DRN-3174111

The complaint

Mr F complains about the advice he received from Berkeley Financial Partners Ltd (Berkeley) to invest in the 'FACET Fund no.3' within his Self-invested Personal Pension (SIPP). He believes that this might have presented more risk that was suitable for his Cautious/Balanced risk profile. He also believes that the fund should have been managed more closely and action taken earlier. At the time Berkeley was an appointed representative of Facet Investment Management Ltd (Facet). As such, Facet is responsible for the actions of Berkeley and has addressed Mr F's complaint.

What happened

Berkeley gave the advice to Mr F but as Facet takes responsibility for that advice I will refer to Facet throughout.

In 2016 Facet provided advice and recommendations to Mr F about his pension provision. At this time Mr F had an existing paid-up pension associated with his employment. Facet recommended that he switch his pension to a Standard Life 'platform' facility and invest his pension fund in a Discretionary Fund Management arrangement (DFM) – the FACET DFM. Because of an identified need to reduce investment risk, Mr F was recommended to invest in the FACET Fund No. 3.

The FACET Fund no 3 is made up of holdings in the FACET Cautious and FACET Balanced funds.

Mr F accepted the advice and his pension fund was switched to the FACET No.3 fund.

The Facet Cautious Fund and Facet Balanced Fund were suspended in 2019. Then in 2020 it was confirmed that the funds would be wound-up and the money returned to the investors in the fund. It was confirmed at the time that some of the fund holdings were illiquid and could not currently be sold.

Facet did not uphold Mr F's complaint. It said that the FACET Cautious and Balanced funds had appropriate risk profiles for Mr F. It said that funds had performed well up to the default of the 'Cape Valorem' (Cape) holding. It said that the Cape holding was a secured bond that had a history of paying its 'coupon' on time. After a default by Cape the funds were suspended and no further action could be taken.

Mr F referred his complaint to this service and it was considered by an investigator. He thought the complaint should be upheld. In summary the investigator said:

- The advice to switch to the DFM caused Mr F to incur significantly higher costs as compared to his existing pension.
- There were insufficient benefits to Mr F switching to a new pension arrangement bearing in mind the increase in costs. If he wished to reduce risk then he could have done that within his existing pension.
- Mr F had no previous experience of a DFM and he didn't require a DFM to achieve his goals. He was not an experienced investor nor an active investor.
- The DFM could invest in a very wide range of assets and Facet would have been aware of the risks of that. This led to the liquidity problems that Mr F subsequently

faced.

Facet did not accept the investigator's assessment. In brief, it made the following comments:

- As of 1 February 2017, the top five holdings in the Cautious fund were:

  "Lyxor UCITS ETF Smart Cash C GBP – 8.59%
  Kames Investment Grade Bond – B – 7.17%
  iShares Barclays Index-linked Gilts – 7.12%
  DB X-Trackers SONIA – 7.07%
  iShares Markit iBoxx Corporate Bond – 6.98%"

- As of 1 February 2017 the top five holdings in the Balanced Fund were:

  "Lyxor UCITS ETF Smart Cash C GBP – 7.78%
  Kames Investment Grade Bond – B – 6.82%
  iShares MSCI World Minimum Volatility – 5.50%
  DB X-Trackers SONIA – 4.97%
  iShares Barclays Index-linked Gilts – 4.95%"

- The relatively high level of illiquid and less-liquid assets was due to large redemptions, which skewed the ratio of these investments to higher than usual percentages.
- The Cautious and Balanced funds were suspended on 10 October 2019.
- All less-liquid assets had been sold (by 26 January 2021) and the money returned to holders. So at this point it was only the illiquid investments that remained.
- Mr F was not advised to switch into high risk investments. Mr F was advised to move to an active management DFM who chose to invest into daily traded, risk-rated OEICs. The OEICs were liquid, tradeable, suitable and relevant to his risk profile.
- Mr F's portfolio only invested in retail suitable, daily traded OEICS. These were consistent with his ATR.
- If Mr F had transferred to the Standard Life Platform without the DFM element so as to have flexibility and reduce volatility, and received ongoing advice, he would have incurred higher costs than the DFM route.
- The increase in cost brought about by the advice was 0.25% and there were benefits, such as platform services and constant monitoring with the DFM service.
- The factsheets for the funds were clearly laid out showing the risk ratings of both the balanced and cautious funds.
- The investments made by Facet were into Non-UCITS Retail Scheme (NURS) OEICS. They were suitable for Mr F.
- The DFM did not purchase the high-risk investments for Mr F. They purchased NURS OEICs which were appropriately risk rated for Mr F.
- Mr F's Facet portfolio does not still exist. Mr F transferred his portfolio away from Facet in January 2020 and therefore Facet has had no involvement since then.

The investigator then reviewed the complaint and issued a further assessment. In summary he said that he remained of the view that the investments he had been recommended were higher risk than was suitable for him. Some of the underlying investments brought liquidity risks which were not appropriate for Mr F.

Facet then asked for some information about Mr F’s current pension portfolio and for further time to review and consider the issue.

As a result it made an offer to Mr F in settlement of his complaint. Mr F and Facet then entered into some exchanges about the nature of any redress calculation. However that has not led to any agreement between Facet and Mr F and therefore it is now appropriate for an ombudsman to consider the complaint and issue a Final Decision.

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.

A Confidential Financial Review Form or ‘fact find’ was completed at the time the advice was given. This recorded Mr F’s circumstances. His Standard Life SIPP was noted.

It was also recorded that:

“Agreed with ATR profile. Looking to take a more cautious approach with SL Pension and liked the idea of FACET DFM”.

When Mr F met with Facet in 2016, the money within his existing Standard Life SIPP was invested in the following funds:

- SL Managed – about 40%
- SL Multi Asset Managed (20-60%) – about 28%
- SL UK Equity Select – about 9%
- SL Invesco Perpetual High Income – about 24%

The charges for these funds were:

- SL Managed – 1.02%
- SL Multi Asset Managed (20-60% Shares) – 1.01%
- SL Equity Select – 1.41%
- SL Invesco Perpetual High Income – 1.89%

At the time the ‘weighted average’ of the charges was calculated as 1.25%.

It was set out on Facet’s recommendation or ‘suitability letter’ dated 10 November 2016 that these funds had achieved positive growth of between 50% to 70% over five years. All but one had outperformed their benchmarks.

The recommendation letter recorded:

“Although the performance of all 4 of your funds has been reasonably solid in general terms, the performance of 1 of the funds has been especially disappointing when measured against its respective sector. We should also consider that the overall asset makeup of your portfolio is susceptible to a higher degree of market volatility than you would prefer, especially when you bear in mind around 71% of the portfolio consists of equities and therefore offers a certain amount of restriction in the way of flexibility and diversification should market conditions change to the detriment of the assets in the said funds.

We would equate the degree in which your current portfolio invests in equities to that of someone who has a High Medium Risk which is 1 place higher than your preferred level. You appreciate that over the last 5 years your overall portfolio has performed well, but because you are mindful of volatility, you would like to consolidate those gains. On a *cautionary note we should also bear in mind that it is the opinion of FACET'S discretionary fund managers that in the current economic climate equities appear to be overpriced.*

I am therefore of the opinion that you would benefit from an investment strategy that reduces the volatility of a standard retail investment fund without overly inhibiting the upside potential. A discretionary managed fund can fulfil that objective owing to the fact that the terms of reference of the fund are risk-grade related rather than asset related and in most cases asset restricted.

This provides the fund manager with a free hand as to where to invest and when, and also in respect of the quantum of purchases and sales."

It was also set out:

"investment performance of the FACET No. 3 Model compared with its benchmark fund and this will enable a comparison with your existing Standard Life funds:

Fund/Benchmark/Index	*%* ***Growth 1 year***	*%* ***Growth 3 years***	*%* ***Growth 5 years***
FACET Fund no. 3	***8.42***	***26.58***	***52.04***
ARC Sterling Balanced	***9.90***	***16.61***	***37.89***
7IM Balanced	***9.65***	***17.93***	***44.80***

(Information provided by FE Analytics 26th October 2016)

The performance differential between the discretionary managed fund and your existing Standard Life Portfolio is quite varied with a slight improvement of your current plan over the 1 and 5 year periods, but with a slight improvement of the discretionary managed fund over your current portfolio over the 3 year period, however as your retirement age is getting ever so nearer you would like to consolidate what growth you've achieved and adopt a less volatile strategy going forward, where not so much emphasis is placed on equity growth, and although investment unit prices can go down as well as up, the comparison is indicative of the investment performance potential of the FACET funds given their risk profile.

Additionally, I would refer you to the enclosed graphical representations of the performance against its benchmarks, and these I think illustrate the reduced volatility that discretionary management can offer.

You will see that the total annual management charge is estimated to be 2.06% and this compares favourably with usual annual management charges under normal retail SIPPs particularly when taking into account the benefits of discretionary fund management as described earlier. The graphical representations of the past performance of the FACET No. 3 fund over the last five years compared with its benchmark fund emphasizes the reduced volatility under the discretionary managed fund, and I am of the opinion that any additional costs for the discretionary managed portfolio should be more than offset by both better performance and lower volatility coupled with the positive impact that the latter is likely to have on future regular income withdrawals. That said, there is no commitment long-term to *retaining the FACET fund and if future performance should disappoint for any reason, then a switch back to retail funds generally is a simple matter.*

Upon analysis, therefore, the annual ongoing charge under the proposed new platform SIPP is only marginally higher than under the present arrangements, even allowing for the discretionary fund management approach. Charges, of course, are not necessarily the "be all and end all" of the matter. The greatest impact upon the eventual value of your pension fund will be the net investment growth rate experienced (i.e. after charges) and my considered opinion, as stated previously, is that your growth prospects will be significantly enhanced by the utilization of the FACET discretionary management service."

I do not believe it is disputed that the new arrangement had higher overall charges than applied previously to Mr F's existing scheme. I recognise that Facet believed there were advantages to the new approach which justified that. However I do not believe that there were persuasive reasons to justify the switch.

Mr F was an ordinary retail customer and was not a sophisticated or knowledgeable investor. I have not seen evidence that he required a DFM to achieve his aims – which were, principally, lower volatility whilst obtaining a good level of returns. He could have achieved his aims by switching funds within his existing pension where there was sufficient flexibility and choice in terms of investment funds. He did not require the DFM where the manager could select from a very wide range of assets. As the documentation for the DFM sets out, this could include derivatives, unregulated schemes and hedging strategies - and that brought with it further risks. There was also no guarantee of performance exceeding that of his existing scheme or particular reason why that was likely. I am also not persuaded that Mr F required the continuing oversight of a financial adviser to achieve his aims.

Mr F could have also diversified his investments with his existing pension – and he was already doing so to a certain extent. The recommendation to invest with one investment manager, taking one approach, essentially placed 'all his eggs in one basket'. If the choices or decisions of the manager were 'wrong' in the sense that the fund performed poorly then the majority of Mr F's investment was subject to that. This did transpire when the DFM invested in some assets which became illiquid and/or failed and the DFM subsequently itself failed.

I appreciate that the evidence suggests the DFM changed some of the Balanced and Cautious fund's assets after the advice was given and Mr F's money was invested. But the very wide investment mandate and discretion the DFM had was known at outset – it was always possible that the DFM could invest in the assets it chose. That was reasonably foreseeable.

Furthermore if Mr F had not been given this advice then he would not have invested in the DFM – and not been exposed to the risks and assets in question. So he would not have been invested in some seemingly illiquid assets that have caused him financial loss. It is worthy of note that I have not seen evidence that Facet suggested a switch away from the DFM when the assets changed – and it was taking a fee for keeping the situation under review.

So I do not believe Mr F was given suitable advice to switch his pension funds to the DFM and I therefore uphold the complaint.

Putting things right

My aim is that Mr F should be put as closely as possible into the position he would probably now be in if he had been given suitable advice.

I think Mr F would have remained with his previous provider. However, given his objectives at the time of taking a more cautious approach, it wouldn't be appropriate to obtain a notional value from that provider based on the original investments. Bearing in mind that a more cautious approach was intended I'm satisfied that what I've set out below as an alternative is fair and reasonable given Mr F's circumstances and objectives when he invested. I have noted Mr F's suggestions as to how the redress calculation should be carried out, but I believe that what I have suggested is a fair approach.

What must Facet do?

To compensate Mr F fairly, Facet must:

- Compare the performance of Mr F's investment with that of the benchmark shown below. If the actual value is greater than the fair value, no compensation is payable.

  If the fair value is greater than the actual value there is a loss and compensation is payable.

- Facet should add interest as set out below:
- Facet should pay into Mr F's pension plan to increase its value by the total amount of the compensation and any interest. The amount paid should allow for the effect of charges and any available tax relief. Compensation should not be paid into the pension plan if it would conflict with any existing protection or allowance.
- If Facet is unable to pay the total amount into Mr F's pension plan, it should pay that amount direct to him. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore the total amount should be reduced to *notionally* allow for any income tax that would otherwise have been paid. This is an adjustment to ensure the compensation is a fair amount – it isn't a payment of tax to HMRC, so Mr F won't be able to reclaim any of the reduction after compensation is paid.
- The *notional* allowance should be calculated using Mr F's actual or expected marginal rate of tax at his selected retirement age.
- It's reasonable to assume that Mr F is likely to be a basic rate taxpayer at the selected retirement age, so the reduction would equal 20%. However, if Mr F would have been able to take a tax free lump sum, the reduction should be applied to 75% of the compensation, resulting in an overall reduction of 15%.
- Pay Mr F £350 for the upset and inconvenience this matter will have caused.

Income tax may be payable on any interest paid. If Facet deducts income tax from the interest it should tell Mr F how much has been taken off. Facet should give Mr F a tax deduction certificate in respect of interest if Mr F asks for one, so he can reclaim the tax on interest from HM Revenue & Customs if appropriate.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Facet Fund no.3	Some liquid/some illiquid	FTSE UK Private Investors Income Total Return Index	Date of investment	Date of my final decision	8% simple per year from final decision to settlement (if not settled

					within 28 days of the business receiving the complainant's acceptance)

Actual value

This means the actual amount payable from the investment at the end date.

It may be difficult to find the *actual value* of the portfolio. This is complicated where an asset is illiquid (meaning it could not be readily sold on the open market) as in this case. Facet should take ownership of any illiquid assets by paying a commercial value acceptable to the pension provider. The amount Facet pays should be included in the actual value before compensation is calculated.

If Facet is unable to purchase illiquid assets, their value should be assumed to be nil for the purpose of calculating the *actual value*. Facet may require that Mr F provides an undertaking to pay Facet any amount he may receive from the illiquid assets in the future. That undertaking must allow for any tax and charges that would be incurred on drawing the receipt from the pension plan. Facet will need to meet any costs in drawing up the undertaking.

Fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark.

Any withdrawal from the Facet Fund no.3 should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simpler, I'll accept if Facet totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically.

Why is this remedy suitable?

I've decided on this method of compensation because:

- Mr F wanted Capital growth and was willing to accept some investment risk.
- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It would be a fair measure for someone who was prepared to take some risk to get a higher return.
- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr F's circumstances and risk attitude.

My final decision

I uphold the complaint. My decision is that Facet Investment Management Ltd should pay the amount calculated as set out above.

Facet Investment Management Ltd should provide details of its calculation to Mr F in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr F to accept or reject my decision before 9 May 2022.
David Bird
Ombudsman