

calculating redress in investment complaints

This is a quick guide to help investment advisers and firms who receive relatively few complaints. It explains how redress is likely to be calculated if we uphold an investment-related complaint.

Where we uphold an investment-related complaint, we usually aim to put the consumer in the position they would now be in, if the firm had acted correctly. In complaints about investment advice, this is likely to be the position the consumer would now be in, if they had received suitable investment 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 *unsuitable* investment. In these circumstances, it may be appropriate to award redress based on that investment.

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

In other cases, however, there may be no conclusive evidence as to what suitable investment would have been arranged, if the consumer had not taken out the *unsuitable* investment. In these cases, unless the circumstances indicate otherwise, we usually award redress on a notional capital return, equivalent to Bank of England base rates during the relevant period + 1%.

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* now be in, if they had not taken out the unsuitable investment.

So for cases where the alternative suitable investment is known, we are likely to require the firm to calculate the difference between how the *unsuitable* investment actually performed and how the alternative *suitable* investment *would have* performed to the date the firm pays the redress.

For cases where the alternative suitable investment is *not* known, we are likely to require the firm to calculate the difference between how the *unsuitable* investment actually performed and how some alternative *suitable* investment *would have* performed to date – assuming a return on the amount invested equivalent to the Bank of England base rates during the relevant period + 1%, compounded yearly from the date of investment.

In both cases, the redress is for the investment loss. The law does not require a firm to deduct tax.

what if the consumer no longer has the unsuitable investment?

If the consumer no longer has the investment, we are likely to require the firm to calculate the investment loss up to the date the consumer ceased to have the investment – comparing the consumer’s position *at that date* with the position they *would have* been in at that date, if they had not taken out the unsuitable investment.

In addition to the redress for the investment loss – up to the date the consumer ceased to have the investment – we are likely to require the firm to pay *interest* on the investment loss, from that date up to the date the firm actually pays the redress. This is to reflect the fact that the consumer has been “deprived” of the redress for the investment loss since it accrued (when they ceased to have the investment).

Compensation for being deprived of money is potentially subject to income tax. The law requires the firm to deduct income tax at the lower rate from this interest – but not from the investment loss – and to pay this to the Inland Revenue.

Unless the circumstances indicate otherwise, we are likely to set the interest rate at 8% simple. 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. It is *not* based on what a consumer could get by investing.

what about cases where suitable advice would have been *not* to invest?

In cases where we consider that the only suitable alternative investment would have been a deposit-type account, we are likely to award redress for being “deprived” of the money at a rate equivalent to the interest paid on a suitable deposit account.

A suitable deposit account may be one that the consumer already holds – or one which would have met their requirements. It may be a fixed-term deposit.

what happens when income or other withdrawals have been taken?

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

For example, where an investment is designed to produce a regular income, the firm should not deduct *all* the withdrawals upfront before calculating the return. Instead, the firm needs to make a series of calculations, each one reflecting income withdrawn at a different time.

what about other forms of redress?

Occasionally we may require that an investment should be “rescinded” (unwound back to the beginning) – for example, if the complaint involves a protection policy with little or no investment value. In these cases, we are likely to award a refund of premiums with interest added at a rate of 8% simple.

what if life cover was required?

Where we consider that life cover would have been appropriate for the consumer concerned, this can be taken into account in the calculation of redress by including the cost of an appropriate decreasing-term assurance policy.

how are the calculations run?

Once a firm has established the relevant history of the investment, it will need to enter that data into a spreadsheet – to model the performance of the *unsuitable* investment against the *suitable* investment. These calculations will normally be quite complex and it is 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 firms 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 on their behalf.

The Association of Independent Financial Advisers (www.aifa.net) and the Institute of Actuaries (www.actuaries.org.uk) can suggest companies that offer these services. We cannot recommend which company, if any, should be engaged to carry out redress calculations.

further information

The Bank of England keeps a record of all base rate changes on its website (available as a spreadsheet at: www.bankofengland.co.uk/statistics/rates/baserate.xls).

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).

The exact tax treatment of any compensation awarded to an individual consumer is likely to depend both on the circumstances of the case and on the consumer's own wider financial and tax position. This is not something we can advise on.

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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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