



calculating redress in investment complaints

This is a quick guide to help investment advisers and other financial businesses. It explains how fair compensation is likely to be calculated if we uphold an investment-related complaint.

In assessing fair compensation our general approach is to put the consumer in the position they would be in if the business had acted correctly. What will be right for the consumer will depend on circumstances of each case. So in complaints about investment advice, we need to make sure the consumer is in the position they would be in if they had received suitable advice.

how do we decide what would have been suitable advice?

In some cases, a suitable investment may originally have been discussed as an alternative to the investment taken. In these circumstances, we may tell the business to pay compensation based on the other option(s) discussed.

Similarly, where money was transferred from another investment, we may decide to award compensation based on remaining in the original investment.

There isn't always clear evidence about exactly what other, suitable investment would have been arranged if the consumer hadn't followed the recommendation given, but we may still be able to identify some qualities those investments would have had.

In these cases, we tell the business to compare what the consumer actually got

with a benchmark that would broadly reflect those qualities – for example, a particular stock market index, an average deposit rate or a combination of these.

However, the identification of an appropriate benchmark must take account of the particular circumstances involved. There may be situations which require us to take a different approach – for example, using the Bank of England base rate.

what if the consumer has to pay an advice fee to put things right?

Where we conclude that the consumer was given unsuitable advice and where the consumer had to, or will likely have to, pay fees for further advice to put the matter right, it would be appropriate for the consumer to be repaid for the fees relating to the unsuitable advice. We take the view that a business should not keep fees that it took when it gave advice that we consider was unsuitable.

We will usually tell the business to return the fee(s) it took for unsuitable advice – together with simple interest at 8% a year.

However, where the business has already taken appropriate action to correct the situation without charging a further fee, it would not be fair to ask it to give the fee back.

Where the fee for the unsuitable advice was paid by way of commission that has been taken through charges, compensation for the investment loss should use the actual amount of money the consumer paid. No separate calculation needed in respect of the fees.

what if the consumer still has the unsuitable investment?

Working out the loss involves comparing the consumer's current position with the position they would be in if they hadn't ever had the unsuitable investment.

what if the consumer still has the unsuitable investment – but it can't be sold or surrendered?

Sometimes an investment is suspended, or there is no market for it. This means it can't be sold or surrendered for a value – or the customer might be told that, for any number of reasons, it doesn't currently hold a value. We call these "illiquid" investments.

This doesn't mean that the investment has no intrinsic value. Money might still be released from it in the future – or the circumstances might change and it might become possible to sell the investment for a value.

If we uphold a complaint about an unsuitable investment and the investment is still in force, our compensation award will normally allow for the current market value of the investment.

For an illiquid investment, we would usually say that the value of the investment should be assumed to be nil. This is because no value can be accessed, and we can't be sure about what value, if any, the consumer might be able to realise from the investment in future.

If the business pays the full compensation calculated on this basis, the consumer will have got back the fair value we think is due, so they won't be out of pocket – even if they don't ever receive anything back from the illiquid investment in future.

In these situations, if a value did later become available from the investment, we don't think it would be fair for the consumer to receive this *on top* of the fair value they've already received. So we say ownership of the illiquid investment should be transferred to the business – so that the business will receive any later value or payments from the investment.

It's up to the business to arrange this. It can be done in several ways depending on the specific liquid investment – such as using a deed of assignment or having the investment put into the business's name.

But sometimes the full fair value we think the consumer should receive is higher than the maximum amount the ombudsman can order a business to pay. In that situation, we can *recommend* that the business pay the fair value in full – but they don't have to follow this recommendation.

So if the business chooses to limit the payment to the maximum amount we can order them to pay, we think it's fair for the consumer to keep the illiquid investment. This means the consumer can use any payment which might come from it in future to top up the compensation they've received and make it up to the full fair value. Once what the consumer has received reaches the full fair value, the consumer would be required to allow ownership of the investment to be transferred to the business.

In pension cases if the business takes ownership of the illiquid investment, it should first pay a commercial value acceptable to the pension provider before arriving at the rest of the fair compensation.

what if the consumer no longer has the unsuitable investment?

If the consumer no longer has the investment, we are likely to tell the business to calculate the investment loss up to the date the consumer ceased to have the investment. This means comparing the consumer's position at that date with the position they *would* have been if they hadn't taken out the unsuitable investment.

In addition to the compensation for the investment loss – up to the date the consumer ceased to have the investment – we are likely to tell the business to pay interest on the investment loss, from that date up to the date the business actually pays the compensation. This is to reflect the fact that the consumer has been “deprived” of the compensation for the investment loss since it accrued.

Interest so paid might be subject to income tax. The law requires the business to deduct income tax at the lower rate from this interest and to pay this to HMRC.

Unless there are particular circumstances that change the situation, we're likely to set the interest rate at 8% simple per year. This takes into account what the consumer is likely to get after tax, and what it would otherwise have cost to borrow the money during the period the consumer was “deprived” of it.

what happens when income or other withdrawals have been taken?

The treatment of income and other withdrawals depends on the circumstances of the case. Our general approach is that the calculation of investment loss needs to take into account amounts paid out by way of withdrawals, distributions of capital, or income paid before tax.

The business should ensure that their calculations properly reflect the history of the investment – involving a series of calculations to allow for regular or non-regular withdrawals, as and when they were made.

For example, where an investment was designed to produce a regular income, the business shouldn't deduct all the withdrawals upfront before calculating the return. Instead, they need to make a series of calculations – each one reflecting income withdrawn at a different time.

what about other forms of redress?

Occasionally we decide that an investment should be “rescinded” – unwound back to the beginning. This might happen, for example, if the complaint involves a protection policy with little or no investment value. In these cases, we're likely to award a refund of premiums with interest (added at a rate of 8% simple a year from 1 April 1993, and at 15% simple a year before that).

what if the consumer needed life cover?

If we decide that life cover would have been appropriate for a particular consumer, this can be taken into account in the calculation by including the cost of an appropriate life assurance policy.

Where the investment included life cover and that cost can be identified, we will usually tell the financial business to take this into account – and deduct from the compensation calculation the cost of the life cover that had already been provided. This should follow the same method used for withdrawals and income payments. It is then up to the consumer to decide whether to keep the original policy or surrender it and lose the existing life cover.

how are the calculations run?

Once a business has established the relevant history of the investment, they will need to model the performance of the unsuitable investment against the suitable investment.

These calculations will normally be quite complex – and it's unlikely that they can be carried out manually. There are software packages on the market that have been specifically designed to carry out these calculations.

For businesses that receive relatively few complaints, it may be easier to pay a company that specialises in this type of service to carry out the necessary calculations. We can't recommend which company (if any) a business should work with – but the Association of Professional Financial Advisers (www.apfa.net) and the Institute of Actuaries (www.actuaries.org.uk) can give suggestions.

further information

For more general information (and sample calculations), on our approach to calculation redress in investment complaints, please see our technical note – *calculating compensation in investment complaints* – available online at: <http://www.financial-ombudsman.org.uk/publications/technical-notes/calculating-comp-investment-complaint.html>.

For more general information about the tax treatment of redress, please see our technical notes, *is compensation taxable?* available online at: www.financial-ombudsman.org.uk/publications/guidance/comp_tax.htm.

www.financial-ombudsman.org.uk

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This quick guide gives general information only. It is not a definitive statement of the law, our approach or our procedure. We may decide that fairness requires a different approach in a particular case. Our current approach may develop to reflect changing circumstances in future complaints we receive.

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