DRN-3354788

The complaint

Mr L and Mrs L ('the complainants') say a partner in Houghton Edwards LLP ('HE') churned their Pension and Investment Accounts to generate commission and that he did so through investment switches conducted without their knowledge and without their consent/authority. They seek compensation for the switch fees they incurred, for the loss of growth that they say their accounts would have had but for the switches and for the cost of they incurred in having to transfer their accounts to a new firm.

What happened

The complainants say their accounts were churned between July 2020 and January 2021; that the partner conducted 75 unauthorised switches within their accounts during this period; that he generated and benefited from a total of around £47,000 in switch fees associated with his unauthorised actions; that they can find no other rationale or justification for the switches he conducted, other than the generation of fees; that they were alerted to his actions by the provider of the platform on which their accounts were held; that they never agreed to the application of switch fees in their account; that they incurred around £56,000 in lost growth, that their three accounts (an investment account and two pension portfolios) would have had if they had been left as they were prior to the churning; and that, upon discovery of the partner's/HE's misconduct (which they reported to the regulator and which the regulator is investigating), they were forced to change firms and incurred a £10,000 establishment fee with their new adviser.

One of our investigators looked into the complaint and concluded that it should be upheld. In the main, he said:

- HE's 2015 client agreement with the complainants sets out an advisory service/relationship and there is nothing within it that gave HE discretionary authority. The complainants confirm that prior to July 2020 transactions were agreed with them in advance. HE was invited to provide evidence of discretionary authority but it did not do so. Instead it asserted that the complainants had always been happy with its management of their accounts. HE had no discretionary authority in its service to the complainants.

- With regards to application of switch fees, the complainants say they never agreed to this, and that the 2020 paperwork HE has referred to was presented to, and signed by, them on the understanding that it applied to changing the method of paying fees – not to the addition of switch fees to the service. They believe HE altered the document after they signed it in order to add the provision for switch fees. He (the investigator) cannot determine this claim, but the context in which the documentation was signed suggests that it was unlikely the complainants agreed to the addition of switch fees to the service. Their retirement at the time led to their need to change the way in which the service fees were billed, and they sought to have the fees deducted from their funds (which was not previously the case). Given this purpose, it is unlikely they would suddenly have agreed switch fees that did not exist over the previous years of HE's service. On balance, it is unlikely they agreed to this.

- HE says it considered that the complainants' accounts needed more active management during the COVID 19 pandemic, hence the switching activity. However, it was asked to provide information about the strategy it applied in this regard and it did not provide this, instead it referred to its complaint response letter.

- The complainants have produced a series of messages from HE during the time of the switches which made no reference to the switching activities, but instead it represented that their investments were going well and said nothing about a need to make changes.

- The complainants should be compensated for the loss of value in their accounts (inclusive of redress for the switch fees that were applied) and, for the pension accounts, they should be paid into their pensions if possible. They should also be compensated for the establishment fee they incurred with their new adviser.

The investigator asked HE for its response to his view, but no such response appears to have been given. He then referred the case to an ombudsman.

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.

Having done so, I have reached the same conclusion as expressed by the investigator, for broadly the same key reasons. I endorse and incorporate his reasons into this decision.

In straightforward terms, HE breached the terms of service it agreed with the complainants and the manner in which it did that also breached their trust and confidence. As the investigator said, there is no evidence of a discretionary element in the service agreed with the complainants. HE had no discretionary authority to execute investment decisions in the complainants' accounts without their knowledge and consent/instruction to do so. In this context, by making the switches that feature in the complaint HE went significantly beyond its remit and it caused damage to the trust that the complainants had in it.

The regulatory definitions of churning include:

"*Principle 6 (Customers' interests) requires a firm to pay due regard to the interests of its customers, and treat them fairly. A firm should therefore not "churn" a customer's account, that is, enter into transactions with unnecessary frequency having regard to the customer's agreed investment strategy. A firm should also not switch a private customer within or between packaged products unnecessarily, having regard to what is suitable for that customer. Firms are reminded that a customer's interests are paramount."*

"*A series of transactions that are each suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the client.*"

The general idea is that frequent transactions and/or switches, by a firm, in a client's portfolio should be reasoned and ought not to be carried out only or mainly for the purpose of generating commission for the firm. Instead, they should be carried out in the client's best interests.

In an advisory relationship the firm's role is to give advice, the client retains the final decision on the subject of advice and no transaction happens unless the client agrees/approves. For this reason, whilst the potential for churning can nevertheless still exist in such relationships, the scope for it should arguably be less because of the client's involvement in the process. In contrast, the scope for churning could be more in a discretionary service context where a firm operates with discretion defined by a mandate agreed at the outset, and then thereafter the client is not actively involved in investment decisions.

The complainants should have had the benefit of a service in which there was less scope for churning, the advisory service. This is the service that existed between them and HE, until HE appears to have unilaterally given itself discretionary authority during the period in which it made the switches without the complainants' knowledge or consent. There also appears to be an element of misrepresentation during this period, whereby the investment switches were happening around the same time as HE was communicating with the complainants without mentioning them.

The unauthorised switches should never have happened. In addition, the manner of those switches supports the complainants' allegation that the partner churned their accounts. HE does not appear to have a credible explanation for the strategy it applied, other than its somewhat generic claim that it sought to provide active management in the accounts. The number of switches conducted in the relevant six months illustrates active management but, firstly, it was unauthorised management and, secondly, the investment rationale behind it, if any existed, does not appear to have been explained, so it has not been established that they were made in the complainants' best interests. Furthermore, and in the same context, the generation of almost £50,000 in switch fees for HE during this unauthorised and unexplained pursuit adds to the conclusion that it was not in the complainants' best interests.

I share the investigator's view on the matter of the switch fee agreement. In the absence of evidence of a discussion between both sides about it in 2020 or notice of its introduction at the time, on balance, I consider it inconceivable that the complainants would have agreed to it despite having no such fee in HE's service over the previous years. Aside from this, the primary findings remain that HE had no authority to conduct the switches without the complainants' knowledge and consent/instruction, they were made without such knowledge and consent/instruction and they appear to have been made in order to churn their accounts (because they were numerous and frequent, they generated significant switch fees for HE but there is a lack of evidence that they were in the complainants' best interests).

Overall, on balance and for the above reasons, I uphold the complainants' complaint.

Putting things right

None of what HE did in this case should have been done, and because of its actions it committed a fundamental breach of the trust and confidence the complainants had in it. Following such breach, it was reasonable for them to terminate its service and to take their accounts to a new adviser. As such, an in addition to the effects of HE's actions on their accounts (at HE) there is also a direct causal link between those actions and the establishment cost they incurred with the new adviser.

My aim in compensating the complainants is to try to put them as close as possible into the position they would likely have been in, but for HE's actions. For this purpose, I order HE to compensate them as follows:

- The benchmark to be used for calculating redress is specific to the circumstances of this case. The complainants refer to how their accounts would have performed if they were left as they were prior to the partner's unauthorised switches during the relevant period. I have not seen evidence to confirm that they sought changes to their pensions and investment portfolios at the time so I consider this to be a fair and natural benchmark. As such, HE must calculate, individually, what the complainants' two pension accounts and one investment account would now be worth if they were left unchanged from what they were prior to the unauthorised switches that the partner began to make around July 2020. This means calculation of how each of the three accounts would have performed (and what each will now be worth) based on the contents they had at the time, without any of the unauthorised switches that subsequently happened, without deduction of any of the switch fees that were applied for those unauthorised switches and reflecting any income, distributions and/or dividends they would have been entitled to from the accounts.

  ['*Fair Value'*]

- HE must then calculate the current value of each of the three accounts. In this respect, the complainants should share with HE any information that it reasonably requires in, and that is relevant to, its calculation of this.

  ['*Actual Value*']

- If fair value is greater than actual value in the calculation for any or all the three accounts, the difference must be paid by HE to the complainants as compensation.

  ['*Redress*']

- HE must also pay the complainants the total amount of establishment fee that they incurred when they moved their accounts to their new adviser. As stated above, HE's actions caused them to move to their new adviser and to incur this fee. The complainants should share with HE information that it reasonably requires, and that is relevant to, its calculation of this compensation.

- With regards to the complainants' pensions accounts, HE should pay the redress into their respective pension plans, if possible, to increase their values by the amount of the compensation and any interest. The payments should allow for the effect of charges and any available tax relief. The compensation should not be paid into their pension plans if it would conflict with any existing protection or allowance. If the compensation cannot be paid into their pension plans, HE must pay it directly to them. Had it been possible to pay it into their plans, it would have provided a taxable income, so the compensation should be reduced to *notionally* allow for any income tax that would otherwise have been paid. The *notional* allowance should be calculated using their actual or expected marginal rate of tax at their selected retirement age. They say they are yet to take any tax-free cash from their plans, if so 25% of the redress would be tax-free and 75% would have been taxed according to their likely income tax rate in retirement. The complainants should share with HE information that it reasonably requires, and that is relevant to, its calculation of this.

- HE must provide the calculations of the compensation to the complainants in a clear and simple format.

- HE must pay interest on the total compensation to the complainants at the rate of 8% simple per year from the date of this decision to the date of settlement if, due to no fault of the complainants, HE does not pay them the total compensation within 28 days of being informed of their acceptance of this decision. This provision is to compensate them for late payment of the compensation.

compensation limit

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, £160,000, £350,000 or £355,000 (depending on when the complaint event occurred and when the complaint was referred to us) plus any interest that I consider appropriate. If fair compensation exceeds the compensation limit the respondent firm may be asked to pay the balance. Payment of such balance is not part of my determination or award. It is not binding on the respondent firm and it is unlikely that a complainant can accept my decision and go to court to ask for such balance. A complainant may therefore want to consider getting independent legal advice in this respect before deciding whether to accept the decision.

My final decision

For the reasons given above, I uphold the complaint from Mr L and Mrs L. I order Houghton Edwards LLP to pay them compensation as set out above and to provide them with calculations of the compensation in a clear and simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr L and Mrs L to accept or reject my decision before 27 April 2022.

Roy Kuku
Ombudsman