DRN-3042876

The complaint

Mr H has a self-invested person pension scheme (SIPP) with Redswan Limited. In 2013 Mr H opened the SIPP and in early 2014 he invested in a loan note arrangement with a company I will call MN. That investment has now failed. Mr H's feels Redswan did not carry out adequate checks on the investment and that he would not have invested if it had.

What happened

Background to the complaint

Redswan

In 2013 Redswan was authorised, in relation to SIPPs, to arrange (bring about) deals in investments, to deal in investments as principal, to establish, operate or wind up a pension scheme, and to make arrangements with a view to transactions in investments. It was not authorised to advise on investments.

The introducer

In 2013 Mr H had dealings with a man I will call Mr C. Mr H's wife had also dealt with Mr C from 2007, when she had opened a SIPP with Redswan and started to invest in MN.

Mr C had been a UK authorised IFA but at the time of events in this complaint he had an unregulated business in the UK and later in the Isle of Mann.

Redswan says Mr C was not an introducer for it and that it never paid any commission to him. Redswan says Mr C was an introducer for the MN investment and introduced it to that investment.

MN and Mr J

MN was an Australian company run by a man I will call Mr J. The company described itself as a private non-regulated venture/investment company. It said it was a specialist in *"mid-cap resources, energy and mining investments".*

Redswan says at this time Mr J also ran a regulated fund in Australia and an OEIC investing in Australia available in the UK.

The investment was in the form of a loan note with a one-year fixed term. It was referred to by NM as an "Interest Bearing Loan Agreement". Money was to be loaned and repaid in Australian dollars. The minimum investment was £50,000. The annual interest rate in Mr H's case was 12%. The loan could be rolled over or renewed for a further year when the term ended.

Mr H's investment

Mr H opened the SIPP in October 2013. Mr H transferred an existing personal pension to the SIPP and invested £50,000 in the loan notes issued by NM. The investment was made in January 2014. Mr H rolled over the investment in January 2015.

The collapse of MN

In June 2015 Mr J (and his wife, apparently jointly) committed suicide and it came to light that MN had been misleading investors about its financial position. It seems likely Mr H has lost all the money he invested in MN.

In 2015 a liquidator was appointed for MN. In January 2016 the liquidator issued a report to creditors. It included a number of points including the following (which I have anonymised here and in other extracts quoted below):

> *"**2.1 Background***
> *MN was promoted as a private, non-regulated, venture capital investment company incorporated and domiciled in … Australia. Using loan proceeds of UK based creditors the Company claimed to invest in medium term Australian equity positions and provided fixed annual returns.*
>
> *From registration Mr J was a director and secretary of the company. Whilst a number of other officers were appointed throughout the Company's trading history, Mr J was the sole director since incorporation in 1981…*
>
> *The Company's primary investor base were individual loan creditors and SIPPs based prominently in the UK… The company was not publicly marketed, rather new loan creditors were sought through word of mouth and referral from existing loan creditors.*
>
> *The Company's investment focus was 'midcap' resources, energy and mining services and would invest in short to medium term Australian equity positions.*
>
> *The Company continued to trade until Mr J's death [in] June 2015…*
>
> *2.4.1 **Loan Creditors***
> *…The company utilised an Investment Liaison Manager, Mr C* [ie the Mr C I referred to above]*, based in the UK to liaise with the loan creditors and provide administrative support to the Company. The Company would issue quarterly and annual trading reports to Mr C who would distribute same to the loan creditors. Each quarterly report would disclose the total market value of assets under management by the Company and provide market commentary. The annual report would provide an abridged balance sheet an income statement in addition to the content in the quarterly reports.*
>
> *Mr J would also make biannual visits to the UK to meet loan creditors and discuss the performance of the Company.*
>
> *All parties I have corresponded with regarding the conduct of MN (including staff and contractors) advised that Mr and Mrs J were the only persons involved in the preparation and finalisation of the MN trading reports issued to Mr C…*
>
> *2.5.1 **Pre-Liquidation***
> *I understand through an interview with Mr C that the Company was originally created as a vehicle for Mr J's private wealth investments.*

Mr L began to undertake taxation and accounting services for the Company in 2003. He was responsible for preparing the FY03 financial statements which I understand were the first prepared for the Company.

After being introduced to the Company… Mr C and his wife became the first loan creditors to enter into an interest bearing loan agreement with the Company in July 2004.

From this point the number of loan creditors grew and the Company Continued reporting strong financial performances and capital returns.

Mr L sold his accounting practice, … and retired in …2007. Mr J engaged the new owners to prepare the Company's FY08 financial statements. Due to 'personality clashes' Mr J sought Mr L's services for FY09 accounts which Mr L agreed to. Mr L continued to act as MN's external accountant thereafter….

Mr L prepared the FY13 financial statements for the Company which are the last financial statements prepared for the Company.

It is clear that in comparing the results in the financial statements prepared by Mr L to the results presented in the FY13 creditor trading reports prepared by Mr J, there are large variances, with Mr J's reports overstating the assets and profits of the company loan to creditors…

3.1 Profit and Loss Summary
The table below [which I have omitted] *was prepared by Mr L based on his understanding of the Company's historical performance: …*

This illustrates significant losses in all years [ie FY03 to FY13], which I consider would have deteriorated further in FY14 and FY15 as the interest expense increased. The results presented above show that while in most years the Company made a small trading profit, net losses were reported in all years due to significant commissions and interest expense attributable to the loans from creditors. This indicates the MN never generated sufficient revenue in any trading year from FY03 to FY13 to service loan agreements.

4.2 Liquidator's opinion as to the failure of the Company

Based on my preliminary investigation undertaken to date, it is my view that the failure of the Company was attributable to the following:

> *Poor performance of investments made by the Company;*
>
> *The Company entered into loan agreements with repayment terms (including high fixed interest rates) which greatly exceed its trading revenue and accordingly the Company's ability to repay the same;*
>
> *Falsified financial reports that did not represent an accurate financial position of the Company;*
>
> *Fraudulent transactions entered into the Company (further details are outlined in section 7 of this report);*
>
> *The death of the Company's sole director and secretary Mr J [in] June 2015.*

7.1.1 Falsified financial statements

It appears the Company has been falsifying financial reports to loan creditors since 2003 to misrepresent the trading performance and asset position to current and potential loan creditors. A comparison of the financial statements provided by Mr L and trading reports provided by Mr J show significant differences….

A historical comparison of the two versions of accounts below [ie those prepared by Mr L and those prepared by the Company] illustrates that the financial performance and position of the company has been incorrectly reported from the outset of trading in 2003….

7.1.4 Other accusations
…Mr C, Mr L [and others] have advised me that they believed that the business of the Company was effectively a 'Ponzi' scheme paying returns to creditors from new capital paid to the Company by new or existing creditors. Whilst I have not found conclusive evidence to support this statement my investigation to date indicate a strong likelihood of such activity. In particular, the use of falsified financial statements and poor performance of the Company since commencement of operations supports the notion of a Ponzi scheme.

Further, during my interviews and discussions with the Company's personnel and representatives, the following anecdotal accusations of misconduct have been made:

> *Mr C claimed that during a visit to Australia in 2006 to conduct due diligence on the Company, Mr J arranged a meeting with a man purporting to be the Company's accountant, Mr L. During Mr C's visit to Australia in late 2015 he met Mr L and both men realised that they had not met each other previously and Mr J had allegedly engaged an imposter to act as Mr L in the earlier 2006 meeting.*
>
> *Mr C claims that the false financial statements issued to him by Mr J were produced on false letterheads with incorrect contact details for Mr L and incorrect financial figures.*

It is claimed that the above conduct was an attempt by Mr J to keep Mr L separated from Mr C so that Mr C never knew the true financial position of the Company as understood by Mr L."

The complaint to Redswan

Mr H complained to Redswan. He thought it had failed to make proper checks on MN.

Redswan did not uphold Mr H's complaint. It says it is not the SIPP operator's responsibility to assess the suitability of an investment – this is for any appointed financial adviser. It says it did however require Mr H to confirm he understood the risks in 2014 when he wanted to invest in MN. It thinks it acted reasonably in the circumstances.

The complaint to the Financial Ombudsman Service

Mr H referred his complaint to the Financial Ombudsman Service, and it was considered by one of our investigators. In his view:

- Redswan was under an obligation to carry out due diligence.
- The investment was made on a direct basis so there was no checking needed in relation to any adviser.

- Redswan did not carry out due diligence checks on the investment in 2007 when it first made investment into MN (after SIPP had become regulated). However this did not cause Mr H's loss because the investment would still have been made if reasonable checks had been made.
- Although Redswan did start to revise the warnings it required investors to sign when renewing their MN investments in 2014 this was not linked to the fraud which came to light soon after.

Mr H did not agree with the investigator and asked for his complaint to be reviewed by an ombudsman.

Redswan also did not agree with the investigator. Its points include:

- It is not fair and reasonable to use the specifics of later guidance to criticise earlier practices. The issue must be whether Redswan's approach to due diligence at the time of Mr H's investment in MN was reasonable and in compliance with the Principles. In Redswan's view it was.

- At the time of Mr H's initial investment Redswan knew the investment had existed for a number of years and those investors who wanted it had been repaid. Loan notes are not unusual investments for a SIPP.

- MN provided a signed agreement demonstrating good title and proof of the debt.

- Taken together the information held on MN constituted due diligence.

- It is not reasonable to expect it to take the additional steps Mr H has suggested.

- The FCA did consider and approve its MN file in 2014. It looked only at that file. It did not find any failings. It only made recommendations for further improvements.

- The FCA's approval is strong evidence that it was acting in accordance with its regulator's expectations.

- Redswan agrees with the adjudicator that even if it had performed further due diligence it would not have revealed anything that would have prevented Mr H from investing. Further due diligence would only have confirmed:
    - The company did exist.
    - The company and the director had a long trading history.
    - There was an appointed accountant.
    - The return was reasonable given the risks of the investment.
    - The business activities proposed by MN were not unusual.
    - There was no information in that might have indicated that Mr J was committing fraud or misrepresenting the company's true financial position.

- Mr J admitted in his suicide note that he had falsely represented the position of the company and that only he and his wife were aware of the true financial position. The true position is not something Redswan would have been able to uncover with a reasonable level of due diligence.

- So any failure by Redswan (and it does not agree that there has been any) did not cause Mr H's loss – that was caused by Mr J's sophisticated long running and carefully concealed fraud.

my provisional decision

The complaint was referred to me and I issued a provisional decision. I first explained the basis on which I would consider what was fair and reasonable in all the circumstances of the complaint and the relevant considerations I am required to take into account. I explained why I considered the Principles for Business and various publications issued by the regulator to be relevant. I explained why I thought the complaint should be upheld.

In light of my provisional findings, I needed to consider what would amount to fair compensation for Mr H. I therefore arranged for the investigator to send a questionnaire to Mr H to obtain further information so I could form a clearer view on what she would have done if she had not invested in the MN loan notes.

responses to the provisional decision

Mr H agreed with the provisional decision. He also provided the further information the investigator asked for.

Redswan did not agree with the provisional decision. In summary its points include:

- The provisional conclusion is not fair and reasonable and is open to challenge by way of judicial review on the grounds of irrationality.

- The MN investment is not anomalous or suspicious. The analysis in the provisional decision is flawed as it proceeds from this erroneous starting point.

- Loans to private companies are common place in SIPPs. Redswan's due diligence should be considered in that context.

- The views in the provisional decision are entirely driven by hindsight.

- Redswan undertook reasonable due diligence on the MN investment and complied with any duties owed under the regulator's rules including complying with the Principles.

- None of that due diligence could reasonably have raised any suspicions. Nor could any publicly available information about MN's or its owner Mr J.

- Redswan's due diligence appeared entirely to support the legitimacy of the investment.

- The FCA reviewed Redswan's due diligence on MN and found it was satisfactory. It is irrational for the ombudsman to disregard the FCA's findings and come to a contradictory view based *"purely upon generic regulatory guidance".*

- The suggestion that a SIPP operator's duty extends to instructing local accountants and lawyers to investigate every proposed investment is unrealistic. Such a duty would be absurdly onerous and fly in the face of commercial reality.

- Even if Redswan had acted differently there is no evidence the fraud would have been discovered. It is more likely that Mr J would have fabricated whatever evidence was needed to satisfy local agents.

- In the absence of evidence that further due diligence would have uncovered the fraud or otherwise prevented the investment, the conclusions in the provisional decision

are irrational and not fair and reasonable.

- The issue should be addressed on the balance of probabilities and on that basis the conclusion should be that Redswan did not cause the loss.

- Redswan took reasonable steps to draw the risks of the investment to Mr H's attention. He chose to proceed in any event. Even if Redswan had taken further steps or issued further warnings the investment would have gone ahead in any event. The decision to invest was not based on any due diligence or lack of due diligence by Redswan.

- The provisional decision does not refer to the risk awareness statement it introduced in 2013. The statement first flagged that the investment was heavily geared and later specified the precise borrowing ratio of MN. Mr H continued to roll over his investment despite these warnings. The provisional decision fails to give any weight to these warnings. It is not fair to ignore Redswan's efforts to bring risks to Mr H's attention.

- The circumstances of this case are very different to the *Berkeley Burke SIPP Administration v Financial Ombudsman Service* [2018] EWHC 2878 (Admin) case. In that complaint the SIPP operator carried out no checks. Had it done so problems would quickly have been discovered. Redswan did make checks and the problems were carefully concealed and could not reasonably have been discovered.

- Also, there was no challenge in the *Berkeley Burk*e case on the grounds of irrationality – a point remarked upon by the judge. In this complaint a final decision in line with the provisional decision would be irrational. And the outcome of the challenge would be different to the *Berkeley Burke* decision.

- Redswan does not accept that it was at fault but notes Mr H's comments about fixed rate investing. Any redress should take that into account and be calculated at fixed rate bond deposit rates.

Further submissions by Redswan following the judgment of the High Court in Adams v Options SIPP:

- The court's decision in *Adams v Options SIPP* (formerly known as Carey) [2020] EWHC 1229 (Ch) is highly relevant and supportive of Redswan's position.

- The judge said the contract had a significant role to play in establishing the duties the firm owed to the customer.

- The judge noted that Carey's application form made it clear Carey had not provided advice in relation to the SIPP, and that Mr Adams understood the role the firm would be performing – Carey was simply providing a mechanism for the transfer of pension funds and subsequent investment of those funds. It was not advising on either the SIPP or the underlying funds. It was solely acting on the basis of Mr Adams' instructions given as a result of an investment decision made by Mr Adams.

- The judge concluded that the provisions in the contractual documents did not confer a positive obligation on Carey to choose particular investments or refuse to implement investment instructions because it was of the view that the member had made an unsuitable choice.

- The FCA intervened in the case. The judge rejected its submissions. He held that the key factor in determining the scope of the SIPP operator's obligations is the contract between the parties.

- The contractual position in this complaint is very similar to the position of Mr Adams and Carey. Redswan made it absolutely clear, and Mr H must have understood, that Redswan was not providing advice on the investments proposed for his SIPP and the choice of investment was entirely his responsibility.

- The documentation shows Redswan made it clear to Mr H from the outset, and she accepted, that investment decisions were entirely for him with the assistance of any appointed financial adviser. It cannot be fair, reasonable or rational in light of this and the judge's analysis and comments in *Adams v Options SIPP*, to find that Redswan could only have complied with its duties under the COBS rules by:

    - refusing to accept the MN investment, or
    - undertaking extensive due diligence into the investment including appointing local agents and uncovering Mr J's fraud.

- At its heart this complaint concerns the same inconsistency identified in *Adams v Options SIPP* between the contract Mr H entered into and the duties he now suggests Redswan owed to him. In line with the court's analysis, the ombudsman must conclude that the extent of the duties must be construed by reference to the contract and there can be no suggestion that Redswan is liable on the basis of any perceived failings of due diligence in relation to an investment decision that was entirely Mr H's responsibility.

- The court accepted in *Adams v Options SIPP* that a SIPP operator can properly perform a limited role where the scope of the role has been made clear in the contractual documentation. In such circumstances there is no obligation upon the firm to undertake due diligence on an investment proposed by the SIPP member for inclusion in the SIPP.

- Redswan was clear about the role it was performing, that it was the member's sole decision as to whether or not to invest, and that Redswan could not be held responsible for the member's investment decision. So, the ombudsman should follow the court's conclusion that the SIPP operator is not obliged to go further than required by the contractual documents. The conclusion in the provisional decision is entirely at odds with the analysis in *Adams v Options SIPP*.

- In *Adams v Options SIPP* the judge said:

    - *"The FCA has the power under s.139A FSMA to give "guidance consisting of such information and advice as it considers appropriate" concerning the operation of parts of FSMA or rules made by the FCA among other things. There is no express provision in FSMA which provides a right to an investor to make a claim based on an alleged breach of the guidance issued by the FCA from time to time. This is in direct contrast to the specific right contained in section 138D(2) to seek damages for breach of rules made by the FCA, such as the COBS Rules. The Thematic Review cannot properly be described as a set of rules or even guidance and in my judgment cannot give rise to a claim for failing to follow the suggestions which it makes. Nor in my judgment is it a proper aid to statutory construction of the COBS Rules which must be construed in accordance with the usual principles of construction."*

- In light of the judge's analysis, it is clear that too much weight was placed on the various regulatory publications in the provisional decision. An unfair and unreasonable approach was taken in placing reliance upon publications that post-date the events in question.

- In *Adams v Options SIPP*, the judge appeared (at paragraph 23) to place reliance upon the fact that the regulator had visited Carey to look at its processes in relation to unregulated introducers. By analogy, in this case the ombudsman should place greater weight on the fact that the regulator visited Redswan and specifically reviewed its due diligence in relation to the M investment and found it to be satisfactory.

- As Redswan has previous argued, it's unfair, unreasonable and irrational for the ombudsman to disregard the regulator's findings in relation to specific due diligence and reach a contradictory view based on generic industry wide regulator publications.

- *Adams v Options SIPP* makes it clear that the contemporaneous views of the regulator on the specific activities undertaken by the relevant SIPP operator are a highly relevant consideration in assessing whether the firm complied with its duties.

- The ombudsman is required to take into account relevant law and regulations in coming to a decision on a complaint. If the ombudsman chooses to depart from the law in determining what is fair and reasonable in all the circumstances, he must give his reasons why.

- If the ombudsman proposes to depart from the principles set out in *Adams v Options SIPP,* he is obliged to provide an explanation for the basis on which he is doing so.

- The fairness, reasonableness and rationality of any departure from the principles set out in *Adams v Options SIPP* may need to be considered by the court in judicial review proceedings in due course.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

In considering what's fair and reasonable in all the circumstances of this complaint, I've taken into account relevant law and regulations; regulators rules, guidance and standards; codes of practice; and, where appropriate, what I consider to be good industry practice at the relevant time.

Relevant considerations

The Principles

In my view, the FCA's Principles for Businesses are of particular relevance to my decision.

The Principles for Businesses, which are set out in the FCA's handbook "*are a general statement of the fundamental obligations of firms under the regulatory system"* (PRIN 1.1.2G). And, I consider that the Principles relevant to this complaint include Principle 2, 3 and 6 which say:

> *"Principle 2 – Skill, care and diligence – A firm must conduct its business with due skill, care and diligence.*
>
> *Principle 3 – Management and control – A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems*
>
> *Principle 6 – Customers' interests – A firm must pay due regard to the interests of its customers and treat them fairly.*

I've carefully considered the relevant law and what this says about the application of the FCA's Principles. In *R (British Bankers Association) v Financial Services Authority* [2011] EWHC 999 (Admin) ("BBA") Ouseley J said at paragraph 162:

> *"The Principles are best understood as the ever present substrata to which the specific rules are added. The Principles always have to be complied with. The specific rules do not supplant them and cannot be used to contradict them. They are but specific applications of them to the particular requirement they cover. The general notion that the specific rules can exhaust the application of the Principles is inappropriate. It cannot be an error of law for the Principles to augment specific rules."*

And at paragraph 77 of BBA Ouseley J said:

> *"Indeed, it is my view that it would be a breach of statutory duty for the Ombudsman to reach a view on a case without taking the Principles into account in deciding what would be fair and reasonable and what redress to afford. Even if no Principles had been produced by the FSA, the FOS would find it hard to fulfil its particular statutory duty without having regard to the sort of high level Principles which find expression in the Principles, whoever formulated them. They are of the essence of what is fair and reasonable, subject to the argument about their relationship to specific rules."*

In (*R (Berkeley Burke SIPP Administration Ltd) v Financial Ombudsman Service* [2018] EWHC 2878) ("BBSAL"), Berkeley Burke brought a judicial review claim challenging the decision of an ombudsman who had upheld a consumer's complaint against it. The ombudsman considered the FCA Principles and good industry practice at the relevant time. He concluded that it was fair and reasonable for Berkeley Burke to have undertaken due diligence in respect of the investment before allowing it into the SIPP wrapper, and that if it had done so, it would have refused to accept the investment. The ombudsman found Berkeley Burke had therefore not complied with its regulatory obligations and had not treated its client fairly.

Jacobs J, having set out some paragraphs of the BBA judgment including paragraph 162 set out above, said (at paragraph 104 of BBSAL):

> *"These passages explain the overarching nature of the Principles. As the FCA correctly submitted in their written argument, the role of the Principles is not merely to cater for new or unforeseen circumstances. The judgment in BBA shows that they are, and indeed were always intended to be, of general application. The aim of the Principles- based regulation described by Ouseley J. was precisely not to attempt to formulate a code covering all possible circumstances, but instead to impose general duties such as those set out in Principles 2 and 6."*

The BBSAL judgment also considers section 228 of Financial Services & Markets Act 2000 ("FSMA") and the approach an ombudsman is to take when deciding a complaint. The judgment of Jacobs J in BBSAL upheld the lawfulness of the approach taken by the

ombudsman in that complaint, which I have described above, and included the Principles and good industry practice at the relevant time as relevant considerations that were required to be taken into account.

I've considered the High Court decision in *Adams v Options SIPP*. Since that decision the Court of Appeal has handed down its judgment following its consideration of Mr Adams' appeal. I've taken both judgments into account when making this decision.

I note that the Principles for Businesses did not form part of Mr Adam's pleadings in his initial case against Options SIPP. And, HHJ Dight did not consider the application of the Principles to SIPP operators in his judgment in the High Court. The Court of Appeal also did not consider to the application of the Principles to SIPP operators. So, neither of these judgments provide any assistance with the application of the Principles for Businesses, and in particular, they say nothing about how the Principles apply to an ombudsman's consideration of a complaint.

As outlined above, Ouseley J in the BBA case held that it would be a breach of statutory duty if I were to reach a view on a complaint without taking the Principles into account in deciding what is fair and reasonable in all the circumstances of a case. And, Jacobs J adopted a similar approach to the application of the Principles in BBSAL. I am therefore satisfied that the FCA's Principles are a relevant consideration that I must take into account when deciding this complaint.

COBS 2.1.1R

The rule says:

> "*A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).*"

I acknowledge that COBS 2.1.1R overlaps with certain of the Principles, and that this rule was considered by HHJ Dight in the High Court case. Mr Adams pleaded that Options SIPP owed him a duty to comply with COBS 2.1.1R, a breach of which, he argued, was actionable pursuant to section 138(D) of FSMA ("the COBS claim"). HHJ Dight rejected this claim and found that Options SIPP had complied with the best interests rule on the facts of Mr Adams' case.

The Court of Appeal rejected Mr Adams' appeal against HHJ Dight's dismissal of the COBS claim on the basis that Mr Adams was seeking to advance a case that was radically different to that found in his initial pleadings. The Court found that this part of Mr Adam's appeal was an attempt to put forward an entirely new case rather a challenge to the grounds on which HHJ Dight had dismissed the COBS claim.

Overall, I am satisfied that COBS 2.1.1R remains a relevant consideration – but that it needs to be considered alongside the remainder of the relevant considerations, and within the factual context of Mr H's case.

I note there are significant differences between the breaches of COBS 2.1.1R alleged by Mr Adams and from the issues in Mr H's complaint. The breaches were summarised in paragraph 120 of the Court of Appeal judgment. In particular, as HHJ Dight noted, he was not asked to consider the question of due diligence before Options SIPP agreed to accept the store pods investment into its SIPP. The facts of the case were also different.

So I have considered COBS 2.1.1R - alongside the remainder of the relevant considerations, and within the factual context of Mr H's case, including Redswan's role in the transaction. However, I think it is important to emphasise that I must determine this complaint by reference to what is, in my opinion, fair and reasonable in all the circumstances of the case. And, in doing that, I am required to take into account relevant considerations which include: law and regulations; regulators' rules, guidance and standards; codes of practice; and, where appropriate, what I consider to have been good industry practice at the relevant time. This is a clear and relevant point of difference between this complaint and the judgments in *Adams v Options SIPP*. That was a legal claim which was defined by the formal pleadings in Mr Adams' statement of case.

The regulatory publications

The FCA (and its predecessor, the FSA) has issued a number of publications which remind SIPP operators of their obligations and set out how they might achieve the outcomes envisaged by the Principles.

- The 2009 and 2012 thematic review reports.
- The October 2013 finalised SIPP operator guidance.
- The July 2014 "Dear CEO" letter.

I have set out below what I consider to be the key parts of the publications (although I have considered them in their entirety).

The 2009 Thematic Review Report

The 2009 report included the following statement:

> *"We are very clear that SIPP operators, regardless of whether they provide advice, are bound by Principle 6 of the Principles for Businesses ('a firm must pay due regard to the interests of its customers and treat them fairly') insofar as they are obliged to ensure the fair treatment of their customers. COBS 3.2.3(2) states that a member of a pension scheme is a 'client' for COBS purposes, and 'Customer' in terms of Principle 6 includes clients. It is the responsibility of SIPP operators to continuously analyse the individual risks to themselves and their clients, with reference to the six TCF consumer outcomes…*
>
> *We agree that firms acting purely as SIPP operators are not responsible for the SIPP advice given by third parties such as IFAs. However, we are also clear that SIPP operators cannot absolve themselves of any responsibility, and we would expect them to have procedures and controls, and to be gathering and analysing management information, enabling them to identify possible instances of financial crime and consumer detriment such as unsuitable SIPPs. Such instances could then be addressed in an appropriate way, for example by contacting the member to confirm the position, or by contacting the firm giving advice and asking for clarification. Moreover, while they are not responsible for the advice, there is a reputational risk to SIPP operators that facilitate the SIPPs that are unsuitable or detrimental to clients.*
>
> *Of particular concern were firms whose systems and controls were weak and inadequate to the extent that they had not identified obvious potential instances of poor*

advice and/or potential financial crime. Depending on the facts and circumstances of individual cases, we may take enforcement action against SIPP operators who do not safeguard their customers' interests in this respect, with reference to Principle 3 of the Principles for Business ('a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems').

The following are examples of measures that SIPP operators could consider, taken from examples of good practice that we observed and suggestions we have made to firms:
[…]

- *Being able to identify anomalous investments, e.g. unusually small or large transactions or more 'esoteric' investments such as unquoted shares, together with the intermediary that introduced the business. This would enable the firm to seek appropriate clarification, e.g. from the client or their adviser, if it is concerned about the suitability of what was recommended.*

…"

The 2012 Thematic Review Report

The 2012 report included the following:

> *"Principle 2 of the Principles for Business, states a 'a firm must conduct its business with dues skill, care and diligence'.*
>
> *Some SIPP operators were unable to demonstrate that they are conducting adequate due diligence on the investments held by members or the introducers who use their schemes, to identify potential risks to their members or to the firm itself. In some firms this was made worse by over-reliance on third parties to conduct due diligence on behalf of the operator. In some cases this resulted in taxable investments being inadvertently held, and monies in potentially fraudulent investments."*

The 2013 finalised guidance

In the October 2013 finalised SIPP operator guidance, the FCA states:

> *"This guide, originally published in September 2009, has been updated to give firms further guidance to help meet the regulatory requirements. These are not new or amended requirements, but a reminder of regulatory responsibilities that became a requirement in April 2007.*
>
> *All firms, regardless of whether they do or do not provide advice must meet Principle 6 and treat customers fairly. COBS 3.2.3(2) is clear that a member of a pension scheme is a "client" for SIPP operators and so is a customer under Principle 6. It is a SIPP operator's responsibility to assess its business with reference to our six TCF consumer outcomes."*

The October 2013 finalised SIPP operator guidance also set out the following:

> ***"Relationships between firms that advise and introduce prospective members and* SIPP operators**
>
> *Examples of good practice we observed during our work with SIPP operators include the following:*

- *Confirming, both initially and on an ongoing basis, that: introducers that advise clients are authorised and regulated by the FCA; that they have the appropriate permissions to give the advice they are providing; neither the firm, nor its approved persons are on the list of prohibited individuals or cancelled firms and have a clear disciplinary history; and that the firm does not appear on the FCA website listings for un- authorised business warnings.*
- *Having terms of business agreements that govern relationships and clarify the responsibilities of those introducers providing SIPP business to a firm.*
- *Understanding the nature of the introducers' work to establish the nature of the firm, what their business objectives are, the types of clients they deal with, the levels of business they conduct and expect to introduce, the types of investments they recommend and whether they use other SIPP operators. Being satisfied that they are appropriate to deal with.*
- *Being able to identify irregular investments, often indicated by unusually small or large transactions; or higher risk investments such as unquoted shares which may be illiquid. This would enable the firm to seek appropriate clarification, for example from the prospective member or their adviser, if it has any concerns.*
- *Identifying instances when prospective members waive their cancellation rights and the reasons for this.*

Although the members' advisers are responsible for the SIPP investment advice given, as a SIPP operator the firm has a responsibility for the quality of the SIPP business it administers.

Examples of good practice we have identified include:

- *conducting independent verification checks on members to ensure the information they are being supplied with, or that they are providing the firm with, is authentic and meets the firm's procedures and are not being used to launder money*
- *having clear terms of business agreements in place which govern relationships and clarify responsibilities for relationships with other professional bodies such as solicitors and accountants, and*
- *using non-regulated introducer checklists which demonstrate the SIPP operators have considered the additional risks involved in accepting business from non- regulated introducers*

In relation to due diligence the October 2013 finalised SIPP operator guidance said:

"Due diligence

Principle 2 of the FCA's Principles for Businesses requires all firms to conduct their business with due skill, care and diligence. All firms should ensure that they conduct and retain appropriate and sufficient due diligence (for example, checking and monitoring introducers as well as assessing that investments are appropriate for personal pension schemes) to help them justify their business decisions. In doing this SIPP operators should consider:

- *ensuring that all investments permitted by the scheme are permitted by HMRC, or where a tax charge is incurred, that charge is identifiable, HMRC is informed and the tax charge paid*
- *periodically reviewing the due diligence the firm undertakes in respect of*

the introducers that use their scheme and, where appropriate enhancing the processes that are in place in order to identify and mitigate any risks to the members and the scheme

- *having checks which may include, but are not limited to:*
    - *ensuring that introducers have the appropriate permissions, qualifications and skills to introduce different types of business to the firm, and*
    - *undertaking additional checks such as viewing Companies House records, identifying connected parties and visiting introducers*
- *ensuring all third-party due diligence that the firm uses or relies on has been independently produced and verified*
- *good practices we have identified in firms include having a set of benchmarks, or minimum standards, with the purpose of setting the minimum standard the firm is prepared to accept to either deal with introducers or accept investments, and*
- *ensuring these benchmarks clearly identify those instances that would lead a firm to decline the proposed business, or to undertake further investigations such as instances of potential pension liberation, investments that may breach HMRC tax- relievable investments and non-standard investments that have not been approved by the firm"*

The 2014 Dear CEO letter

The July 2014 *"Dear CEO"* letter provides a further reminder that the Principles apply and an indication of the FCA's expectations about the kinds of practical steps a SIPP operator might reasonably take to achieve the outcomes envisaged by the Principles.

The *"Dear CEO"* letter also sets out how a SIPP operator might meet its obligations in relation to investment due diligence. It says those obligations could be met by:

- *Correctly establishing and understanding the nature of an investment.*
- *Ensuring that an investment is genuine and not a scam, or linked to fraudulent activity, money-laundering or pensions liberation.*
- *Ensuring that an investment is safe/secure (meaning that custody of assets is through a reputable arrangement, and any contractual agreements are correctly drawn-up and legally enforceable).*
- *Ensuring that an investment can be independently valued, both at point of purchase and subsequently.*
- *Ensuring that an investment is not impaired (for example that previous investors have received income if expected, or that any investment providers are credit worthy etc).*

I acknowledge that the 2009 and 2012 reports and the *"Dear CEO"* letter are not formal *"guidance"* (whereas the 2013 finalised guidance is). However, the fact that the reports and *"Dear CEO"* letter didn't constitute formal guidance doesn't mean their importance should be underestimated. They provide a *reminder* that the Principles for Businesses apply and are an indication for the kinds of things a SIPP operator might do to ensure it is treating its customers fairly and produce the outcomes envisaged by the Principles. In that respect, the publications which set out the regulator's expectations of what SIPP operators should be doing also go some way to indicate what I consider amounts to good industry

practice at the time, and I am therefore satisfied it is appropriate to take them into account.

Like the ombudsman in the Berkeley Burke case, I don't think the fact that some of the publications post-date the original investment in this case means the examples of good industry practice they provide were not good practice at the time of the events. Although the Dear CEO letter was published after the original investment in 2014 must of the information had been published before the original investment and in any event the Principles that underpin all the Regulator's comments existed throughout, as did the obligation to act in accordance with those Principles.

It is also clear from the text of the 2009 and 2012 reports (and the *"Dear CEO"* letter published in 2014) that the regulator expected SIPP operators to have incorporated the recommended good industry practices into the conduct of their business already. So, whilst the regulator's comments suggest some industry participants' *understanding* of how the standards shaped what was expected of SIPP operators changed over time, it is clear the standards themselves had not changed.

It is important to bear in mind that the reports, Dear CEO letter and guidance gave non-exhaustive examples of good industry practice. They did not say the suggestions given were the limit of what a SIPP operator should do. As the annex to the *"Dear CEO"* letter notes, what should be done to meet regulatory obligations will depend on the circumstances.

It's also important to keep in mind the judgments in *Adams v Options* did not consider the regulatory publications in the context of considering what is fair and reasonable in all the circumstances bearing in mind various matters including the Principles (as part of the regulator's rules) or good industry practice.

Overall, in determining this complaint I need to consider whether Redswan complied with its regulatory obligations as set out by the Principles to act with due skill, care and diligence, to take reasonable care to organise its business affairs responsibly and effectively, to pay due regards to the interests of its customers (in this case Mr H), to treat them fairly, and to act honestly, fairly and professionally. And, in doing that, I'm looking to the Principles and the publications listed above to provide an indication of what Redswan could have done to comply with its regulatory obligations and duties.

The relationship between Mr H and Redswan

Redswan says that, consistent with the decision in *Adams v Options*, the regulatory obligations must be read in the light of the contract between the customer and the SIPP provider.

Redswan says Mr H signed an application form on that included:

> *"I have been provided with a copy of the Plan's Key Features & Introductory Guide. I have been given the opportunity to ask questions if there is anything I do not understand."*

And

> *"I hereby acknowledge that I have neither sought nor received any advice from Redswan… as to the suitability of the Plan to my personal circumstances. I also understand that such together with all investment / other decisions, rest either with myself and / or (where appointed) my financial adviser and any separate agreement I have with them governs the services they provide in respect of my membership of the Plan."*

Redswan also says the Key Features & Introductory Guide included:

> *"Different investments have different levels of risk associated with them. You, together with your financial adviser (if any), are responsible for ensuring they meet your and your beneficiaries' requirements."*

I accept that Redswan made clear to Mr H that it was not giving him financial advice. Their relationship was non-advisory or execution only as in the *Adams v Options* case

There is no suggestion or evidence that Redswan advised Mr H in relation to the MN investment.

However, I don't think the point that Redswan had a limited role as an execution only SIPP provider absolved Redswan of its regulatory obligations to treat customers fairly when deciding whether to allow investment into the MN loan notes. I do not say that Redswan had an obligation to advise Mr H or to consider the suitability of the investment for Mr H. It was however required, in its role as an execution only SIPP provider, to consider whether it was an appropriate investment to make within its SIPP.

In my provisional decision I said:

> *"Overall in the circumstances of this complaint, I think Redswan's duty as a SIPP operator was to treat Mr H fairly and to act in his best interests and its duties included taking reasonable steps to at least:*
>
> - *ensure that it understood how the investment would operate;*
> - *ensure that it did not accept into a SIPP an investment that is likely to give rise to tax liabilities within the scheme (such as unauthorised payments);*
> - *ensure that a proposed underlying investment for a SIPP is a genuine asset and is not part of a fraud or a scam or pensions liberation..."*

When I said that I was referring to Redswan as an execution only SIPP operator and it remains my view that it was under those obligations in that limited capacity.

I note that Redswan has said:

> *"back in 2007 we consider that checking the status of the investment and, correctly confirming that it was an investment that was allowed by HMRC rules complied with our obligations under the Principles at the time.*
>
> *In any event, however, in checking to see whether the investment was permitted by HMRC's rules we reviewed the investment prospectus and so familiarised ourselves with the features of the investment. We therefore allowed ourselves an opportunity to understand the nature of the investment and to identify any obviously inaccurate or concerning information."*

This indicates that Redswan – in broad terms – considers that it did carry out checks that were in line with the steps I have referred to above.

what due diligence checks did Redswan carry out on MN?

In my provisional decision I said:

One of our investigators asked Redswan:

> *"What due diligence did you carry out on MN (and the loan, for example the purpose) when [the consumer] requested the investment? For example, did you carry out any checks on the directors (such as whether they had criminal records), did you ask what the loan would be used for?"*

Redswan replied as follows:

> *"At the time [the consumer] made his investment, our obligation as SIPP operator was simply to ensure that the investment choice did not contravene HMRC rules, which as a loan note it did not.*
>
> *In any event, we note there is no comparable entity in Australia to the UK's Companies House and there were therefore no publicly accessible accounts we could obtain in relation to MN.*
>
> *Mr J, sole director of MN, was executive chairman and founder of [name asset management company given] and a search of the internet revealed he was a well-respected, regulated investment professional. Further, [that company] operated a UK regulated OEIC, [name given]. No publicly available information on Mr J could reasonably have raised any suspicions regarding either his competence and honesty or the legitimacy of the investment. In addition, and Australian Tax Office ruling was obtained in 2007 for an exemption from Australian withholding tax on the MN return. The fact that Mr J was apparently open with the tax authorities regarding MN's trading activities further reinforced the impression there was nothing untoward about Mr J or MN.*
>
> *Regarding the purpose of the loan, I refer you to clause 3 of [the consumer's] signed loan agreement. The funds provided were to be used primarily in the acquisition of shares/equities solely in the Australian financial markets, as deemed suitable by MN.*
>
> *We note that the FCA has considered and approved our file on the MN investment. We had a thematic review visit in 2014, as did other SIPP operators. As part of the review the FCA reviewed our MN files and concluded as follows:*
>
> > *<u>"Due Diligence on investments</u>*
> >
> > *You advised us that the firm had not taken on any new non-standard investments other than continuing investments in a single investment: A private Australian company issuing Loan Notes.*
> >
> > *Our assessment of the due diligence on this investment did not find serious failings although it was agreed you will consider retaining original signed copies of contract notes in the future, so that the scheme can produce these if needed."*
>
> *We also emphasise that, even if there had been an obligation on this firm to undertake due diligence on the investment in 2007 and even had the firm undertaken such due diligence, we would have found nothing to suggest that the investment was unsuitable to be held in a SIPP or any suggestion that*

anything untoward was taking place. It now appears that the sole director of MN, Mr J, perpetrated a long running and carefully concealed fraud. In a letter written 15 June to "the relevant authorities" Mr J explained:

> *"…only myself and my wife have known the actual financial position of the company. I have falsely represented the position to all my consultants, associates and investors…*
>
> *…I alone have produced all of the quarterly reports, annual accounts etc to a large extent falsely promoting the company's financial position."*

The documents produced by Mr J and provided to this firm and to investors were professional and convincing. They provided no clue that anything untoward was occurring in relation to MN. No amount of due diligence undertaken by the firm would have uncovered the fraud that Mr J was apparently carrying out. If there has been a failure on the part of this firm to comply with its obligations in relation to due diligence, which … is not accepted, this has not caused Mr H's loss in any event. Had due diligence been carried out it would have revealed any concerns regarding MN and Mr H's investment would have proceeded in any event."

As explained above I disagree with Redswan about whether or not it should have carried out due diligence checks on the investment. The issues are therefore:

Were the checks made by Redswan reasonable in the circumstance? Before that there is a preliminary point about whether I [am] bound by or otherwise obliged to come to the same conclusion on this point as the FCA? If I am not, and I think the checks were [not] reasonable in the circumstances, I need to consider whether reasonable checks would reasonably have led to a different outcome and if so what outcome.

When responding to my provisional decision Redswan has referred to some additional checks in made from 2010 which I mention below.

am I bound by the FCA's conclusion about Redswan's due diligence?

In my provisional decision I said:

> *I set out above the things I am required to take into account in deciding what is fair and reasonable in all the circumstances. One of those things is guidance issued by the regulator. I do not consider the view of the FCA supervisor who inspected Redswan's due diligence to be "guidance" I am required to take into account. But even if it is I am only required to take relevant guidance into account I am not bound by it.*
>
> *I am required to form my own view on all the matters relevant to my determination of this complaint. I can, and do, take into account the view expressed by the FCA but I am not bound by it or otherwise bound to reach the same conclusion.*

Redswan says it's irrational for me to disregard the FCA's findings and come to a contradictory view based *"purely upon generic regulatory guidance".*

To be clear, I do not disregard what Redswan has told me about the visit and report. I have taken it into account. I have however formed my own view as I am bound to do. I am

considering the circumstances including nature of the relationship between the parties, and all of the evidence and arguments in order to decide what is fair and reasonable taking in to account relevant law and regulations; regulators rules, guidance and standards; codes of practice; and, where appropriate, what I consider to be good industry practice at the relevant time.

was the due diligence carried out by Redswan reasonable in the circumstances?

In my provisional decision I said

> *I have considered the sort of points suggested by [the] FCA as an appropriate approach.*
>
> ***how was the investment to operate?***
>
> *The investment was a one year fixed term fixed rate loan to an unregulated and unregistered Australian Company. The contractual interest rate (in 2013 when Mr H first invested) was 12%. The money loaned was to be used "primarily in the acquisition of share/equities solely in the Australian financial markets, as deemed suitable by the Company".*
>
> *At the time the Bank of England base rate was 0.5%.*
>
> *In my view these basic facts give raise to some initial thoughts:*
>
> - *there is a contractually fixed return*
> - *but the money is to be invested in an asset class that does not provide guaranteed returns.*
> - *the investment has a short term of only one year with guaranteed repayment at the end of a year*
> - *but the money is to be invested in an asset class that has no guarantee that it will not have lost value at the end of only one year.*
> - *the return was high*
> - *and suggests the need to invest in higher risk investments, investments that might well have higher volatility and perhaps short term liquidity issues.*
>
> *So how is MN to pay the contractual return and repay the money loaned if required at the end of the one year term (rather than rolled over)? The answer is from unguaranteed investment performance. That means MN is bearing the risks of those returns not being sufficient.*
>
> *And that brings into focus the nature of the investment. It is an unsecured loan to MN - an unlisted unregulated Australian company.*
>
> ***is this a permitted type of investment for a SIPP?***
>
> *A SIPP is a very flexible form of pension arrangement. HMRC makes rules about what sort of investments are permitted. There is no problem in principle with this type of investment being held in a SIPP.*
>
> ***did the proposed investment seem genuine, or was it part of a fraud or a scam?***

In my view this was an anomalous investment for a UK investor. It may have been a permitted type but that does not mean it was not anomalous. It deviated from usual or normal investments in a number of respects:

- *the investors were based in the UK but the investment was with an Australian Company.*
- *the investment and the return were not in Sterling.*
- *the counterparty, MN, was an unlisted and unregulated company.*
- *The investment involved a guaranteed return (in Australian dollars) while the disclosed underlying investment purpose involved an asset class that gives a variable unguaranteed return.*

It is now known that Mr J was not managing MN honestly. And there is some indication that the dishonesty had started before the investment in the loan notes in 2007 for the other consumers whose complaints I have reviewed.

It is however important to think about how things seemed in 2007 on the basis of what was known and reasonably discoverable then not on the basis what is known only in hindsight.

In my view it is right that a due diligence process uses a critical eye. It is not about hoping for the best. It is about thinking around an issue and looking to see if there are things that should give cause for concern.

I have outlined the nature of the investment above. In my view the structure of the investment does have some of the features of a Ponzi investment fraud. That doesn't mean it obviously was a Ponzi scheme. But there [are] points that make one wonder such as:

- *the offering of a fixed rate of return is typical of a Ponzi scheme.*
- *so too is the offering of a consistent return as market investment returns typically go up and down over time.*
- *Ponzi schemes are also typically not registered or regulated funds and often involve unregulated sellers.*

There are other points that make one wonder:

- *In this case there was an unregulated fund – when Mr J apparently also managed a regulated fund that was available to UK investors and which also invested in Australia. So why was Mr J offering an unregulated fund to UK investors that involved risk for the operator (MN) rather than a straightforward equity fund without investment risk to the fund operator?*

- *And why was he doing that if his fund had 15 million Australian dollars in undistributed profit reserves? Why was he putting those reserves at risk?*

- *And did he even have those reserves? Was MN good for the guarantee it was giving? Or was it only going to be able to repay leaving investors from the money it got in from new investors like a Ponzi fraud?*

This is not a question that would only occur to someone who is unduly suspicious. It is a fairly basic point that a guarantee is only as good as the person or company giving it. So the basic question arises does the MN have the financial strength to give the guarantee it was giving – is it credit worthy? If it is not it might be that it was

being unwise in giving a guarantee. Or it might be that it was deliberately trying to mislead. In either event the investment is unsafe and how would someone know without checking?

In my view there was enough here for a SIPP operator to have concerns that it would reasonably want to satisfy itself about in 2007 or if they had been carrying out such checks for the first time in 2013 when Mr H first invested.

Further it is clear from comments such as the following (that I have quoted above) that important points should be independently checked.

- *"Findings from our review included firms failing to:*
  - *… to independently verify that assets were real and secure, or that investment schemes operated as claimed"*

- *"We found that, typically, firms had difficulty completing due diligence for non-standard overseas investment schemes where firms did not have access to local qualified legal professionals or accountants."*

In my view it was not and is not a reasonable answer to the above to say that there were no publicly accessible accounts for MN because there was no equivalent to Companies House.

In my view Redswan should reasonably have done one of two things:

- *Obtained independent verification of the financial position of MN; or*
- *Decide that was not feasible for it [to do so] and decide that as it could not satisfy itself about MN's financial position it would not allow the loan note investments in its SIPPs.*

Redswan does not agree with much of the above. It says the investment is not anomalous or suspicious and that it did undertake reasonable due diligence and complied with the duties under the regulator's rules including the Principles. It says:

- It reviewed the MN prospectus before allowing the investment to proceed.
- A search relating to Mr J the sole director of MN revealed he was a well-respected regulated investment professional.
- It established that Mr J was also the executive chairman and founder of an asset management company and it operated a UK regulated OIEC.
- It established that the Australian Tax Office ruling was obtained in 2007 for an exemption from Australian withholding tax on the MN return. The point that Mr J was apparently open with the tax authorities regarding MN's trading activities reinforced the impression that there was nothing untoward about Mr J or MN.
- From 2012/13 onwards Redswan obtained copies of all MN accounts including those from previous years. From 2010 onwards Redswan also obtained copies of MN's quarterly investment reports. The position presented by these documents was consistent with the position as presented by Mr J to investors and there was nothing in the documents to raise suspicions or concerns.
- From 2010 onwards Redswan also started to attend annual investor meetings held by Mr J with UK investors. The fact Mr J organized the meetings and was open to speaking directly with investors supported the legitimacy of the investments.
- From 2014 onwards, in light of published guidance from the FCA, Redswan obtained information about certain of MN's assets. This did not raise any concerns. In some cases Redswan obtained information from publicly available sources demonstrating

that MN was a major shareholder in certain companies. In other cases Redswan was provided with information from Mr J which appeared convincing at the time but ultimately transpired to be fabricated. There was however nothing in this information at the time that caused concern.

- Ultimately no publicly available information on Mr J could reasonably have raised any suspicions regarding either his competence and honesty or the legitimacy of the investment. MN appeared to be a legitimate investment that had been trading successfully for years and run by a respected and regulated individual.
- The checks and approach were consistent with the Principles.

I note all these points but in my view it is clear that execution only SIPP providers should be alert to the possibility of fraudulent investments. By their nature fraudulent or scam investments are not labelled as such. The fact that an investment seems to have a successful record does not rule out the possibility that the investment is a fraud – the fraudster needs the appearance of success to draw in investors. And the fact an investment is managed by a regulated individual does not rule out the possibility of a fraud.

The level of checks called for will vary from case to case. In this case as MN has said Mr J was the only director of an unregulated investment about which there was no publicly available information.

It is clear Redswan did not independently assess the investment in 2007 when it permitted some other investors to invest in MN. Nor did it do so in 2013 when it permitted Mr H to do the same. In 2007 in relation to MN it relied on the information provided by those connected to it. It made some checks on Mr J but none on MN. It did not check its accounts. It did not seek any form of independent verification of the accounts or the financial position of MN. Nor did it do so in 2013 before Mr H invested.

Redswan says it could not obtain independent verification of information from a Companies House type public register because there isn't one in Australia.

And Redswan says it is not realistic for it to instruct local lawyers and/or accountants in Australia to check on MN. It says such a requirement is absurdly onerous and flies in the face or commercial reality.

I accept that loan notes as an investment type may not be unusual for a SIPP but that is not the complete point. Redswan should have ensured that it understood how the investment – referred to by MN as a "Guaranteed Capital Growth Agreement"- would operate. And in my view for the reasons set in my provisional decision there was reason to have concerns about the investment and it should have:

- Obtained independent verification of the financial position of MN; or
- Decided that was not feasible for it to do so and decide that as it could not satisfy itself about MN's financial position it would not allow the loan note investments in its SIPPs.

Redswan says it is not realistic for it to instruct local lawyers and/or accountants in Australia to check on MN. But a SIPP operator is required to treat its customers fairly – even within the context of a non-advised service - and it must act in accordance with its customer's best interests in a way that is consistent with its obligations as the operator of an execution only SIPP. Bearing that in mind it is responsible for the quality of its SIPP business. That is both the regulatory and commercial context in which it operates. That means it should carry out appropriate due diligence before it allows an investment – checks that are fit for purpose. And if it is not economically viable to carry out the checks it should not allow the investment.

That is the way to reasonably act in its clients' best interests and also in its own interests within the context of the execution only service.

I should make it clear that the comment about locally qualified lawyers and accountants was not a point made up by me off the cuff years after the event and with the benefit of hindsight. The comments were the considered published view of the regulator about how SIPP operators should satisfy obligations in existence since 2007. The point may not have been made expressly until the 2014 CEO letter but the letter is commenting on how the existing obligations on SIPP operators were to be satisfied.

I do not consider the point about the need for information to be independently verified to be a new or novel requirement. It is an obvious point when the purpose of due diligence is kept in mind. And the comment about locally qualified lawyers and accountants is just a particular illustration of the basic point that effective due diligence should be carried out – which amongst other things means sufficiently independent and expert to be reasonably reliable.

And in this case the nature of the investment and the factors I referred to in my provisional decision mean that there was a reasonable need for that level of due diligence. And that this should have been apparent to Redswan in 2007 and not just with the benefit of hindsight.

For the avoidance of doubt I do not say now, and did not say in my provisional decision that the only course open to Redswan was to appoint lawyers and accountants in Australia. I said in my provisional decision, and I say now, that if that does not make business sense then Redswan should instead have decided not to allow the investment into its SIPP wrappers. To choose the course of not making reasonable due diligence checks and to accept the investment in its SIPPs is not fair and reasonable in the circumstances.

what would have happened if Redswan had independently verified MN's financial position?

In my provisional decision I said:

> *"According to [the] liquidator's report I have quoted above:*
>
> - *Mr J had been misreporting the financial position of MN from 2003 ie for three to four years before Mr H's application to invest in 2007 and way before Mr H invested in 2013.*
> - *When Mr C went to Australia in 2006 to make his checks he was deceived by Mr J who arranged for an imposter to impersonate the accountant used by MN.*
>
> *It does therefore seem that by 2007 (when the other consumers invested) Mr J's fraud had started. There was therefore something to be discovered – it is not apparently the case that all was in order in 2007 and the fraud only began much later and closer to the time of its eventual discovery.*
>
> *According to the liquidator's report:*
>
> > *7.1.1 Falsified financial statements:*
> >
> > *It appears the Company has been falsifying financial reports to loan creditors since 2003 to misrepresent the trading performance and asset position to current and potential loan creditors. A comparison of the financial statement provided by [Mr L] and trading reports provided by [Mr J] show significant differences…*

A historical comparison of the two versions of accounts below illustrates that the financial performance and position of the Company has been incorrectly reported from the outset of trading in 2003.

Historical profit/Loss Comparison FY03 to FY13 [I will only quote FY03-FY06]

$	*Financial statement (prepared by Mr [L])*	*Financial statement (prepared by the Company)*	*Variance*
FY03 Profit/(Loss)	*(72,018)*	*2,419,000*	*(2,491,018)*
FY04 Profit/(Loss)	*(105,494)*	*735,000*	*(840,494)*
FY05 Profit/(Loss)	*(1,055.673)*	*1,230,000*	*(2,285,673)*
FY06 Profit/(Loss)	*(1,600,434)*	*1,013,000*	*(2,613,434)*

Balance Sheet Comparison… [I will only quote FY03-FY06]

$	*Financial statement (prepared by [Mr L])*	*Financial statement (prepared by the Company)*	*Variance*
FY03 Profit/(Loss)	*(72,016)*	*8,791,000*	*(8,863,016)*
FY04 Profit/(Loss)	*(177,510)*	*11,302,000*	*(11,479,510)*
FY05 Profit/(Loss)	*(1,233,182)*	*14,253,000*	*(15,486,182)*
FY06 Profit/(Loss)	*(2,833,616)*	*15,016,000*	*(17,849,616)*

It is possible that in this case in 2007, Mr J would either have refused to co-operate in any checks made by Redswan or would have made similar attempts to deceive as in 2006 with Mr C. But it should be borne in mind that Redswan ought to have used local legal professionals or accountants to act on its behalf. Such agents would have been appropriately sceptical and diligent and would not just accept things at face value.

If Mr J had refused to co-operate that would or should have sounded alarm bells for Redswan and it would have refused to allow the investment in the loan notes.

The alternative is, in my view, Redswan would have discovered that there was cause [for] concern about Mr J and MN. In my view reasonable independent verification would have led to the discovery that MN was providing figures to investors and potential investors that varied considerably from the figures prepared by its accountants. In this event it would not have allowed the investment in the SIPP in the loan notes issued by MN."

My view remains as set out above.

so would reasonable checks have made any difference?

In my provisional decision I said:

In the reports I have quoted above the FCA said it found widespread misunderstanding amongst SIPP operators of the obligations they were under. In my view Redswan did misunderstand the obligations it was under in 2007 and [2014]. If it had understood those obligations it would have:

1. *Decided it was not prepared to make the kind of checks that were reasonably required given that the investment was with an unlisted and unregulated company overseas making the checking process more difficult.*

2. *Or it would have made reasonable steps to independently verify MN's financial position and*
    - *MN would have expressly refused to cooperate,*
    - *or MN would have been uncooperative and obstructive such that Redswan would have realised its enquiries were being frustrated and it would have drawn an unfavourable conclusion from that*
    - *or serious concerns (other than non-cooperation) would have been discovered.*

In all of these events Redswan would have decided not to allow the investment in the Loan Note in the SIPP in 2007. And it would still have been of that view in [2014 when Mr H invested].

Redswan has been clear that it thinks it was not economically viable to use local agents in Australia to make checks on MN. This therefore means that the first of the two options above is the more likely and that Redswan would not have allowed the invested in MN for that reason.

In relation to the second point, Redswan says that Mr J would have done whatever was necessary to conceal his fraud and would have successfully done so. It says the fraud was elaborate and sophisticated. And, it says that instructing a local professional to carry out independent due diligence checks on MN would not have brought the fraud to light.

I have carefully considered the submissions that Redswan has made on this point. However, I think this is an unlikely scenario. Credible independent local professionals would have been appropriately trained and would have approached the issue with no pre-conceived ideas.

Redswan says that Mr C was successfully 'duped' by Mr J's fraud and that this suggests Mr J would have been able to also trick other professionals who were looking into the MN investment. However, Mr C was already an investor with MN when he visited Australia in 2006 and may well have been thinking of a potentially profitable business relationship with it when he made that visit to Australia. He was no longer truly independent. In my view, there is a significant possibility that he would have been susceptible to confirmation bias. By contrast, the only interest a credible local independent agent would have had was to carry out a thorough and professional job of undertaking appropriate due diligence checks.

I accept that there is evidence that the fraud was successfully concealed for some years. But that does not, in my view, lead to the forgone conclusion that Mr J would have satisfied independent professional agents in 2007 (when Redswan first started to allow investments into MN in its SIPPs after establishing and operating SIPPs became regulated) or 2014 (when Mr H invested) that the investment was not a fraud. And, I note that here is no evidence that independent professionals were actually deceived by Mr J at that time.

Mr C's own due diligence checking went so far as trying to meet MN's accountant, Mr L. I do not know if Mr C asked for that meeting or if it was Mr J's idea. In any event apparently in 2006 an imposter was used to impersonate Mr L. It seems unlikely locally qualified lawyers and/or accountants would have been so easily deceived. They might have known Mr L professionally as part of the Western Australia business community. They could easily have made direct contact with him to discuss the accounts and to ask for his cooperation in the due diligence checks it was making – and I consider that likely. If they had contacted Mr L it seems likely to me that the fraud would have been discovered – hence the use of the imposter to stop Mr C from talking to Mr L.

It is my view that the use of the imposter by Mr J was daring and does show the lengths he was willing to go to. But that was in his dealings with Mr C. That he was prepared to go to

that length also shows Mr J's vulnerability to discovery. It is difficult to know if Mr J would have been so daring if the due diligence was being carried out by appropriate local professionals. Mr J might well have thought it was too risky and not co-operated in the due diligence process.

It is my view that, on the balance of probabilities, it is more likely than not that adverse conclusions would have been drawn had appropriate local professional agents been used to carry out appropriate due diligence on MN and Mr J in 2007. And it would still have been its view I 2013/2014. And as a result, Redswan would not have accepted the MN loan note investment into its SIPP wrappers in 2007 and it still would not in 2013/2014. I am satisfied that had Redswan taken steps to independently assess MN, the financial position of the company would have been identified.

what would have happened if Redswan had acted appropriately?

In my provisional decision I said:

> *It is my view that the possibilities I have numbered two above would have meant that Mr H would not have invested in the loan notes at all in the SIPPs. He would have realised there was cause for some concern and it is more likely than not that he would have chosen some other investments for his pension instead.*
>
> *What about if Redswan had just said it did not want to allow the investment because of the difficulty in making appropriate checks? This may not have been enough in itself to put Mr H off investing. So he might have tried some other SIPP provider.*
>
> *I accept that the regulator has said that many SIPP providers did not understand the obligations they were under. And so it is possible that Mr H would have gone to a different SIPP provider who would have made the same error as Redswan and Mr H would have suffered the loss in his SIPP with provider number two instead. I do not however consider this to be a fair and reasonable way to approach things.*
>
> *I have to try to work out the position Mr H would reasonably have been in if Redswan had acted differently. In my view the fair and reasonable view is that - if he had not immediately dropped the idea of investing in MN in his SIPP – [Mr H] would have gone to another SIPP provider or providers who would have acted as Redswan should have done. So the later SIPP provider(s) would either have refused the investment because it was too much trouble or it would have decided not to allow the investment in the loan notes after making the reasonable checks I have discussed above. And so ultimately if not immediately Mr H would have decided to find some other investment for his pension.*

Redswan says Mr H's decision to invest was driven not by any due diligence or lack of due diligence by Redswan but by advice Mr H received from Mr C. So even when Redswan warned Mr H about the risks of the MN investment he still wanted to go ahead with the. Mr H was asked to confirm his acceptance of the following:

1. *The investment is high risk & speculative in its very nature;*
2. *The investment involves a currency risk which could negatively affect the valuation of your holdings over time. That risk is not offset or insure against in any way by financial instruments such as hedging, for example;*
3. *The company's latest results (Abridged Balance Sheet 2013) shows that it has total funds of AU$108,135,000, of which shareholders' funds are AU$20,110,000 (18.6%) and the rest (81.4%) is borrowed, by way of loans such as this one, for example. Shareholders' funds are at risk first should the company ever run into financial difficulty but you should be awre that it is*

borrowing in excess of its net assets to make further investments;

4. *The investment term is fixed for a full twelve month period, i.e. you cannot redeem funds at any time throughout the investment term, your investment can only be redeemed on the actual anniversary date;*
5. *As the investment is issued by a private limited company based in Australia, unless you have bought the investment under the specific recommendation of a UK regulated financial adviser there is no recourse to any regulatory financial compensation scheme in the event of its failure of ombudsman scheme if you should have a complaint about it."*

A similar warning was issued prior to the roll overs in 2015.

Mr H was introduced to the idea of investing his pension in MN by his wife who had been investing since 2007 and by Mr C. But there is no evidence to indicate Mr H was especially motivated to invest in MN as with the investor in the *Adams v Options* case who was motivated by a cash back payment. And while I note the warnings, they do not relate specifically to the issues such as Redswan being unable to carry out checks to reasonably satisfy itself that the investment was appropriate for its SIPP.

So I do not think the warnings show that Mr H would have insisted on investing in MN if Redswan had refused to allow the investment in its SIPP.

In my view the introduction of the warnings by Redswan in 2013, does not absolve Redswan of its responsibility to have carried out sufficient due diligence on the MN loan note investment prior to accepting the investment into its SIPP wrapper.

my conclusion on the merits

Taking all of the above into consideration – individually and cumulatively – I think in the circumstances of this case it is fair and reasonable for me to conclude that Redswan should not have accepted the MN loan note investment into its SIPP wrapper. If it had undertaken sufficient due diligence before doing so, it would have identified either that the investment was not safe to include in its SIPPs, or that it was unable to obtain sufficient information on the investment in order to draw a conclusion as to whether it was safe or not and in that situation it ought to also have refused to include it in its SIPPS.

Or alternatively, and more likely given what Redswan has said in response to my provisional decision, it should have decided that it was not economically viable for it to carry out reasonable due diligence on the MN investment. In which case it should have refused to allow the investment in its SIPP wrapper because it was unable to reasonably conclude it was an investment it was happy to have in its SIPPs.

Given these failings, I think it is fair and reasonable in the circumstances for Redswan to be accountable for the losses Mr H has suffered.

I say this having given careful consideration to the judgment in *Adams v Options SIPP*, but also bearing in mind that my role is to reach a decision that is fair and reasonable in the circumstances of the case having taken account of all relevant considerations.

Putting things right

In my provisional decision I said:

The normal way that a problem like this should be put right is to compare the position Mr H is now in with the position she would reasonably be in if things had not gone wrong. It is not easy to know what Mr H would have done if Redswan had refused to allow the investment in the MN loan notes as we have little information about what Mr H was investing in what his objectives were and so on. I do not therefore currently know whether it is more likely that Mr H would have left his existing pension arrangements as they were or whether he would have opened a SIPP and invested in something else.

I will therefore arrange for the investigator to send a questionnaire to Mr H to obtain further information so I can form a clearer view on how things should be put right for Mr H.

In addition I note that Mr H will have suffered considerable distress and inconvenience. He has seen her Redswan pension lose, in effect, all its value overnight at around the time when he would have been thinking about retiring in the relatively short term. I accept this would have been very shocking and distressing. I currently think I will award Mr H £500 compensation for this distress and inconvenience.

While Redswan has said that Mr H should be compensated at bond deposit rates I cannot see that there is any evidence that Mr H would have done anything with his pension if Redswan had not permitted the MN investment in its SIPP. This is because his wife would not have investor her pension in MN at it apparent success would not have caused him to think about his own pension. On balance it seems more likely than not that Mr H would have left his pension with his existing provider.

fair compensation

My aim is that Mr H should be put as closely as possible into the position he would reasonably be in if things had not gone wrong. In my view that means comparing Mr H's present position to the position he would be if he had not moved his existing personal pension.

It is therefore my view that Redswan should put things right as follows:

Redswan should calculate fair compensation by comparing the value of Mr H's pension, if he had not transferred, with the current value of his SIPP. In summary:

1. Obtain the notional transfer value of Mr H's previous pension plan, if it had not been transferred to the SIPP.
2. Obtain the actual transfer value of Mr H's SIPP, including any outstanding charges.
3. Pay a commercial value to buy the loan note (or treat it as having a zero value in the above calculations – see below).
4. Pay an amount into Mr H's SIPP so that the transfer value is increased to equal the value calculated in (1). This payment should take account of any available tax relief and the effect of charges. It should also take account of interest as set out below.
5. Pay Mr H £500 for the distress and inconvenience the avoidable problems with his pension will have caused him.

If there are any difficulties in obtaining a notional valuation of the previous pension, then for half the investment: FTSE UK Private Investors Income Total Return Index; for the other half: average rate from fixed rate bonds should be used instead as a reasonable proxy for the type of return that could have been achieved if suitable funds had been chosen taking account of Mr H's likely attitude to risk.

If Redswan is unwilling or unable to purchase the investment the *actual value* should be assumed to be nil for the purposes of the above calculation. And Redswan may ask Mr H

to provide an undertaking to account to it for the net amount of any payment the SIPP may receive from the investment. That undertaking should allow for the effect of any tax and charges on the amount Mr H may receive from the investments and any eventual sums he would be able to access from the SIPP. Redswan will need to meet any costs in drawing up the undertaking.

If Redswan is unable to pay the total amount into Mr H's SIPP it should pay the compensation as a lump sum to Mr H. But had it been possible to pay into the SIPP it would have provided a taxable income. So the total amount should be reduced to *notionally* allow for any income tax that would otherwise have been paid.

The *notional* allowance should be calculated using Mr H's marginal rate of tax at retirement. For example, if Mr H is a basic rate taxpayer in retirement, the *notional* allowance would equate to a reduction in the total amount equivalent to the current basic rate of tax. However, if Mr H would have been able to take a tax free lump sum, the *notional* allowance should be applied to 75% of the total amount.

The compensation resulting from this loss assessment must be paid to Mr H or into his SIPP within 28 days of the date Redswan receives notification of his acceptance of my final decision. Interest must be added to the compensation amount at the rate of 8% per year simple from the date of my final decision to the date of settlement if the compensation is not paid within 28 days.

My final decision

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Redswan Limited should pay Mr H the amount produced by that calculation – up to a maximum of £150,000 (including distress and/or inconvenience but excluding costs) plus any interest set out above.

If Redswan Limited does not pay the recommended amount, then any investment currently illiquid should be retained by Mr H. This is until any future benefit that he may receive from the investment together with the compensation paid by Redswan Limited (excluding any interest) equates to the full fair compensation as set out above.

Redswan Limited may request an undertaking from Mr H that either he repays to Redswan Limited any amount Mr H may receive from the investment thereafter or if possible, transfers the investment at that point.

Mr H should be aware that any such amount would be paid into his pension plan so he may have to realise other assets in order to meet the undertaking.

Redswan Limited should provide details of its calculation to Mr H in a clear, simple format.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £150,000, I recommend that Redswan Limited pays Mr H the balance plus any interest on the balance as set out above.

This recommendation is not part of my determination or award. It does not bind Redswan Limited. It is unlikely that Mr H can accept my decision and go to court to ask for the balance. Mr H may want to consider getting independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr H to accept or reject my decision before 1 March 2022.

Philip Roberts
Ombudsman