

please write to Financial Ombudsman Service
South Quay Plaza
183 Marsh Wall
London
E14 9SR

switchboard 020 7964 1000
main fax 020 7964 1001

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Dear consumer

an update on our work on split capital investment trusts (“splits”)

This is a letter we are sending to all consumers who have a “splits”-related complaint with us. The purpose is to update you on what our work on “splits” involves and what the current issues are, as we focus on resolving the remaining cases.

The letter sets out the overall picture, so that you can see the wider context of the “splits” issues we are working on. We will keep in touch with you separately about specific developments relevant to your own particular case.

We have now already settled over two-thirds of the 5,700 “splits”-related complaints that we have received – involving around 500 separate financial firms. These disputes have been among the most complex that we have handled at the ombudsman service – and our “splits” work has involved a great deal of time and resource.

However, by the first part of this year we aim to have resolved over 80% of all “splits” complaints. This will leave only the most challenging disputes, which we then expect will take several more months’ intense work, before we are able to resolve those cases too.

We explain in more detail the nature of these challenges – and how we are tackling them – later in this letter. But first, it might be helpful to explain how we will be handling complaints in cases where a separate offer is made by Fund Distribution Limited (FDL).

Fund Distribution Limited (FDL)

As you will be aware, the industry regulator, the Financial Services Authority (FSA), carried out a regulatory inquiry into certain issues connected with “splits”. In December 2004 the FSA announced that a number of “splits” firms had agreed to contribute to a “distribution fund” for certain eligible “zeros” investors.

This announcement led to Fund Distribution Limited (FDL) being established. FDL is entirely separate from the Financial Ombudsman Service. FDL raised over £144m from firms, to enable it to make payments to investors who had suffered a loss in specific zero dividend

preference shares (and other financial products that invested heavily in “zeros”) and who met certain criteria set out by FDL. FDL has its own terms and conditions in relation to eligibility and time limits *etc* which are different from the ombudsman’s rules.

Following FDL’s deadline for applications last July, we understand that around 40,000 consumers applied for payments from FDL, including 500 whose cases we were already handling. FDL has not been able to make offers as quickly as it originally hoped. The last indication was that progress would be made “early in the New Year”. We liaise with FDL, but we have no influence over FDL’s timescales. We understand that consumers will have five to six weeks in which to decide whether to accept or reject any offer made by FDL.

If a consumer decides to accept an offer from FDL, FDL will require the consumer to withdraw any complaint with the ombudsman service about the investment covered by the FDL payment. This means that the ombudsman service will close that complaint, without reaching a conclusion on the merits of the dispute with the financial firm.

However, in some cases the consumer may have purchased more than one “splits” investment – not all of which are covered by FDL – or may have raised other concerns not directly related to the zero covered by FDL’s compensation arrangement. We may be able to continue investigating those aspects of a complaint, even where a consumer accepts an offer from FDL.

our work deciding cases

Whether or not consumers decide to accept offers from FDL, we will continue to need to resolve a significant number of individual “splits”-related cases – including those outside the scope of FDL’s arrangement.

“Splits” have presented us with particular challenges and complexities since our first involvement in these cases. “Splits” are investment companies quoted on the stock market. They are not regulated by the FSA and the “splits” themselves are outside our jurisdiction. So, for example, we cannot deal with complaints about the *management* of a “split”. But complaints that we have been able to consider include those where regulated financial firms, such as advisers and investment managers, have *advised* on investments in “splits” or in products including “splits”.

The next layer of complexity concerns the types of firms against which the complaints have been made. On the one hand, we have received complaints against product providers who had a high level of expertise in “splits”, as they were the firms that promoted and managed them. On the other hand, we have also received complaints against independent financial advisers (IFAs), many of whom had lower levels of knowledge and/or expertise than the product providers. This means that we need to take into account different levels of knowledge for different firms – with levels of knowledge also changing over time. For

example, an IFA could be expected to have a greater degree of knowledge about “splits” in, say, 2001 compared to 1997.

The number and variety of “splits” products is equally complex. The complaints we have received have involved over 100 split capital investment trust companies, each with different classes of share – in some case, more than five classes – which in turn generally differed in risk. A significant number of “splits” had reorganised or changed their capital structure over time. To get to the bottom of this, we established a specialist team to analyse hundreds of reports and accounts, prospectuses and stockbrokers’ monthly data – together with the marketing literature produced by product providers *etc.* As a result of this work, we have so far carried out over 3,500 risk assessments of various “splits” shares spread over a period of several years.

Where possible, we have focused on “lead cases” – selecting one or more complaints as examples of a wider group of apparently similar cases. This approach enables us to explore these “lead cases” in depth, and to draw general conclusions about many of the issues that affect the wider group of cases. This helps minimise duplication of effort for all involved, whilst ensuring that any issues specific to individual complaints can still be considered.

The majority of the “splits” complaints that we are still considering relate to one or more of these “lead cases”. The nature of these “lead cases” means that they are very strongly contested. Where we have issued assessments indicating that we are likely to uphold complaints, the firms involved have responded with vigorous and extensive representations, disputing any liability.

Typically, firms have argued that we are applying hindsight to circumstances that the firms themselves could not have foreseen – and that we are judging firms according to standards that are too high. A number of firms have employed specialist City lawyers to present and argue their cases with us. We have needed to consider very carefully wide-ranging legal arguments – and we have had to take into account the possibility of being judicially reviewed in court, should any party remain unhappy with a decision we make. Judicial review is a legal process which we would want to avoid, as it could mean substantial delays for consumers.

In many cases, firms have produced “expert reports” to comment on issues they believe are relevant to the background to these cases. We have so far received over 20 of these reports, comprising hundreds of pages of closely-argued text. The evidence presented on behalf of a firm in one case alone includes several lever-arch files of evidence. In that case, our adjudicator had concluded that the firm was liable to pay compensation. The firm challenged that conclusion and the ombudsman issued his own provisional decision, broadly agreeing with the adjudicator’s decision. The firm requested a hearing which took place and gave rise to further evidence and arguments to consider. The case now awaits the ombudsman’s final decision.

In part, this volume of material and argument reflects the complexity of the underlying issues involving “splits”. However, these complexities alone do not fully explain the nature and extent of the submissions we have received from some firms. Whilst it is right that the parties

have adequate opportunity to make necessary representations, we will, where appropriate, use our powers to set acceptable time limits for those submissions.

issues with some specific firms

The complexity of the issues in the “splits” cases – and the extent of the submissions and arguments from many firms – is set against the background of financial problems experienced by a small number of the firms involved.

Exeter Fund Managers went into administration in March 2005. As a result of this, we are not able to process any new complaints against Exeter Fund Managers. Without the administrator’s agreement or the consent of the court, we are also unable to continue work on the 300 or so complaints about the firm that we had already received.

We told the consumers involved that we were putting their cases on hold at the request of the administrator (PricewaterhouseCoopers) – and that we would let them know, if we were able to progress the complaints. Since then, these consumers have been receiving updates from the administrator. In November 2005 the administrator confirmed that it was intending to put a scheme of arrangement in place during the first quarter of 2006.

This means that at present it looks unlikely we will be able to carry out further work on complaints involving Exeter Fund Managers – and any compensation due to its customers will be a matter either for the administrator’s scheme of arrangement or for the Financial Services Compensation Scheme (the statutory “final safety net” for customers of failed investment firms).

BFS Investments plc did not participate in FDL. It has sold its business to Premier Asset Management plc but retains liabilities relating to before the business was sold. The directors of BFS decided to seek a creditors’ voluntary liquidation, at a meeting of creditors on 10 February. The indication is that there are insufficient funds to meet potential claims against BFS. Further information can be found on the Financial Services Authority’s website (www.fsa.gov.uk).

We have stopped working on BFS cases until the situation is clearer. If BFS is unable to pay compensation, then there is no value in us concluding individual cases. We will review the suspension of the cases, if it emerges that BFS does have sufficient assets to make dealing with them worthwhile. However, the likely outcome is that claims will have to be made to the Financial Services Compensation Scheme. This is a free, independent service for consumers who have lost money dealing with an authorised financial services firm that is unable, or likely to be unable, to pay claims against it. If necessary, we will pass cases direct to the Financial Services Compensation Scheme. In the meantime, we will continue to keep in touch with affected consumers.

We are aware that some other firms involved in “splits” complaints may have financial difficulties as well. In some cases, this could mean a firm might not be able to pay the consumer the required redress, if we upheld a complaint. However, if this happened, we would refer the consumer to the Financial Services Compensation Scheme.

next steps

I am sorry about the length of this letter – but I hope it is helpful in keeping you in the picture on the current issues involving “splits” complaints. Although some of these issues are complex, we are still pressing ahead and making progress on many fronts. This is why – as I explained earlier in the letter – we aim to have settled over 80% of cases by the first part of this year.

In the meantime, we remain grateful for your continued patience. We will update you again when we have more news – either about developments on your own individual case, or more generally. And we will continue to update our website, where we have a special frequently-asked-questions page on “splits” complaints.

Yours sincerely

Garry Poole
casework manager
020 7093 7001