants by the adviser in 2009.

I also note the low volatility of the historical returns from the [X] Fund. The fund had shown a steady return in the 3 years prior to the March 2010 review, and significantly less volatility compared to other product areas in the market at the time.

The fund's performance was such that the complainants sought to invest a further £20,000 into it at the October 2011 investment review with [Investment Company D] before being advised by [Investment Company D] against doing so in order to better diversify their portfolio.

On the basis of the above I would not consider it unreasonable for an adviser to consider the [X] Fund a suitable investment to include as part of a (Low/Moderate' risk portfolio at the time of the March 2010 review.

Analysis - Risk Profile of Portfolio

Notwithstanding my conclusions regarding the suitability of the [X] Fund investment above, the concentration of the complainants' investable assets into this one single investment was not suitable. At the time of the March 2010 review I note that the [X] Fund was the only investment within their portfolio.

In assessing the issue of concentration, it is necessary to identify the complainant's investable assets. In the March 2010 financial review, the adviser lists their investable assets as:

- Lump sum investment, £69,000 approx.
- Cash, £25,000
- Maturity of policy, £13,700

[Investment Company D] have since confirmed that the exact value of the [X] Fund, which was listed as 'Lump Sum Investment', was actually £70,648. In CIFO's initial view on this complaint, the complainants' investable assets were considered to be £109,348, which is the combined total of the listed investments.

The complainants have stated that the cash and maturing policy should not be treated as investable assets. They say the cash was held within their business reserve account, where it was never intended to be invested. In addition, they say the majority of the proceeds of their maturing policy were intended to be used as a cash gift.

Barring any evidence of disclosure by the complainants, I do not consider it reasonable to expect the adviser to know these details. In addition, I note that the complainants sought to invest an additional £20,000 from these same investable assets into the [X] Fund in October 2011. Clearly the investment of £70,648 did not represent the full extent of investable assets in their own minds. I therefore consider it fair and reasonable to assess the complainant's total investable assets as £109,348 at the time of the March 2010 review.

To ensure sufficient portfolio diversification, I would consider it reasonable to invest a maximum of 25% of these assets in the [X] Fund. 25% of £109,348 is £27,377. The value of the [X] Fund investment as at March 2010 was £70,648. I therefore conclude that the investment in the [X] Fund was over-concentrated by £43,311.

I have considered the complainants' argument that sufficient diversification of a portfolio cannot be achieved without a minimum of between 40 and 50 separate investments.

I consider this approach to diversification to be more applicable to investments in individual stocks rather than funds. The [X] Fund invested in policies across a wide range of providers and offered an inherent degree of diversification, albeit within a single asset class. I therefore do not accept the argument that even more diversification was warranted in the portfolio beyond the 75% of investable assets inherent in my conclusion. Our calculation of opportunity cost for the other 75% uses a diversified portfolio benchmark.

I therefore reaffirm that I consider 25% to be a reasonable maximum proportion of the complainants' investable assets to be invested into a single diversified fund.

On the basis of the above, I consider that the complainants were significantly overinvested in the [X] Fund at the time of the March 2010 review. I consider that [Investment Company D] was responsible for suitably diversifying the complainants' portfolio following the March 2010 review, and by virtue of their failure to do so, left the portfolio unsuitably invested.

Analysis - [X] Fund Restructuring Proposals

The FCA announcement in November 2011 triggered an extraordinary volume of redemption requests by investors in TLPIs. This caused a liquidity crisis for many funds in this asset category, including the [X] Fund. Restructurings of the funds were common.

In September 2013 the [X] Fund issued a circular to all investors notifying them of restructuring and the option to remain in Continuing Shares or switch to the Run-Off Shares.

The complainants were offered a meeting to discuss these two restructuring options by [Investment Company D]. This was declined by their daughter, who was acting on their behalf. She stated that they would switch into the Run-Off Shares based on her own assessment of the two options and proceed without any further assistance from [Investment Company D].

CIFO's initial proposal reflected [Investment Company D's] view that the advisory relationship was ended at this point and that [Investment Company D's] responsibility for the ongoing performance of the fund should be adjusted based on the different returns associated with the two options.

After further consideration, I conclude that there is no evidence that [Investment Company D] advised the complainants to remain in the Continuing Share class, whereupon they would have received a final redemption earlier this year.

While I acknowledge that the choice to remain in the Continuing Shares may have been the more suitable option and was the option [Investment Company D] had recommended to all the clients they met with, I consider that this can only be fully determined with the benefit of hindsight.

Notwithstanding the choice made by the complainants' daughter, I do not consider it reasonable to hold the complainants responsible for the financial consequences of that choice, especially in the absence of any advice received from [Investment Company D] to the contrary.

It therefore follows that I also do not consider that [Investment Company D's] responsibility for any financial loss should be cut-off as at September 2013. [Investment Company D's] relationship with the complainants, and their responsibility for the unsuitably invested portfolio, continued through to the date of this determination.

Compensation - Financial Loss

I conclude that redress should be awarded on the basis that [Investment Company D] failed to ensure sufficient diversification of the portfolio.

I consider the first reasonable opportunity for [Investment Company D] to address the over-concentration in the [X] Fund would have been at the March 2010 review. By failing to do so, [Investment Company D] allowed the portfolio to remain exposed to the associated risk of financial loss.

This risk materialised in December 2011 when the [X] Fund was suspended. At this point a further investment had been made into the [Y] Bond, but the [X] Fund was still the majority holding within the portfolio by a large margin.

I consider that up to £27,337 (25%) of the complainants' investable assets (£109,348) could have reasonably been invested into the [X] Fund. At the time of the March 2010 review the [X] Fund investment was valued at £70,648.

£27,337 is 39% of £70,648, which means 61% (or £43,311) of their [X] Fund investment should have been invested in other suitable investments.

After reviewing the evidence, I am not satisfied that the complainants were advised to remain in the Continuing Shares, or advised against entering the Run-Off Shares when their daughter told [Investment Company D] they would be doing so in September 2013.

I therefore consider that they should be compensated for the loss associated with 61% of the [X] Fund investment which became, and remains, illiquid with occasional distributions due to [Investment Company D's] failure to appropriately diversify the portfolio in March 2010.

I have factored in the three redemption payments which the complainants have received when calculating this loss. These were £2,011.24 in September 2014, £15,229.62 in December 2015, and £2,559 in August 2016.

I consider that 61% of these redemption payments should be credited against the redress payable by [Investment Company D].

I therefore consider the complainants' loss to be £31,234, which is £43,311 less 61% of the £19,799 in redemption payments which should be credited to [Investment Company D].

Compensation - Opportunity Costs

In addition to the above, I consider that it is reasonable for the complainants to receive compensation based on what their £43,311 (and the lesser invested amounts subsequent to each of the redemptions) would have returned had the funds been suitably invested into 'Low/Moderate' risk investments from March 2010 to the present date.

As previously stated, I do not concur with [Investment Company D's] contention that the evidence supports the advisory relationship between [Investment Company D] and the complainants was terminated in September 2013. The [X] Fund continued to correspond with [Investment Company D] in relation to the complainants' holdings, and the adviser herself told the complainants that she would continue to keep them updated following their decision to opt for the Run-Off class of shares in September 2013.

I have factored in the two redemption payments made in September 2014 and December 2015, as it would not be reasonable to benchmark opportunity costs on the entire £43,311 when the investable amount would not have been the same for the entire period due to these redemptions. The third redemption made in August 2016 has no impact on the opportunity cost calculation.

The calculations for each period and their corresponding PCI benchmark period returns are provided in the attached Appendix A.

Resolution - Run-Off Shares

As consideration for the compensation listed above, I consider that it is reasonable for [Investment Company D] to take back ownership of a percentage of the remaining illiquid Run-Off Shares associated with the unsuitable portion of the investment so that they may benefit from any distributions in future. It would not be fair for the complainants to continue holding all of the shares and thereby be compensated again if they realise any return in future.

Of the 570.575 shares initially held by the complainants per my previous calculations, I consider that 39% of these could have reasonably been held by them, representing 25% of their investable assets.

Of these shares, 204.133 have already been redeemed, leaving 366.442 remaining within the fund.

Following this redemption, [Investment Company D] should take ownership of 61% of the remaining shares. The complainants should continue to hold the remaining 39%.

Decision

My final decision is that [Investment Company D] should pay compensation of £31,234 and opportunity costs of £12,558.30 to the complainants for a total of £43,792.30, subject to confirmation of exact values and benchmark returns as of the payment date. This decision is conditional on ownership of 61% of the remaining Run-Off Shares being transferred to [Investment Company D].

The complainants should take any reasonable steps required by [Investment Company D] to facilitate the share transfer. The remaining 39% of the Run-Off Shares should remain in the complainants' possession.

Douglas Melville
Principal Ombudsman & Chief Executive

Appendix A

Apportionment Calculations (£ Terms)

The complainants had £109,348 of investable assets at the time of the March 2010 review. I consider 25% of investable assets, or £27,337, to be a reasonable amount that could have remained invested in the [X] Fund.

Following the March 2010 review the complainants had £70,648 in the [X] Fund. This means 61% of the [X] investment, or £43,311, was over-concentrated and therefore unsuitable.

From this amount I have taken 61% of the three redemption payments already made and apportioned them to [Investment Company D] in order to calculate the share of the [X] investment to be retained by the complainants.

Apportionment Calculations (£ Terms)	**Values**
March 2010 Investable Assets	£109,348
Reasonable Percentage in [X]	25%
Reasonable Amount in [X] (25%)	£27,337
March 2010 Amount in [X]	£70,648
% of [X] that should have been diversified	61%
Amount of [X] that should have been diversified	£43,311
Less than 61% of £19,799 in Redemptions	£12,077
Unsuitable Share in [X]	**£31,234**

Appendix B

Opportunity Cost Calculation

An appropriate low/moderate risk benchmark return has been sourced from the Private Client Indices (PCI). Consideration has been given to the two redemption payments, whose associated opportunity costs have been apportioned to [Investment Company D]. The third redemption has no impact on the opportunity cost calculation.

Opportunity Cost Calculation	**Values**
Amount that should have been diversified	£43,311.00
Low/Mod Risk Benchmark Return Mar 2010 – July 2016	30.18%
Gross Opportunity Cost	**£13,069.09**
Sep 2014 Redemption (61%) Apportioned to [Investment Company D]	£1,226.86
Low/Mod Risk Benchmark Return Sep 2014 – July 2016	7.9%
Opportunity Cost Apportioned to [Investment Company D]	**£96.92**
Dec 2015 Redemption (61% Apportioned to [Investment Company D]	£9,290.07
Low/Mod Risk Benchmark Return Dec 2015 – Jul 2016	4%
Opportunity Cost Apportioned to [Investment Company D]	**£413.87**
Net Opportunity Cost	**£12,558.30**

Appendix C

Apportionment Calculations (in share terms)

570.575 represents the total number of shares the complainants held in the [X] Fund prior to redemptions. On 1st January 2014 these shares were re-designated into 'Run-Off Shares'. However, the number of shares remained the same so this re-designation does not affect the apportionment calculations.

Apportionment Calculations (Share Terms]	**Values**
Total Shares	**570.575**
Reasonable % Held by Complainants	39%
[Investment Company D] Share	348.051
Complainant Share	222.524
Total shares redeemed*	**204.133**
[Investment Company D] Share of Redeemed [X] Fund Shares (61%)	124.521
Complainant's Share of Redeemed [X] Fund Shares (39%)	79.612
[Investment Company D] Takes Back in Shares	**223.530**
Complainants Keep in Shares	**142.912**

*Shares redeemed on 1/9/14	16.569
*Shares redeemed on 4/12/15	162.173
*Shares redeemed on 31/8/16	25.391