DRN-3367187

**The complaint**

Mr T complains that Tier One Capital Ltd ('TOC') gave him unsuitable advice when they recommended him multiple times to invest in the West Auckland (WA) Project, a private funding circle (PFC) investment.

Mr T invested both from personal funds and later through his Self-Invested Personal Pension (SIPP). His direct investment outside the SIPP forms part of a separate complaint, so this decision only deals with Mr T's direct investments into WA through his SIPP.

**What happened**

Mr T had already previously invested into WA on the advice of TOC outside the SIPP in 2015. Mr T transferred his personal pension worth around £290,000 to a SIPP in 2016. He was advised by TOC to invest £100,000 of his funds into the WA project in April 2016. Mr T's capital was returned to him with interest and he reinvested the sum of £100,000 into the next stage of the project in March 2018.

WA was a lending project which started in 2015 to provide funding for a development of 110 houses. The investment was part of a syndicated property loan with a maximum term of two years. Interest of 10% per year was to be paid to investors quarterly. TOC described the investment as being of moderate risk.

TOC say interest payments stopped in late 2019 when the project suffered financial difficulties. From what I understand there is no concrete prospect of when or if capital repayments or further interest payments will be paid. TOC said eventual losses would be known by the end of 2021, but the Financial Ombudsman Service has not been informed by either party that a final conclusion on the project has been reached.

Mr T complained in 2020. He says the investment has not carried the security in assets that was promised. He says he was a cautious investor and he was not interested in risk believing the investment to be asset backed. In an email to TOC in June 2020 he said:

*These investments were sold to me on the basis there was very little to no risk as the security would always cover any shortfall.*

TOC admitted in their initial response to Mr T in May 2020 that there had been gaps in their sales advice process and record keeping and they said there were inconsistencies in the information Mr T was provided with. The adviser who had recommended the WA investment to Mr T was not working for TOC anymore. They said it was unclear whether the advice to invest into WA had been suitable or not.

They offered Mr T to delay the complaint resolution until the outcome of the project and full losses would be known. TOC said they would then revisit the complaint. Alternatively, they offered to use a forecasted capital loss position of 40%. After deducting interest payments Mr T already received on his total direct investment into WA (which included £25,000 invested from personal funds), they calculated losses to be £10,000 and offered to pay another £1,000 to acknowledge they had fallen below their service standards. They offered to keep this sum in TOC's account accruing interest of 3% a year and use it to pay for ongoing charges or-if Mr T didn't want to use their services anymore-pay the sum of £11,000 to him directly.

Mr T rejected the proposals and referred his complaint to this service. TOC provided their file to the Financial Ombudsman Service. They now say the advice given was suitable. Our investigator upheld the complaint. He considered Mr T was a cautious investor and that the WA investment exceeded his attitude to risk. He also felt Mr T's exposure to the WA investment was too high, given that he also held other PFC investments.

TOC disagreed. They referred to Mr T's significant overall asset value which includes large amounts of cash, several valuable cars, a buy to let property and company shares. They said when Mr T was advised to invest in 2016 the WA investment accounted for 6.6% of Mr T's investable assets which was a reasonable amount. They also say Mr T fully understood the risks of the investment and had invested into numerous projects of a similar nature.

As no agreement could be reached, the complaint was referred for an ombudsman's 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.

TOC gave Mr T investment advice and so they needed to make sure their recommendations were suitable for him.

Mr T originally met with TOC in 2015. A meeting note dated 3 February said:

*[Mr T] explained he would ideally wish to simply generate an income a bit better than what he currently is achieving with a raft of cash deposits with the mainstream banks. [TOC] discussed the importance of completing the risk questionnaire to allow a more informed decision on where best to allocate funds within risk parameters they will be comfortable with and which achieve their goals.*

Mr T and his wife completed a risk questionnaire which showed Mrs T was very risk averse. Mr T was recorded as being risk category 4 which I assume was equivalent to lowest medium risk. He said on his attitude to risk form he was neither risk averse or a risk taker. He strongly agreed or agreed with statements which said:

- *I have been extremely cautious in my past financial investments.*
- *I believe that it is reckless to take financial risks*
- *When I'm faced with a financial decision I am generally more concerned about the possible losses than the possible gains*
- *I would rather get a guaranteed rate of return than be uncertain about my investments.*
- *I do not feel comfortable with financial uncertainty.*

And he disagreed with:

- *I would accept potential losses in order to pursue long-term investment growth*
- *Taking investment risks is important to me*

He ticked a box to say he felt *slightly comfortable* when he took a financial risk and small/medium losses could be tolerated.

Having looked at the questions he answered I agree with the investigator that he was a cautious investor. This is also backed up by the fact that Mr T and his wife held the vast majority of their money in cash and premium bonds. They had a rental property and Mr T had a pension. The couple didn't have any other significant investments at the time. And another meeting note on 4 February 2015 stated that the adviser thought the risk questionnaire suggested Mr T had a preference for lower risk investments.

From what I've seen Mr T wanted to get better returns than he got from cash deposits. An investment report in 2018 said Mr T wanted to do better than low returns on cash accounts and wanted to outpace inflation. This in my view is quite different to investing into high risk, unregulated investments. I don't think the evidence suggests he needed or wanted to take much risk with his money.

I appreciate Mr T was high net value client with large sums of cash available to invest. And in comparison to his overall assets the sum invested in WA was relatively small. So I agree that he had the financial capacity to lose some of his investment. However, this doesn't make mean the investment was suitable. I've also taken into account that by the time he was advised to invest through his SIPP, he already had been recommended PFC investments outside his SIPP. The adviser also suggested Mr T should invest his whole pension transfer value into PFC. A meeting note of 17 February 2016 shows the adviser recommended him to split £300,000 into four different projects. So Mr T's exposure to higher risk investments was a lot higher than just his £100,000 investment through his SIPP into WA.

I don't think the PFC investments matched Mr T's attitude to risk and were generally suitable for him. He didn't have any significant investment experience and so I'm not persuaded he would have had the relevant knowledge and experience to fully understand the risks these investments held. These were unregulated investments with substantial liquidity, credit and market risks. Even when he had entered several PFC investments, he had done so based on advice he received from TOC, so I don't think his knowledge and understanding of risks automatically would have increased. From what I've seen he trusted the adviser to recommend investments which were in line with his attitude to risk.

Mr T kept referring to these investments being 'asset backed' and a couple of years later he said he preferred 'bricks and mortar' to equity investments. TOC seems to take this as evidence that Mr T understood what he was doing, however I take a different view.

I think Mr T likely thought the idea of having land or properties acting as a security was reassuring and he might have felt he understood the concept of investing in property better than equities which he didn't have experience with and might have felt more abstract and volatile to him. Also TOC told him in 2016 this was a moderate investment which would have given him no reason to think otherwise.

And even in 2018, when TOC said WA was a high-risk investment, they reassured Mr T in their suitability report that

*'the project is asset backed to a strong degree, and whilst this remains a private loan supporting a single project the project carry's a relatively conservative loan to Gross Development Value. The process outlined is therefore one which we feel can mitigate a large portion of the risks inherent in this activity however it is still sensible for each investor to acknowledge the potential for such a project to change in shape or form as the project progresses.'*

I don't think this made it clear enough how much risk this investment really entailed and how this differed from the investments recommended before in the same project which were previously described as low and moderate investments.

In my view this investment from the start was a higher risk, non-standard and unregulated investment. Although I appreciate risk factors were described in the suitability report, I don't think Mr T would have understood the full risks of the PFC proposition in general. His wife was risk averse and he was cautious. I don't think the PFC investments were right for them.

They had no need to take risk with their money to achieve high returns. Their financial situation in my view was comfortable and a diversified low risk portfolio of standard investments which could have included for example bonds, gilts and property funds (if Mr T didn't want to invest much in other equity shares) would have been far more suitable in my view.

Whilst TOC have said the first investment was a moderate investment, I disagree. It might have been less risky than later funding tranches, but I still think this non-standard investment was a lot higher risk than Mr T was willing or had a need to take. I appreciate Mr T held quite a few of PFC investments in his portfolio and some were successful.

Overall, I don't think the WA investment should have been recommended to Mr T.

**Putting things right**

In assessing what would be fair compensation, I consider that my aim should be to put Mr T as close to the position he would probably now be in if he had not been given unsuitable advice. With suitable advice I think Mr T would have invested the sum of £100,000 differently in 2016 and would not have invested this sum again in 2018. I don't know exactly where Mr T would have invested his money instead, however I think the below recommendation is fair and reasonable in the circumstances.

**What should TOC do?**

Mr T's first investment in 2016 was successful and he received interest payments. It is the investment in 2018 which is in difficulty and which might cause Mr T losses.

Both Mr T's gains and losses from the WA investments through his SIPP need to be taken into account here, as with suitable advice he also wouldn't have earned any interest from the WA investments.

To compensate Mr T fairly, TOC must:

- Compare the value of Mr T's outstanding WA investment in the SIPP with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

- TOC should also pay interest as set out below.

- If TOC is unable to pay the total amount into Mr T'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 T won't be able to reclaim any of the reduction after compensation is paid.

- The notional allowance should be calculated using Mr T's actual or expected marginal rate of tax at his selected retirement age.

- For example, if Mr T is likely to be a basic rate taxpayer at the selected retirement age, the reduction would equal the current basic rate of tax. However, if Mr T would have been able to take a tax-free lump sum, the reduction should be applied to 75% of the compensation.

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

| Investment name | Status | Benchmark | From ("start date") | To ("end date") | Additional interest |
|---|---|---|---|---|---|
| WA investment | Still exists but illiquid | For half the investment: FTSE UK Private Investors Income Total Return Index; for the other half: average rate from fixed rate bonds | 2016 | 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. If at the end date the investment is illiquid or like in this case it's uncertain how much capital and/or interest will be returned, it may be difficult to work out what the *actual value* is. In such a case the *actual value* should be assumed to be zero. This is provided Mr T agrees to TOC taking ownership of the investment, if they wish to. If it is not possible for TOC to take ownership, then they may request an undertaking from Mr T that he repays to TOC any amount he may receive from the investment in future.

I appreciate TOC would like to wait until the value of the investment is known. However, I don't think it's fair for Mr T to have this continued uncertainty, so calculations should be done now.

***Fair value***

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

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, TOC should use the monthly average rate for one-year fixed-rate bonds as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other distributions paid out of the investments 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 TOC totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically. If any distributions or income were automatically paid out into a portfolio and left uninvested, they must be deducted at the end to determine the fair value, and not periodically.

**Why is this remedy suitable?**

I have chosen this method of compensation because:

- Mr T wanted capital growth with a small risk to his capital.
- The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to his capital.

- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is a mix of diversified indices representing 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.

- I consider that Mr T's risk profile was in between, in the sense that he was prepared to take a small level of risk to attain his investment objectives. So, the 50/50 combination would reasonably put Mr T into that position. It does not mean that Mr T would have invested 50% of his money in a fixed rate bond and 50% in some kind of index tracker fund. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mr T could have obtained from investments suited to his objective and risk attitude.

**My final decision**

I uphold Mr T's complaint and ask Tier One Capital Ltd to compensate him as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr T to accept or reject my decision before 18 April 2022.

Nina Walter
**Ombudsman**