DRN-3659182

The complaint

Mr K complains about the advice he received from AFH Independent Financial Services Limited (AFH) to switch from his personal pension plans to a Self-Invested Personal Pension (SIPP) so that he could use the services of its Discretionary Fund Manager (DFM).

Mr K is being represented by a Claims Management Company (CMC). Any reference to Mr K will include information received from the CMC.

What happened

I issued a provisional decision on 2 August 2022 upholding the complaint. Both parties have accepted the outcome. In summary the background to this complaint is as follows:

- In August 2018, Mr K transferred from a defined benefit (DB) pension with his Occupational Pension Scheme (OPS) to a Scottish Widows Retirement Plan (SW plan). This followed advice from an Independent Financial Adviser (IFA). AFH had no involvement in this advice.

- Once transferred from his OPS, Mr K's pension funds were invested as follows:

  - The SW plan had a value of around £988,086. The SW fund invested predominately in equities including a small proportion in listed property securities and had some exposure to fixed interest securities.
  - Mr K also held a SIPP with Transact which was valued at around £45,314. This was already invested in an AFH Discretionary Portfolio for a client with an attitude to risk (ATR) of 3.

- In summary, Mr K's circumstances at the time of the advice was as follows: he was 55 years old and was married; his yearly salary was £54,000; he wanted to retire at 56 years old with a yearly salary of £40,000; his yearly expenses were £30,000; his home was jointly owned, valued at £450,000 and mortgage free and; he had investments in his employer's company valued at £80,000.

- AFH assessed Mr K's attitude to risk as '3'. The portfolio for this risk rating was described by AFH as trying to strike a balance between long-term capital protection and exposure to assets that had the potential to offer real rate of returns. And it was always likely to have a minimum exposure to equities which would be a maximum of 70% of the portfolio.

- The suitability report dated 14 January 2019, recorded that Mr K met with the AFH DFM managers. And because his pension funds were over £1million, he wanted a 'bespoke' management and portfolio design' to manage his pension funds.

- The adviser went on to say Mr K was fully aware bespoke type services involved additional risk and the strategy would concentrate on outperforming over and above his stated risk profile. The adviser said Mr K had accepted there was a higher cost associated with a DFM service, but that he (Mr K) was willing to pay a premium for this type of service.

- In terms of the charges, the total transfer value of Mr K's pensions by the date of the suitability report, was noted to be £1,031,086. The initial AFH adviser charge was 1% which equated to £10,310. Other cost comparisons set out in the suitability report were as follows:

  - Transact SIPP – total cost 2.01% which included ongoing management costs (OMC) of 1%.
  - SW plan – 0.78% which included OMC of 0.50%.
  - AFH DFM – 2.20% which included OMC of 1.50%.

- In addition to the above costs, AFH recommended that Mr K switch to a James Hay SIPP as it was only through this that he could use its 'Private Wealth' DFM services. Cost comparisons were shown in the suitability report as follows:

  - James Hay platform costs was 0.20% - SW plan was nil and Transact was 0.68%.
  - James Hay annual fee was £195 - SW plan was 0.08% and Transact was £80.
  - James Hay drawdown annual fee was £150 - the SW plan and Transact were nil.
  - James Hay tax-free cash lump sum withdrawal was £100 per crystallisation - the SW plan and Transact was nil.
  - James Hay dealing charges were £25 per trade - SW plan was nil and Transact dealing charges were £3.75 per trade.
  - The James Hay transfer out charge was £150 - the SW plan and Transact was nil.

- The adviser recommended the transfer to the James Hay SIPP and AFH Private Wealth service (DFM service) on the following basis:

  - The adviser didn't think Mr K's objectives could be achieved without moving to an alternative scheme.
  - Although Mr K would incur additional costs the adviser was satisfied these were justified given his (Mr K's) personalised investment objectives.
  - Mr K had confirmed the cost was not a main objective and it was more about accessing an enhanced investment service.
  - Mr K required a service that was more bespoke to his views on the type of assets he would wish his investment funds to engage with.
  - Mr K was unable to gain access to his preferred investment management service offered through AFH Private Wealth.

I'm now issuing my final decision on the matter.

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.

As both parties have added nothing further, my final decision remains as set out in my provisional decision which is as follows:

AFH was required to follow the relevant rules set out by the regulator. These include the overarching Principles for Businesses – principles 1 (integrity), 2 (due skill, care and diligence), 6 (customers' interests) and 9 (reasonable care) are of particular relevance here.

Amongst other things, to fulfil its duties AFH had to know its client, act in his best interests, and give suitable advice. Taking into account Mr K's circumstances, I'm not persuaded that the switch and subsequent investment via a DFM was suitable. This came at significant cost and resulted in him incurring additional fees in respect of his pension.

By switching his existing pensions to one SIPP with a DFM service, Mr K incurred additional costs. On top of an initial advice fee of just over £10,000, he was paying higher ongoing charges. This significantly increased his costs because his main pension fund with SW, which was just under £1million, had previous ongoing charges of 0.78%. When Mr K transferred to James Hay so that he could use AFH's DFM services, he was now liable to pay ongoing fees to a SIPP provider as I've outlined above, along with 2.20% for the DFM services from AFH.

I can see the costs were clearly set out to Mr K in the suitability report and in other paperwork. He was also given illustrations showing the impact of the costs on his pension funds. But I don't think him being given clear, fair and not misleading information, made the advice suitable for him. I also don't think providing suitable risk warnings, made unsuitable advice, suitable. It was for AFH to make this assessment based on a number of factors.

Mr K's pension was substantial, and he was relying on this to produce a significant income in his (early) retirement. His risk was assessed to be balanced; this appears to have been broadly cautious-medium. His investment needs could easily have been met by his existing plan arrangement through the SW investment funds at a much lower cost.

There's also no indication that Mr K was unhappy with his existing arrangements. He met the AFH adviser prior to receiving his DB transfer advice. But this transfer had only happened around six months prior to the advice to switch to new pension plans. So, Mr K hadn't had an opportunity to see how the SW plan in particular, had performed. And it seems it was a referral from an AFH adviser that led Mr K to seek its advice. In my view, the switch appears to have been driven by the adviser not Mr K. And it's not been suggested Mr K was an insistent client or that he was otherwise likely to go against suitable advice from his adviser.

It should also be noted that due to the transfer advice regarding his DB scheme, less than six months before he received advice from AFH, Mr K would've incurred initial adviser fees there also. And then within a very short space of time, he incurred an additional £10,000 worth of initial adviser fees. He was then subject to even higher ongoing fees. Mr K hasn't been able to provide the suitability report in respect of the DB/ OPS transfer advice, and as far as I'm aware, he has not complained about this advice to date. But I would've thought that if a DFM service was thought suitable for him when he had transferred, it would have been recommended as part of advice given only six months earlier.

That said, the use of a DFM did mean Mr K's pension funds were being closely monitored and should've required little oversight from him. And the suitability report said in several places that Mr K was looking for a 'bespoke' service, which seemed to be his main motivation for wanting to switch his pension arrangements to AFH. AFH noted in the suitability report this would give Mr K direct access to his own bespoke investment manager and would give him confidence that his funds were being managed by an investment professional, where the portfolio would be designed to his own specific retirement objectives.

But from what I can see, Mr K's investment fund with SW was already being managed by an investment professional. And from the fund fact sheet, the investment fund itself met with Mr K's objectives of growth and to meet his retirement needs. I can't fairly see having a 'bespoke' service had previously been an issue for him. Given Mr K's circumstances and *attitude to risk, if he'd been suitably invested, I don't think his pension required the kind of level of oversight/management the DFM was offering.*

Further, there was no indication that investment through a DFM would get Mr K better returns which would outweigh the higher charges. Being a balanced investor and with not a lot of investment experience, I think Mr K would have benefitted more from a low-cost and more basic arrangement which could have been reviewed on an annual basis by the adviser to make sure he was still invested appropriately and kept informed. I also note he wanted advice about his drawdown options but he didn't need a DFM service to help him with this. A key consideration should have been to keep charges as low as possible as these would certainly affect growth.

The regulator made clear in 2009 that a pension switch was unsuitable if the new arrangement incurred extra costs without good reason. And for the reasons I've set out above, overall, I see no real justification for the requirement of a DFM service and incurrence of the additional costs associated with this.

I haven't seen anything that would lead me to conclude Mr K was likely to disregard suitable advice. I know AFH has said Mr K wanted its services but his primary reason for approaching AFH was to receive suitable advice. And it seems the idea of a DFM was introduced to Mr K by one of its advisers' prior to him (the adviser) joining AFH. Given what AFH said about the benefits of a DFM, this may have seemed attractive to an inexperienced investor such as Mr K. But I'm not persuaded, as I've said, it was needed given the increased costs and the funds already available to him via his SW plan and Transact SIPP.

So, I think that but for AFH's unsuitable advice Mr K would've retained his existing pension arrangements and not incurred the additional costs associated with this advice.

For all these reasons, I am upholding this complaint.

Putting things right

My aim is that Mr K 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 K would have remained with his previous providers Scottish Widows and Transact (the previous providers). However, I cannot be certain that a value will be obtainable for what the previous policies would have been worth. I am satisfied what I have set out below is fair and reasonable, taking this into account and given Mr K's circumstances and objectives when he invested.

What must AFH Independent Financial Services Limited do?

To compensate Mr K fairly, AFH Independent Financial Services Limited must:

- Compare the performance of Mr K's investment with the notional value if it had remained with the previous providers. If the actual value is greater than the notional value, no compensation is payable. If the notional value is greater than the actual value, there is a loss and compensation is payable.
- AFH Independent Financial Services Limited should add interest as set out below.
- If there is a loss, AFH Independent Financial Services Limited should pay into Mr K's pension plan to increase its value by the 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 AFH Independent Financial Services Limited is unable to pay the compensation

into Mr K'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 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 K won't be able to reclaim any of the reduction after compensation is paid.

- The *notional* allowance should be calculated using Mr K's actual or expected marginal rate of tax at his selected retirement age. It's reasonable to assume that Mr K is likely to be a higher rate taxpayer at the selected retirement age, so the reduction would equal 40%. However, if Mr K 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 30%.
- Income tax may be payable on any interest paid. If AFH Independent Financial Services Limited deducts income tax from the interest, it should tell Mr K how much has been taken off. AFH Independent Financial Services Limited should give Mr K a tax deduction certificate in respect of interest if Mr K 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**
James Hay SIPP	Still exists and liquid	Notional value from previous providers	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.

Notional Value

This is the value of Mr K's investment had it remained with the previous providers until the end date. AFH Independent Financial Services Limited should request that the previous providers calculate this value.

Any additional sum paid into the James Hay SIPP should be added to the *notional value* calculation from the point in time when it was actually paid in.

Any withdrawal from the James Hay SIPP should be deducted from the notional 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 AFH Independent Financial Services Limited totals all those payments and deducts that figure at the end to determine the notional value instead of deducting periodically.

If the previous providers are unable to calculate a notional value, AFH Independent Financial Services Limited will need to determine a fair value for Mr K's investment instead, using this benchmark: FTSE UK Private Investors Income Total Return Index. The adjustments above also apply to the calculation of a fair value using the benchmark, which is then used instead of the notional value in the calculation of compensation.

Why is this remedy suitable?

I've chosen this method of compensation because:

- Mr K wanted Capital growth and was willing to accept some investment risk.
- If the previous providers are unable to calculate a notional value, then I consider the measure below is appropriate.
- 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 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 K's circumstances and risk attitude.

My final decision

I uphold the complaint. My final decision is that AFH Independent Financial Services Limited should pay the amount calculated as set out under the heading 'Putting things right'.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr K to accept or reject my decision before 20 September 2022.

Yolande Mcleod
Ombudsman