

The complaint

Mr H with the help of a professional representative complains that Inter-UK Financial Services Limited (Inter-UK) are at fault for the losses he suffered from his pension.

What happened

In February 2018, following a transfer to a SIPP Mr H met with Inter-UK to discuss his investment strategy going forward for his retirement plan.

Inter-UK recommended an Income Model Portfolio with SVS fund managers as the most suitable investment strategy based on his circumstances, attitude to risk, and objectives. However, it doesn't look like any other methods were discussed or even considered for Mr H's funds. And in reality, Mr H was in fact invested in a different model portfolio with SVS, the Mixed Model Portfolio.

Mr H's attitude to risk (ATR) was assessed as balanced or lowest-medium. It said Mr H's preferred investments would be cash, cash-type assets, bonds, or UK commercial property, with typically fewer higher-risk investments such as UK and overseas shares.

The Financial planning questionnaire noted Mr H as being self-employed working as a courier and earning £1,000 per month net income (£15,000/year gross). His fund value was approximately £400,000, he had no other pensions or savings.

Mr H signed to agree to the fees charged by Inter-UK, a £1,500 initial fee for the advice and 1% ongoing fee. The 1% ongoing fee was paid in return for a number of promised functions such as (but not limited to):

- *'Professional expertise and governance embedded into our investment processes*
- *Quarterly Portfolio Rebalancing*
- *Quarterly valuations*
- *Six monthly review meetings*
- *Review of risk profile*
- *Review of asset allocation (if required)*
- *Updates and valuations'*

There is a message between Mr H and Inter-UK to say the investment in SVS had been delayed due to further due diligence checks. An account statement shows the Mixed Model Portfolio was setup for Mr H on 26 April 2018 and the investment split was approximately 48% Fixed Income Holdings, 23% Smallcap holdings, 17% cash and 12% FTSE 350 holdings.

The Fixed Income Holdings were mainly in Corporate Bonds offering returns in interest of 6.25% or more over a fairly short period of time between 3 and 5 years. These were not bonds from large recognisable firms and instead were listed on small exchanges (the majority on the Irish exchange) with very little information available about the structure and appear to be unregulated without recourse to the FSCS.

Later in 2019 SVS collapsed as the regulator had investigated it and blocked it from doing new business. The FCA had been in contact with SVS as early as January 2018 about the lack of due diligence, high concentration and liquidity risk of some of the bonds SVS had invested clients' money in. Of particular concern were the Corporate Finance Bonds Ltd of which Mr H was invested in a number of different bonds relating to this firm.

Mr H's representatives complain that Inter-UK Financial Services Limited shouldn't have recommended Mr H invest with SVS. They say even the most basic of due diligence would've discovered that the portfolio's SVS were promoting were unsuitable for Mr H.

Inter-UK in response have explained that it doesn't have any record of the due diligence done at the time as the business has changed hands. However, it believes due diligence would've been carried out. But it felt it wasn't a realistic expectation for it to have looked so closely into the arrangements within SVS's portfolios to discover conflicts of interests between SVS and the bond seller as argued by Mr H's representatives.

Our investigator looked into matters and upheld the complaint he said that Inter-UK ought to have carried out due diligence on the SVS portfolios and had it done so, it would've seen that the investments within were not suitable for Mr H.

Inter-UK said that it would've applied the same due diligence to this DFM (SVS), as any other, but hasn't been able to evidence this because the record is no longer available. Inter-UK states that in hindsight it is easier to say that extra due diligence was needed however SVS would've been treated as any other firm as they were FCA authorised (without restriction) at the time. And so on that basis it will have concluded that all threshold conditions were being met.

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.

And having done so, I will be upholding this complaint for broadly the same reasons as the investigator. I'll explain why, in more detail below.

Adviser's responsibilities in terms of due diligence and outsourcing investment strategy was given a lot of attention in regulator updates and by May 2016 at the latest both the regulator and an industry body (the PFS) had made it clear that there was an obligation on an adviser to carry out research on any DFM recommended and '*look under the bonnet*'.

This included:

- Looking into a current breakdown of assets in any proposed model portfolio
- How the DFM manages those assets
- To make sure its risk profile aligns with the DFM's and any recommended portfolio
- Did it agree appropriate restrictions with the DFM about what the customer was and wasn't allowed to invest in
- Look into how the DFM would typically invest for a certain attitude to risk

We don't have much evidence to say how Inter-UK and SVS interacted. The portfolio that was initially recommended by Inter-UK wasn't what was eventually used. And the suitability report is contradictory about whether it was the DFM or Inter-UK's risk rating that would be used to select a portfolio. Regardless, the adviser had a responsibility to act in their client's best interests and is responsible for what subsequently happened.

This is especially true here as Mr H remained a client of Inter-UK after the advice had been given and paid fees for agreed services such as; *‘Professional expertise and governance embedded into our investment processes, Review of risk profile and Review of asset allocation (if required).’*

As a minimum Inter-UK ought to have looked at SVS’s portfolios and what was within them prior to recommending them to Mr H. And again as a minimum after the investment was put in place it should’ve checked the holdings within.

Had it done so it would’ve quickly become clear that both the portfolio it recommended and the holdings that Mr H actually ended up in were wholly unsuitable for the attitude to risk it had ascertained.

The makeup of the portfolio, even disregarding the fixed interest holdings, was clearly too high risk for Mr H. In its own suitability report Inter-UK had concluded that the majority of Mr H’s suitable investments would be cash, cash-type assets, bonds, or UK commercial property. Yet approximately 35% of his fund was invested in SmallCap holdings and FTSE350 holdings. SmallCap stocks tend to be volatile, with a high level of risk as they are less established firms often with shaky finances and often do not pay a dividend. Similarly many of the holdings within the FTSE 350 selection were of less established firms. These are not investments suitable for a low risk investor especially at the level invested within and even more so when you consider them alongside the rest of the portfolio.

The fixed interest holdings recommended were in the majority in a company called Corporate Finance Bonds Ltd.

In 2017 the FCA had issued a notice advising that DFM arrangements were the new target for investment scams. So Inter-UK ought to have been aware of this and remained vigilant in its due diligence for this potential occurrence. And it appears that the bonds invested within here, meet the concerns raised by the FCA.

Regardless of this, Inter-UK ought to have done basic due diligence and had it done so, it would’ve been apparent that nearly 50% of Mr H’s funds invested within these bonds was unsuitable. I don’t know what, if any, due diligence Inter-UK had carried out but it’s clear its approach to selecting the DFM didn’t go far enough in terms of understanding the characteristics, balance or appropriateness of the holdings that were proposed and made for Mr H’s portfolio. It appears these bonds were Unregulated Collective Investment Schemes’ (UCIS), and certainly highly specialised and unregulated funds. There is evidence from other cases involving these bonds (and prior to the investment made by Mr H) about the notes on suitability and risk flagged in the literature associated with these specialist investments. With regards to the Corporate Finance Bonds Ltd that Mr H invested within, the wording below is typical of what was in the literature across the different bonds it offered.

“Suitability Prospective purchasers of the Notes of any Class should ensure that they understand the nature of such Notes and the extent of their exposure to risk, that they have sufficient knowledge, experience and access to professional advisers to make their own legal, tax, accounting and financial evaluation of the merits and risks of investment in such Notes and that they consider the suitability of such Notes as an investment in the light of their own circumstances and financial condition.” “Unlike a bank deposit, the Notes are not protected by the Financial Services Compensation Scheme (the “FSCS”) or any other government savings or deposit protection scheme. As a result, the FSCS will not pay compensation to an investor in the Notes upon the failure of the Issuer. If the Issuer goes out of business or becomes insolvent. Noteholders may lose all or part of their investment in the Notes.”

Mr H also had a holding in Angelfish Investments PLC – which I’ve included an extract from:

“The Preference Shares are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should only invest in the Preference Shares if they have the expertise (either alone or with a financial adviser) to evaluate how the Preference Shares will perform under changing conditions, the resulting effects on the value of the Preference Shares and the impact this investment will have on the potential investor’s overall investment portfolio.”

Had Inter-UK looked into these investments it would’ve been very clear to it as a financial advisory service that these investments weren’t suitable for Mr H.

Even if it hadn’t looked closely into them, it ought to have known that Corporate Bonds as a product (even within top firms – that these clearly were not) have inherent risk, are riskier than Government Bonds and have the potential for complete loss of funds.

I appreciate the investments made didn’t match the portfolio originally recommended but regardless this point stands for both portfolios as whilst the percentage of holdings were different, the actual investments within were similar. And as I’ve said above Inter-UK had a responsibility to look into Mr H’s investments after they’d been made as well.

The level of investment within the Corporate Bonds also meant there was a clear lack of diversification across Mr H’s portfolio that should’ve been apparent to Inter-UK. Especially when considering another 35% of Mr H’s funds were invested in what amounts to a high risk stock portfolio.

I think its clear Inter-UK failed in its duty to Mr H and it likely didn’t carry out any due diligence or was aware that what SVS was selecting was high risk. And had they carried out their role correctly and acted in Mr H’s best interests, he wouldn’t have suffered the losses he now has. So I think it needs to put things right for Mr H.

I appreciate there is a second party (SVS) involved here who’s actions may have also played a part in Mr H’s losses. However, I’m deciding the complaint against Inter-UK (not SVS) and I’m satisfied that without their unsuitable advice in recommending SVS, Mr H wouldn’t have suffered the losses that he has.

From what I’ve seen Inter-UK failed to do proper due diligence on SVS to ensure they fully understood their investment strategy and whether it was appropriate for Mr H’s circumstances. If they had done so, I think they ought to have realised that SVS’s investment strategy included speculative investments which likely weren’t suitable for Mr H. So in the circumstances of this case I consider it fair and reasonable that Inter-UK compensates Mr H for all his losses.

Putting things right

Fair compensation

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

I take the view that Mr H would have invested differently. It's not possible to say *precisely* what he would have done differently. But I'm satisfied that what I've set out below is fair and reasonable given Mr H's circumstances and objectives when he invested.

What must Inter-UK do?

To compensate Mr H fairly, Inter-UK must:

- Compare the performance of Mr H'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.
- Inter-UK should also add any interest set out below to the compensation payable.
- Inter-UK should pay into Mr H'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 Inter-UK is unable to pay the total amount into Mr H'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 H won't be able to reclaim any of the reduction after compensation is paid.
- The *notional* allowance should be calculated using Mr H's actual or expected marginal rate of tax at his selected retirement age.
- For example, if Mr H 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 H 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 Inter-UK deducts income tax from the interest it should tell Mr H how much has been taken off. Inter-UK should give Mr H a tax deduction certificate in respect of interest if Mr H 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
SVS Mixed Model Portfolio	No longer in force	FTSE UK Private Investors Income Total Return Index	Date of investment	Date ceased to be held	8% simple per year on any loss from the end date to the date of settlement

Actual value

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

Fair value

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

Any additional sum paid into the investment should be added to the *fair value* calculation from the point in time when it was actually paid in.

Any withdrawal from the SVS Mixed Model Portfolio 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 Inter-UK 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 H 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 H's circumstances and risk attitude.

My final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £160,000, I may recommend the business to pay the balance.

Inter-UK Financial Services Limited should provide details of its calculation to Mr H in a clear, simple format.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Inter-UK Financial Services Limited should pay Mr H the amount produced by that calculation – up to a maximum of £160,000 plus any interest on the amount set out above.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £160,000, I recommend that Inter-UK Financial Services Limited pays Mr H the balance plus any interest on the amount as set out above.

This recommendation is not part of my determination or award. It does not bind Inter-UK Financial Services 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.

My final decision

I uphold Mr H's complaint and direct Inter-UK Financial Services Limited to put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr H to accept or reject my decision before 29 April 2023.

Simon Hollingshead
Ombudsman