DRN-3622376

The complaint

Mr M complains he was given unsuitable advice by Base Financial Limited (BFL) to switch his personal pension to a self invested personal pension (SIPP) with a new provider and invest via a Discretionary Fund Manager (DFM).

At the time BFL was an appointed representative of The Tavistock Partnership Limited (TTP). TTP is responsible for the advice BFL gave. For ease I've just referred below to TTP which should be taken, where appropriate, to include BFL.

What happened

Mr M had a personal pension with a fund value of £35,984. The fund was invested in the provider's with profits (6%) and stock exchange (94%) funds. The charges were an assumed annual charge of 0.659% and a management charge of 0.75% and 0.15% respectively.

I've seen various documents, including a fact find completed in April 2016 setting out Mr M's circumstances and objectives. His attitude to risk (ATR) had been assessed as moderate (six out of ten). The suitability report dated 20 April 2016 recommended that Mr M switch to a SIPP (administered by Gaudi Regulated Services Limited) and invest via Beaufort Securities Limited (BSL), a DFM, in its Total Return Medium High Risk Portfolio. The fees would be an initial advice charge of 2% of the switch value. There was an annual ongoing advice charge of 1%, an annual management charge of 0.18%, a set up charge of £75 plus VAT and an annual SIPP charge of £165 plus VAT.

Mr M accepted the recommendation. He made two contributions each of £10,000 in July and August 2016. He also made regular monthly contributions of £100 between July 2016 and January 2017.

In January 2017 TTP contacted Mr M saying that BSL was withdrawing its DFM service and a new manager would need to be found. BSL was no longer able to accept any new money. This was due to the regulator, the Financial Conduct Authority (FCA), identifying some concerns regarding systems and controls within BSL's DFM business. BSL agreed to work with the FCA and in the best interests of customers it was decided BSL's DFM business would cease.

Mr M met with TTP about moving the funds held with BSL. A suitability report was issued on 24 February 2017. In March 2017 TTP instructed BSL to encash as much of Mr M's portfolio as possible. In June 2017 cash was paid into Mr M's SIPP. At the beginning of July 2017 the provider confirmed the SIPP held £32,588.61 in illiquid assets. Mr M opened a new SIPP in September 2017 with a different provider into which £20,111.16 was transferred.

BSL was placed into administration in March 2018. Mr M made a claim to the Financial Services Compensation Scheme. It rejected his claim and said he needed to complain to TTP as it had given advice to invest via the DFM.

Mr M complained to TTP but it didn't uphold the complaint. Amongst other things, TTP maintained the portfolio was suitable for Mr M. His capacity for loss had been discussed.

Although it was his only pension provision he was planning to sell his business for a substantial amount. The recommended portfolio had a risk rating of between 6 and 7 which matched Mr M's ATR. The investments were made by BSL as the DFM and the choice of funds in the portfolio was the DFM's responsibility and not TTP's.

Mr M referred his complaint to us. One of our investigators looked into what had happened. He wasn't convinced that switching to the SIPP was necessary as Mr M's existing personal pension permitted employee and employer contributions. And, although Mr M wanted flexibility at retirement, he was only 42 at the time of the advice and he didn't plan on retiring for another 13 years at least. Mr M could've switched funds if those he was invested in didn't match his ATR. But Mr M wasn't complaining about the SIPP, just the investments made via the DFM. The investigator's view was that Mr M wanted the wider range of funds permitted by a SIPP and so he'd have switched to a SIPP anyway.

The investigator said the switch had been recommended to facilitate investment via the DFM. The investigator didn't think investing via a DFM was suitable. Mr M was a moderate risk investor with little previous investment experience.

The investigator didn't agree the selected portfolio matched Mr M's medium ATR. The suitability report said: '*To help reduce the overall risk to your portfolio I am recommending the 'Medium High' risk portfolio as it has increased fixed interest exposure and reduced equity exposure giving more stability approaching Brexit'*. The fund fact sheet showed the fund could hold up to 70% equities and only 40% in fixed income. There was no breakdown of the largest holdings so TTP couldn't be sure it aligned with the degree of risk Mr M was prepared to take, particularly as the DFM had what was described as *'an unconstrained approach'*.

The investigator noted that one of the fund aims was to invest in high yielding corporate debt. The investigator said there was a difference between high yielding (non-investment grade) debt and investment grade debt – the former has high yields in direct relation to the higher risk of default and therefore loss of an investor's capital. There was a target allocation of up to 40% in fixed income which could've been all non-investment grade debt. That meant a significant proportion was invested in high yield (and therefore high risk) debt which wasn't consistent with a medium risk approach.

The investigator also said that the charges for the new arrangement were considerably higher and so that was another reason for not recommending the DFM and model portfolio.

TTP had said in the pension replacement plan switch report: '*Based on funds past record it is unlikely the optimum growth within the risk profile will be achieved be retaining the existing plans*'. And answered in the affirmative when asked if it was anticipated fund performance would be better. But TTP's own research showed the annualised performance of Mr M's existing stock exchange fund over the last three years was 8.26% and 6.16% over 5 years. The with profits fund had a 4% pa guaranteed return. The fact sheet for the recommended model portfolio said the expected average returns were 5.32%. So there was no evidence that the new arrangement would optimise any return over and above Mr M's existing plan.

In conclusion the investigator said he'd not seen anything to show Mr M needed or wanted a DFM. He was a retail investor with limited experience. BSL was an unsuitable investment manager at the outset and its portfolio was unsuitable. The investigator set out how TTP should calculate and pay compensation to Mr M.

TTP said it wanted to comment in response to the investigator's view. We gave TTP further time in which to do so. But, although we've been in contact with TTP several times since, including informing TTP that the complaint was being referred to an ombudsman to decide, we haven't received any further comments from TTP.

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 agree with the investigator that Mr M's complaint should be upheld.

Mr M isn't complaining that a SIPP shouldn't have been recommended. His complaint just relates to the advice to invest with the DFM. I agree with the investigator that Mr M was likely to have switched his personal pension to a SIPP anyway. And I note he's since switched to another SIPP which would also indicate that he did want that type of pension vehicle. So all I'm looking at is the recommendation to invest Mr M's pension fund via the DFM in its Total Return Medium High Risk Portfolio.

I've considered first if using a DFM was suitable. I've considered the then regulator's finalised guidance: '*Assessing suitability: Replacement business and centralised investment propositions (July 2012)*'. In deciding whether to use a DFM the following factors are likely to feature: the likely cost; the size of the funds under management; the investor's knowledge and experience; and if the benefits and the costs were properly explained and understood by the investor.

I don't think Mr M, taking into account that his fund size was modest, had any need for a DFM and the extra layer of charges that would impose. Mr M was an ordinary retail client. He wasn't an experienced investor and, even if he thought he might want to be able to access at some stage the wider range of investments that a SIPP offered, that didn't mean he needed a DFM.

Mr M's objectives in switching were to review his existing pension plan with a view to improving on it; open a new pension for lump sum and monthly company contributions; and improve on current returns. As noted above, Mr M's existing pension plan was able to accept employee and employer contributions. And that objective was unrelated to having a DFM.

I don't see that the new arrangement was likely to produce better returns. It was higher charging and so the extra fees would have to be covered to produce a net higher return. And, as the investigator pointed out, it seems that TTP's own research indicated that Mr M's existing funds were doing well. The expected average returns from the recommended DFM portfolio were 5.32%. So it was unclear that Mr M's objective of better returns would be met. In my view, the extra costs of using a DFM weren't justified by the potential for improved performance.

If I thought using a DFM might be suitable then I'd go on to consider other issues, such as if the particular DFM selected was suitable, what instructions were given to the DFM and if the asset selection (the portfolio) was consistent with the mandate, including the investor's ATR. Because I don't think Mr M should've been recommended to use a DFM, the suitability or otherwise of the DFM selected and any other issues largely fall away. But I'd note that there were some question marks over the particular DFM. It had been fined twice by the FCA, in 2003 and 2006, for various breaches of the FCA's Principles for Businesses.

I also note the investigator's concerns about the makeup of the selected portfolio and whether it could properly be regarded as suitable for investor with a moderate ATR. I agree that the inclusion of high yield/high risk debt is likely to have increased the level of risk the portfolio represented. The portfolio may have been higher risk than Mr M's moderate ATR should've dictated. TTP was also aware that BSL's model portfolios didn't have a lengthy track record.

TTP has said that BSL invested in illiquid funds which was outside the mandate that TTP had given. But the point is that I don't think a DFM was suitable in the first place. So, and regardless of whether the DFM didn't invest as TTP had been led to believe, Mr M shouldn't have had a DFM. He was only invested with the DFM because TTP had advised him to do that. I can't see he'd have invested with the DFM otherwise.

The recommendation to use a DFM wasn't suitable for Mr M. TTP is responsible for the losses Mr M has incurred in consequence of being invested with the DFM. I agree with the what the investigator said as to how TTP should put things right for Mr M. I've set the redress out again here.

Putting things right

In assessing what would be fair compensation, my aim is to put Mr M as close as possible to the position he'd probably now be in if he'd been given suitable advice. I think Mr M would have invested differently. I can't say precisely what he'd have done instead, but I'm satisfied that what I've set out below is fair and reasonable, given Mr M's circumstances and objectives when he invested.

To compensate Mr M fairly The Tavistock Partnership Limited must:

- Compare the performance of Mr M's investment with that of the benchmark shown below. If the ***fair value*** is greater than the ***actual value***, there's a loss and compensation is payable. If the actual value is greater than the fair value, no compensation is payable.
- Pay any interest.
- If there's a loss it should be paid into Mr M's pension plan to increase its value by the amount of the compensation and any interest. The payment should allow for the effect of charges and any available tax relief. Compensation shouldn't be paid into the pension plan if it would conflict with any existing protection or allowance.
- If The Tavistock Partnership Limited is unable to pay the compensation into Mr M's pension plan, it should pay that amount direct to him. But had it been possible to pay into the plan, it would've provided a taxable income. Therefore the compensation 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 M won't be able to reclaim any of the reduction after compensation is paid.
- It's reasonable to assume Mr M is likely to be a basic rate taxpayer at the selected retirement age so the reduction would equal 20%. However, if Mr M would've 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%.
- In addition, The Tavistock Partnership Limited must pay Mr M £300 for the distress caused by the worry in fearing he'd lost his pension fund or a large proportion of it.
- Details of the calculation should be provided to Mr M in a clear, simple format.
- Income tax may be payable on any interest paid. If The Tavistock Partnership Limited considers it's required by HM Revenue & Customs to deduct income tax from that interest, it should tell Mr M how much has been taken off and give him a tax deduction certificate in respect of interest if Mr M asks for one, so he can reclaim the tax on the interest from HM Revenue & Customs if appropriate.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Beaufort Securities Limited Total Return Medium High Risk Portfolio	No longer in force	FTSE UK Private Investors Income Total Return Index	Date of investment	Date ceased to be held and then any loss carried forward against the same benchmark to the date of settlement	N/A

actual value

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

If, at the end date, the portfolio is illiquid (meaning it cannot be readily sold on the open market), it may be difficult to find the actual value of the portfolio. So the actual value should be assumed to be nil to arrive at fair compensation. The Tavistock Partnership Limited should take ownership of the illiquid portfolio by paying a commercial value acceptable to the pension provider. This amount paid should be included in the actual value before compensation is calculated.

If The Tavistock Partnership Limited is unable to purchase the portfolio the actual value should be assumed to be nil for the purpose of calculation. The Tavistock Partnership Limited may wish to require that Mr M provides an undertaking to pay to The Tavistock Partnership Limited any amount he may receive from the portfolio in the future. That undertaking must allow for any tax and charges that would be incurred on drawing the receipt from the pension plan. The Tavistock Partnership Limited will need to meet any costs in drawing up the undertaking.

fair value

This is what the investment would've 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.

The Beaufort SIPP administered by Gaudi Regulated Services Limited only exists because there are illiquid assets. In order for the SIPP to be closed and further fees that are charged to be prevented, those investments need to be removed. I've set out above how this might be achieved by The Tavistock Partnership Limited taking over the portfolio, or this is something that Mr M can discuss with the provider directly. But I don't know how long that will take. Third parties are involved and we don't have the power to tell them what to do. If The Tavistock Partnership Limited is unable to purchase the portfolio, to provide certainty to all parties, I think it's fair that The Tavistock Partnership Limited pays Mr M an upfront lump sum equivalent to five years' worth of wrapper fees (calculated using the fee charged in the previous year to date). This should provide a reasonable period for the parties to arrange for the Beaufort SIPP to be closed.

Why is this remedy suitable?

I’ve chosen this method of compensation because:

- Mr M 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’s a fair measure for someone who was prepared to take some risk to get a higher return.
- Although it’s 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 M’s circumstances and risk attitude.

My final decision

I uphold the complaint. The Tavistock Partnership Limited must redress Mr M as I’ve set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr M to accept or reject my decision before 4 April 2023.

Lesley Stead
Ombudsman