DRN-3714707

The complaint

Mr J says the advice given and the arrangements made by Pi Financial Ltd (PFL), to switch his personal pensions into an Intelligent Money Self-invested Personal Pension (SIPP), with a discretionary fund management (DFM) arrangement with Mayfair Capital Ltd (MCL) and the resulting investments, was unsuitable.

Mr J is represented by CP Financial Claims (CPFC).

PFL is represented by Reynolds Porter Chamberlain LLP (RPC).

What happened

Mr J received advice from a firm called M&S Financial Solutions Limited. At the time of the events complained about it was an appointed representative (AR) of PFL. As principal, PFL is responsible for the acts and omissions of its agent. To keep things simple, I'll just refer to PFL in my decision.

Mr J says he was looking for an independent financial adviser and his brother recommended PFL. He said he had a couple of pensions which he felt were stagnating. He wanted to consolidate them.

During March 2017 PFL gathered information about his objectives, circumstances and attitude to risk. It also made contact with his then personal pension providers to gather data on his existing provision.

Mr J's objectives were recorded in the following terms:

"When discussing your financial needs, aims and goals, we identified that you had not kept track of your pensions and would now like to know how they are invested, opportunities in the market today in terms of diversifying how your pension assets are held. You wanted to invest some monies in more exciting asset classes."

"Your funds have fluctuated since Brexit and you would like to have more active management on your pensions. You find existing providers are really just admin service but would now like advice and ongoing activity on your pensions both in terms of ongoing advice service and also investment decisions on a more regular basis. This will give you confidence that you are keeping in touch with developments on [your] pensions."

"You feel there is an opportunity for growth and given the time the funds can be held then you are confident someone looking after your money can help make money."

"Your target income is around £1,300 per month at age 66. You work part-time 3 days a week through your choice."

"You like gardening and DIY and would like more time to do these in retirement and just have more time on your hands. By age 66 you will have worked for 51 years, as you feel you deserve a break."

"We also considered the importance of having my ongoing service commitment and keeping your pension on track to meet your needs, aims and goals which is a fundamental part of the service we provide."

PFL produced a suitability report for Mr J dated 27 June 2017. In summary it recommended:

- He switched his existing Old Mutual Wealth (OMW) personal pension and Prudential personal retirement plan into an Intelligent Money SIPP.
- He invested the funds in line with his assessed cautious attitude to risk through a DFM arrangement with MCL.

Mr J accepted PFL's recommendations and the switch went ahead, with about £62,000 moving from his OMW plan into his new SIPP on 21 July 2017 followed by around £61,300 from his Prudential plan on 14 August 2017. PFL charged around £4,900 for its initial advice. It also charged him around £1,000 fees for the first year of its ongoing advice. The balance was paid to MCL by 18 August 2017 for investing.

In September 2020, on behalf of Mr J, CPFC raised several concerns with PFL about what had happened to his pension arrangements in 2017. It said the advice to move from his existing pensions had been unsuitable. He had a low appetite for risk and capacity for loss. It said the investments made with his pension funds had been inappropriate. It said Mr J had incurred unnecessary costs as a result of the transaction. And that he had suffered significant financial detriment as a result of its actions.

PFL refuted Mr J's complaint. It said his experience with his former pension providers hadn't been good – they had been hard to contact and offered fairly poor returns on their fund choices. It said given his knowledge, experience and appetite for risk, the switch to the SIPP with an active management arrangement had been suitable.

The Investigator reviewed Mr J's complaint and upheld it. She had concerns about the advice PFL provided, in particular in relation to matters such as costs of the new arrangement and disclosure of these; the alignment of investments made with his risk appetite; and recommended fund management.

PFL disagreed with the Investigator's findings and conclusions. It maintained its advice had been suitable, appropriate for Mr J's objectives, circumstances and risk outlook. It also said MCL had a direct relationship with Mr J and that it was responsible for all investment advice given to him. It argues in this situation the chain of causation had been broken by MCL failing to adhere to the original agreement between the parties.

As both parties didn't agree with the Investigator's view, Mr J's complaint was passed to me to review afresh. I issued my provisional decision in August. RPC has provided further submissions on behalf of PFL. In summary it said:

"Our client's position is that the pension switch and recommendation of a DFM was suitable as:

- *The charges were made clear to Mr J in writing and the overall annual fee with the Intelligent Money SIPP was lower than his existing providers.*
- *His old plans would not have met his retirement income needs, as they would have run out age 83, and so no benefits were lost.*
- *Our client's assessment of Mr J risk profile was suitable.*
- *The recommendation to use a DFM was explained in clear terms and so Mr J was aware of the "added value" of a DFM."*

"Further, our client argues that the responsibility and liability for the suitability of Mr J's portfolio construction both initially and ongoing lies solely with Mayfair Capital, who were responsible for assessing his attitude to risk and ensuring that the investments they made (or recommended to him) were suitable for him on an ongoing basis."

I've thought carefully about what RPC has said and have addressed its main arguments in arriving at my final 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.

Where there's conflicting information about what happened and gaps in what we know, my role is to weigh the evidence we do have and to decide, on the balance of probabilities, what's most likely to have happened.

I've not provided a detailed response to all the points raised in this case. That's deliberate; ours is an informal service for resolving disputes between financial businesses and their customers. While I've taken into account all submissions, I've concentrated my findings on what I think is relevant and at the heart of this complaint.

I'm upholding Mr J's complaint. I'll explain why.

How does the regulatory framework inform the consideration of Mr J's case?

The first thing I've considered is the extensive regulation around transactions like those performed by PFL for Mr J. The FCA Handbook contains eleven Principles for businesses, which it says are fundamental obligations firms must adhere to (PRIN 1.1.2 G in the FCA Handbook). These include:

- Principle 2 - which requires a firm to conduct its business with due skill, care and diligence.
- Principle 3 - which requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- Principle 6 - which requires a firm to pay due regard to the interests of its customers.
- Principle 7 - which requires a firm to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

So, the Principles are relevant and form part of the regulatory framework that existed at the relevant time. They must always be complied with by regulated firms like PFL. As such, I need to have regard to them in deciding Mr J's complaint.

Further, COBS 2.1.1 R requires a firm to act honestly, fairly and professionally in accordance with the best interests of its clients, in relation to designated investment business carried on for a retail client. The definition of "designated investment business" includes "arranging (bringing about) deals in investments".

COBS 9.2.1R sets out the obligations on firms in assessing the suitability of investments. They are the same things that I look at when reaching a decision about whether the advice was suitable. In summary, the business must obtain the necessary information regarding:

the consumer's knowledge and experience in the investment field relevant to the advice; their financial situation; and their investment objectives.

When I consider a case where someone has switched their pension funds, I look at their circumstances at the time. Why were they interested in switching? Were those wants or needs reasonable? And so, should the adviser have recommended the switch?

Each case is different, but I'd expect the switch to be in Mr J's best interests to make the advice suitable. And in this regard, I'd expect to see a comparison was made between his former pensions and the recommended new arrangement.

In 2009 the Financial Conduct Authority (FCA), then the Financial Services Authority, published a checklist for pension switching that I think is still helpful today. It highlighted four key issues it thought should be focussed on:

- *Charges* - has the consumer been switched to a pension that is more expensive than their existing one(s) or a stakeholder pension, without good reason?
- *Existing benefits* - has the consumer lost benefits in the switch without good reason? This could include the loss of ongoing contributions from an employer, a guaranteed annuity rate or the right to take benefits early.
- *Risk* - has the consumer switched into a pension that doesn't match their recorded attitude to risk (ATR) and personal circumstances?
- *Ongoing fund management* - has the consumer switched into a pension with a need for ongoing investment reviews but this was not explained, offered or put in place.

It's also important to review the FCA's specific stance on advice provided about SIPP's. For example, in April 2014 it issued an industry alert which said:

"Where a financial adviser recommends a SIPP knowing that the customer will transfer or switch from a current pension arrangement to release funds to invest through a SIPP, then the suitability of the underlying investment must form part of the advice given to the customer. If the underlying investment is not suitable for the customer, then the overall advice is not suitable."

"If a firm does not fully understand the underlying investment proposition intended to be held within a SIPP, then it should not offer advice on the pension transfer or switch at all as it will not be able to assess suitability of the transaction as a whole."

Further, when considering the use of a DFM, the regulator has made clear that amongst other matters, firms need to take into account issues such as:

- Likely cost: do the overall costs justify the potential for improved performance?
- Size of funds under management: once a consumer has a moderately-sized fund, they may benefit from a model portfolio which is rebalanced automatically by a DFM ranging all the way up to bespoke arrangements for clients with larger funds.
- Investor's knowledge and experience: FCA has said the adviser needed a reasonable belief that the investor could understand the nature of the risks of the underlying investments the DFM might make.
- Level of disclosure: whether the benefits vs costs of the arrangement were explained to the investor in terms they were likely to (or appeared to) understand.

It's also important to consider whether a particular DFM was appropriate. The approach each firm takes to managing funds and interacting with the adviser and investor is different.

So different DFM's might be suitable for clients in different situations. Several factors are relevant in this case.

The conduct of proper due diligence. If an adviser relied only on prepared literature, weaknesses in the DFM's operations may have been overlooked. Features that an adviser should consider in their due diligence include:

- Variation in cost structures between DFM's - some charge per transaction they make, in addition to an annual charge.
- What was the DFM's typical investment philosophy (in terms of assets they preferred), whether this was a model portfolio or not? Would those assets be appropriate?
- Whilst past performance can't be relied upon, it can provide an indication of the degree of success the DFM might have in future. If it didn't have a track record this would reasonably have increased the enquiries the adviser should have made.

The regulator was clear there was a positive obligation on the adviser to carry out this research, rather than supplying the DFM with a risk rating and hoping 'all will be right in the end'. They were recommending a DFM as a solution to their client's needs and that meant 'looking under the bonnet'.

Also, how the DFM will specifically invest this investor's funds. Did the adviser obtain a current breakdown of assets in any proposed model portfolio, and the DFM's guidelines as to how it manages those assets? How did the adviser ensure that its attitude to risk scale mapped appropriately across to the DFM's? And if the DFM's mandate wasn't sufficiently limited, did it agree appropriate restrictions on what it was and wasn't allowed to invest in?

If there was no specific agreement between the adviser and the DFM, how could it be sure that the DFM had accepted responsibility for risk-mapping the adviser's score to its portfolios?

What instructions did the adviser give the DFM on the attitude to risk or model portfolio to use? Did the adviser effectively give the fund manager freedom to do as it thought appropriate? If this has occurred the adviser will have a responsibility for what subsequently happened – particularly given their obligations to act in the client's best interests.

Was the DFM's initial asset selection broadly consistent with its mandate? What due diligence did the adviser carry out at the beginning? Did the DFM fail to get the asset allocation right from the outset, or did things gradually wander off course? If the DFM departed from the mandate, did the adviser react to this?

Regulatory guidance and industry best practice required the adviser to monitor the DFM's ongoing performance, having agreed a schedule for information to be exchanged between them. Could any losses caused by the DFM have been avoided by the adviser's actions?

Did PFL meet the regulatory obligations it was bound by when advising Mr J?

I don't think PFL met the requirements placed on it in this case. I'll explain why.

There are several documents relating to PFL's transaction with Mr J that are important to my consideration, these include the fact-find, risk appetite questionnaire, pension replacement contract form and the suitability report.

PFL recorded that Mr J was 61 at the time of the advice. He was married and had one dependent child. He worked part-time earning around £16,500. His wife earned around £24,000. Details of their monthly household expenditure was scant – with the record suggesting this was £800.

No liabilities were recorded for Mr and Mrs J. They owned their home, which was said to be worth £180,000. His wife also had £30,000 in an ISA. Mr J was said to have some experience of investments but that his knowledge was limited. He'd previously received services from a financial adviser.

Mr J anticipated retiring at 66. His OMW personal pension and his Prudential personal retirement plan had a combined transfer value of over £124,000. Aside from his state pension, this represented his total retirement pot. It's also recorded that he thought a net monthly pension of about £1,300 would be required.

There are some basic problems with the information PFL has provided. For example, I can't see evidence of modelling carried out by PFL which shows how the advice it gave Mr J in 2017, came together to deliver his income requirements in retirement.

I can't see PFL had the information it needed to understand what returns Mr J needed to achieve with his personal pension in order to meet the stated objective for his income in retirement. I think such analysis would've been important to his being able to take an informed decision about what to do with his personal pensions.

PFL's role wasn't simply to facilitate what Mr J wanted. He may've wanted to invest in more *exciting* assets. But of course planning for an income in retirement is a serious, complicated and some might say mundane matter. He may've been attracted to using a DFM arrangement because he'd been concerned about recent market volatility and wanted more active management of his situation. But did he need such arrangements given his retirement income objective, and experience?

PFL was in a good position to have analysed, tested, challenged and advised Mr J about what was in *his* best interest for retirement planning. It knew pension pots built up over many years are to provide for a retirement income.

So, these fundamental problems with PFL's approach undermined the rationale for the switch of Mr J's personal pensions. It recommended Mr J switch his provision into an Intelligent Money SIPP, with a DFM arrangement with MCL and to invest in a cautious portfolio of assets. There are a number of other specific weaknesses with its advice.

Charges

PFL charged Mr J around £4,900 for its initial advice, that was 4% of his fund value.

In its suitability report dated 27 June 2017, PFL noted the charges for his SIPP and the underlying funds were *likely* to be higher than those Mr J was being charged by his existing providers but that *he believed* these would be recovered by higher growth. I think PFL was being ambiguous here.

In responding to the Investigator's argument about ongoing costs RPC said:

"As noted, the Old Mutual Plan attached an Annual Management Charge of up to 1.75%, and there would have been a further Annual Management Charge for the Prudential plan, which could vary over time, coupled with a charge for the Prudential With Profits Fund."

"In contrast, the Intelligent Money SIPP had an ongoing service charge of 1% of the combined £120,703 assets, being £1,207.03 per annum, plus a Fund Annual Management Charge of £150. As a result, the overall annual fee was lower with Intelligent Money SIPP."

"…Therefore, the charges were reasonable and the effect of the charges were adequately highlighted to [Mr J]. As a result, taking into account the relevant charges it was suitable for the fund switch to the Intelligent Money SIPP to be recommended to [Mr J]."

Like its suitability report for Mr J, in my provisional decision I said I found find this explanation unclear, incomplete and unconvincing. While the cost to switch appeared reasonably straight-forward, arguably the more important analysis of what ongoing costs would be, and the effect of these on any returns his new arrangements might achieve, wasn't transparent.

RPC initially noted that the pension replacement contract form (PRCF) showed an important reason for Mr J switching included the high charges of his former pensions. According to the same form completed by PFL, the costs associated with his OMW plan was actually 1.25% of the value of the funds. But for his Prudential plan they were said to be 'not transparent'.

In responding to my provisional decision RPC seems to now face in different directions on matters around charging. For example, it says:

*"…the Client Financial Information Form (the **CIF**) shows that Mr J was not in fact concerned by the scheme charges. This is shown in the section "15. Your General Investment Views and Goals" which provided a series of questions for Mr J to provide a score in response, with 1 being the lowest, "not at all" and 5 being the highest, "very". …in response to the question, "are you aware of the level of charges imposed on your existing pension scheme(s)", Mr J answered "not at all", providing a score of 1 (showing that the scheme charges were Mr J's lowest priority). This evidences that fees were not of a concern to him."*

This isn't my reading of his response. The CIF form was completed on 10 March 2017. I think it's more likely than not Mr J was saying he wasn't at all aware of the charges being made by his existing pension providers.

My view here is strengthened by what was recorded on the PRCF, which was completed on 30 June 2017 presumably after Mr J had been informed about the charges being levied on his existing policies. It clearly notes high charges as a reason for him wanting to switch. This was along with the policies no longer being suitable for his investment objectives and that a drawdown facility wasn't available.

It's also of note the PRCF doesn't identify poor investment performance, a desire to consolidate, poor service or attitude to risk as drivers for Mr J switching his pension provision. Yet some of these have been referenced in submissions to in part justify the recommendations made by PFL.

RPC also said (bolding is my emphasis):

*"The Retirement Income Report dated 26 June 2017 shows that the existing plan charges **could be** as much as 3.1% each year and **so it appears unlikely** that the new arrangements would cost him more."*

I find this observation muddies the waters further. That's because the fee schedule it refers to was for only one of Mr J's previous pension plans. The rate was one of several rates potentially chargeable by the provider to different clients in different situations. And I think it's of note PFL has never suggested this was the charge he incurred.

In responding to my provisional decision, RPC has tried to clarify what charges Mr J would've incurred with the arrangements recommended by PFL. It has said:

"…the Intelligent Money SIPP had the following annual charges: an ongoing service charge of 1% of the combined £120,703 assets, being £1,207.03 per annum and a fund Management Charge of £150.

In addition, there was a 1.5% dealing commission payable to Mayfair Capital, which was a percentage based dealing fee per trade (which was made up of 1.00% dealing commission and 0.5% stamp duty). Mr J was therefore in control of whether dealing commission was payable, given that he could agree to trade, or refuse any investment recommendations Mayfair Capital provided to him..."

"…Note that these extracts were also included in the Suitability Report and so Mr J was made well aware of the charges involved and that he was in control of the dealing commission payable. Therefore, the new arrangements actually cost Mr J 1% per annum of the fund value plus £150 and any dealing commission payable. As noted, the Suitability Letter provides that there "could" be underlying costs of the stocks/shares brought, but Mr J's Discretionary Adviser would discuss this with him and so he would be made aware if there were any underlying costs."

"Further…Mr J confirmed that he understood that he had a responsibility to say no if he didn't agree to any recommendations made, as the SIPP Application states: "It is your trading account and you are in control. If you are unsure of any advice provided by your investment adviser, then you must NOT proceed with the transaction". As such, Mr J was in control of how his pension was invested, including any underlying costs."

"As explained…this meant that the overall annual fee was lower with Intelligent Money SIPP (as the Old Mutual Wealth (Old Mutual) Plan had an Annual Management Charge of up to 1.75% and there would have been a further Annual Management Charge for the Prudential plan, along with a charge for the Prudential With Profits Fund)."

I'm grateful for RPC's attempt to explain the charges, unfortunately I'm not persuaded by its explanations. For example, there's no mention of the fees Mr J would be charged by PFL for its ongoing advice service, this was agreed as 1% of his fund value. The comparison to make here was with his former arrangement, where I understand he paid his former adviser 0.5% per annum.

I note the potentially significant dealing commission of 1.5%. The fact that Mr J could manage this cost by telling the DFM he didn't want to accept its investment proposals seems wrong-headed. Presumably the logic for using a DFM was the active management of his funds to achieve good returns. So, it can reasonably be assumed such costs were likely to be incurred.

Further, I don't think its sufficient to allude to potential additional costs such as those associated with buying and selling stocks/shares. Even if they couldn't reasonably be quantified, this required further explanation to help Mr J understand what these charges would be, their likely frequency and scale.
And I note RPC hasn't been able to confirm the actual costs associated with Mr J's former pension plans.

I don't agree that because certain documents in certain places identified certain charges that Mr J would incur, and because he signed various documents to say he understood everything means that PFL is off the hook. It had a duty to be clear, fair and not misleading in the information it provided.

Ultimately, if PFL and RPC are still struggling to convey what charges and fees Mr J would be charged under the new arrangements recommended, and crucially how these compared with those incurred under his former arrangements, and the impact these would've had on the relative returns, it wouldn't be reasonable for me to conclude he should've understood these matters.

Rather than Mr J benefitting from lower costs, as was suggested initially by RPC was one of his motivations for switching, from the evidence available to me it's more likely than not he faced a substantial uplift in the overall fees and charges he'd be paying as a result of all PFL's recommendations.

RPC says Mr J opted for the arrangements recommended by PFL because he wanted the opportunity to improve the performance of his pension funds and he thought the new arrangements would cover the higher overheads. But it wasn't for him to be the judge in terms of the prospects for improved investment returns under MCL's management – PFL needed to provide its assessment.

I can't see that PFL provided Mr J with an analysis showing the performance of his former personal pensions. Further, I'd not seen what yield PFL was targeting with its recommendations.

In responding to my provisional decision RPC has now produced figures which it says show that one of Mr J's former personal pensions achieved average annual growth over the prior decade of around 2.84%. It says PFL's recommendations were targeting an annual return of 3.48%, consistent with his risk attitude.

I'm grateful to RPC for trying to fill in the gaps on the analysis after the event – but I can't see Mr J was provided with this information in the suitability report or elsewhere in a clear and fair manner. However, even now there are problems with what it has told this Service. The historic return figures provided are for only one of his former pension plans. We have no information about whether the figures are before or after inflation. And we don't know if they are based on the same mix of investments in his plan.

In order to exceed the drag of increased costs and then provide an improved return on investment, there needed to be a reasonable prospect of significant performance improvement under the new arrangements. But the information provided on behalf of PFL hasn't demonstrated this was the case.

Further, the fund manager it proposed was only established in 2016 and became regulated in April 2017. So, it seems there couldn't have been any historical performance data to show whether the yield RPC now says PFL was targeting was realistic.

In responding to my provisional decision RPC said:

"The Suitability Letter states that "the charges for the new recommended SIPP and underlying funds are likely to be higher than those with your current providers but you believe these will be recovered by higher growth, although not guaranteed". However, it was not for our client to assess "whether the new arrangements would cover the higher overheads" (as the FOS suggests) as our client was not advising on the investments to be made."

RPC is wrong about the regulatory requirements placed on its client in this regard. I've already set out at some length what these obligations entailed. It was of course for PFL to have informed Mr J about the overall costs and projected returns associated with all the recommendations it was making.

PFL still hasn't responded effectively on this matter. It follows that it hasn't done enough to satisfy me there was a clear potential for Mr J to be better off, compared to his then existing personal pensions, as a result of its recommendations, given the fees and charges he was incurring and the nature of the investment strategy it was recommending.

Existing benefits

The next matter I've considered was whether Mr J has lost any benefits in the switch without good reason. It's unfortunate that again PFL's audit trail and explanations are lacking on this matter. In its suitability report it said of his Prudential pension plan:

"Your existing plan has guarantees at certain ages. For instance at age 66 based on projection of fund being £82,800 then you will receive a guaranteed pension of £5,000 per annum…You are aware of this but prefer full flexibility on how you access the fund and how the fund is managed in the meantime compared to this type of guarantee."

PFL didn't make clear that its commentary related to just one of Mr J's pensions. I think it would've been easy for him to have assumed the bullet point related to both his plans. I think the lack of a more fulsome explanation about what he would be giving up is even more telling if we consider this alongside another of PFL's reasons for him switching his pensions. PFL told him:

"You are likely to have a shortfall in meeting your income at retirement target of £15,600 per annum with the pensions being moved projected to produce £4,410 per annum and state pension at £7,000 per annum. However, you will be making additional contributions monthly and this will be the subject of annual reviews to see how you progress against your desired income target."

There are several flaws here in PFL's reasoning. Firstly, Mr J's Prudential plan alone had a reasonable prospect of delivering him £5,000 per annum. As the pension income report it commissioned indicated, Mr J would receive a state pension of about £8,300. The gap between these two sources of income and his stated target annual income in retirement was just £2,300.

Leaving aside any new contributions Mr J was planning to make, it seems likely then that his existing pension provision, if not exceeding his objective, was very close to it. This again undermines PFL's advice.

In responding to my provisional decision RPC said:

"…The FOS provide that…Mr J was "very close" to meeting his objective, but no explanation is provided regarding how Mr J would be in a position to make "new contributions" to fill the gap and whether this would be realistic. Further, the Retirement Income Report shows that if he kept his existing Old Mutual and Prudential plans then his income would run out at age 83 and so this shows that his old plans would not have met his retirement income needs."

"…Therefore, the fact that the growth in funds in respect of Mr J's existing plans were not guaranteed and that they would run out by age 83, shows that the advice to switch was reasonable and no benefits were lost in doing so."

I don't find the arguments made by RPC to be telling. It doesn't address the inaccuracies in PFL's suitability report about what Mr J's then existing pension provisions could deliver. This showed an exaggerated gap between his provision and his objectives. This is likely to have had a significant impact on his decision making. RPC doesn't take into account the additional contributions Mr J was likely to make prior to his retirement. And the fact that returns to his pensions weren't guaranteed applied equally to the new arrangements it was recommending.

Further, in effect RPC acknowledges Mr J's existing provision was close to meeting his objectives, with funds projected to run out when he reached 83 (slightly longer than the average life expectancy for a male in the UK). Taking into account the other matters identified, I remain of the view there that a reasonable case has not been made for him to switch his pension arrangements.

Risk

Mr J completed a risk appetite assessment. PFL said he was a cautious investor. It went on to describe this in the following terms:

"Cautious investors typically have low levels of knowledge about investment matters and limited interest in keeping up to date with investment issues. They may have some limited experience of investment products, but will be more familiar with bank accounts than riskier investments."

"In general, cautious investors do not like to take risks with their investments. They would prefer to keep their money in the bank, but may be willing to invest in other types of investments if they are likely to be better for the longer term."

Cautious investors can take a relatively long time to make up their mind on investment matters and can often suffer from regret when investment decisions turn out badly."

I'd start by noting that Mr J's former Prudential pensions was a with profit fund, and so a reasonable fit for his assessed risk outlook. His OMW pension was invested in over 30 funds. These appear to have ranged across the whole gamut – from low to high risk, so my working assumption is overall it represented a balanced portfolio. This appears to have been in excess of his attitude to risk.

I think the assessment PFL conducted of Mr J's risk appetite was a reasonable starting point. Mr J wasn't a novice in investment matters. He wanted to achieve higher returns than cash. And he stated that he could cope with infrequent periods where his investments might fall in value. But Mr J's investment horizon was limited – he had less than five years until retirement.

In responding to the Investigator's view, RPC advanced a case that suggested Mr J had significant experience of investments. It said:

"…the Mayfair Capital application to open a SIPP (signed by Mr J on 26 September 2017) provides that Mr J traded between 3 to 40 collective investments and bonds each year, with an average trade size of £3,000, which had been managed for 10 years. Mr J also had shares (such as Major shares and Alternative Investment Market shares), which he traded less than 3 times a years with an average trade size of £3,000. Mr J therefore had previous investment experience and was aware of market volatilities…"

"The SIPP application also provided that there were not any type of products, investment or markets that Mr J did not want to invest in, and that he understood the risks associated with his choice of products. He also stated that he did not have a limit (i) to the maximum monetary value that he was prepared to risk on any individual trade, (ii) the maximum number of Advisory Only trades with Mayfair on a monthly basis and (iii) the maximum number of Discretionary Only trades with Mayfair on a monthly basis."

The information gathered by PFL about his knowledge and experience presents a different picture. From 13 products that were set out for him, he identified experience of investing in ISA's, an endowment, pension plans and shares.

I've thought carefully about this matter. I place more weight on the information PFL gathered in preparation for its advice, than the information gathered by MCL after the switch of his funds had been given effect. That's because the information captured by PFL was itemised and clear. Mr J also went on to provide details about the products he'd used. On the other hand, the information as presented from the MCL form brigades' products together – it's not clear exactly what he was confirming about his experience.

On balance, I don't think Mr J was particularly knowledgeable about investment and pension matters. Of course, that's why he sought professional advice from PFL.

In its suitability report, PFL explained to Mr J that his funds would be invested in a cautious portfolio. It set out the typical assets that he might hold in this, including global equities (48%), government bonds (30%), corporate bonds (20%) and cash (2%). It said:

"This is a guideline to which Mayfair Capital Ltd will invest within, an exact portfolio will be drafted upon a discussion with yourself to the gain an understanding of your current financial situation and investment objectives before working with you to maximise performance within the boundaries of your appetite for risk. There could be additional costs as this will depend on the underlying investments."

In responding to my provisional decision RPC said:

"…it is not clear why our client needed to ascertain the exact split of the holdings, given that it was for Mayfair Capital to determine how the funds were to be invested within the balanced risk mandate and in any event, the fund composition would "change frequently" in order to maximise performance within the boundaries of Mr J's appetite to risk. As such, it doesn't make sense that a precise breakdown was required by our client (or at all) at that stage, given that the fund holdings were to be selected and managed by Mayfair Capital and that they needed to undertake their own risk profile of Mr J, to be cross checked against our client's assessment. As noted in the Suitability Report, Mayfair Capital's role was to provide an exact portfolio upon discussion with Mr J, and they would provide a dedicated investment manager, who would then tailor the portfolio according to Mr J's investment objectives and financial resources."

It's a problem for PFL that it didn't have a handle on the investments Mr J would be making in his new SIPP. The regulator required that it took a close interest in where Mr J's funds would be placed. Generic descriptions about the sort of investments his pension might make wasn't sufficient. If the underlying investment wasn't suitable, then the advice wasn't suitable.

RPC did go on to acknowledge:

"Nevertheless, our client did receive regular reports and so they did monitor the fund's performance on an ongoing basis."

That's what I would've expected given the service Mr J was paying PFL for. And yet despite this oversight we know Mr J ended up investing in a range of assets that were above his assessed appetite for risk.

PFL said it chose MCL as fund manager for Mr J because:

"At Mayfair Capital Ltd they recognise that each of their clients' requirements are different, which is why they allocate a dedicated Investment Manager to be your personal point of

contact. Your manager will seek to gain an understanding of your current financial situation and investment objectives before working with you to maximise performance within the boundaries of your appetite for risk.

It doesn't appear as though PFL told Mr J about the lack of performance data for MCL, given it was a relatively new entrant to the market. This added more risk into the mix. It should've been more fulsome about this. It should've set out why using this DFM was a better option than more established fund managers.

Neither am I convinced by PFL's assessment of Mr J's capacity for loss – another key element of the risk assessment process it had to undertake. It said:

"Your capacity for loss [is] 30%. Up to that you feel your standard of living would not be compromised."

PFL hadn't been clear how it had arrived at its 30% loss assessment on capacity. RPC has now said:

"…the adviser states that "if there are no additional notes then this would signify [the] client has calculated a figure during the conversation"

It wasn't for Mr J to assess his capacity for loss. This was something PFL should've led. But that's not the impression given here by PFL.

While Mr J had a partner who would receive her own pension benefits, Mr J was investing all his pension provision. He had some other assets, in particular his home, but these were modest. I think he had a limited capacity for loss given his overall financial circumstances and how long he had to go until retirement.

Ongoing fund management

Mr J is said to have wanted his funds to be spread across more diverse investments, with some in more exciting asset classes. He wanted his funds actively managed. I'd note that the OMW personal pension he had was an actively managed portfolio. It's not clear he would've appreciated this from the suitability report PFL provided. Nor that he could've chosen up to 100 funds from the 500 it had available. It's not clear these matters were explored effectively with him.

Mr J hadn't used a DFM arrangement previously. The concept was introduced by PFL. There was a duty of care on it to make sure the firm it was recommending was appropriate for him. But it's not clear to me he would've had a clear idea about the added value being provided by MCL and PFL respectively. Yet he was paying a lot of money for both services. PFL said of MCL:

"At Mayfair Capital Ltd they have a different approach to investment services. Rather than slotting you into someone else's financial model, they custom build a service around you. The type of service you choose will be determined by how actively involved you want to be in the management of your investments and how confident you are with monitoring the balance of risk and reward yourself."

"Their approach is to listen to our clients' needs then tailor an investment strategy that fits their investment objectives, knowledge, experience and financial resources. Inherent within our culture is the belief that an approachable and dependable relationship with all their clients will surpass their expectations for service and value. This is achieved by allocating each individual client their own qualified personal investment manager who centres the service around them."

It’s difficult to understand how PFL could recommend MCL based on its different approach to investment services. I say this because MCL was registered with the FCA in April 2017, only a few months before PFL recommended it to Mr J.

PFL has said its compliance director carried out due diligence into MCL. And that following the exercise it was accepted as one of its permitted investment houses.

A key element of PFL’s recommendation for Mr J to switch his personal pension into the Intelligent Money SIPP appears to have been the expectation the DFM investment portfolio would perform better than his existing plan. If that’s the case then it begs the question, on what that expectation was based upon?

MCL was a newly registered business. It had no track record of investment performance. Whilst past performance can’t be relied upon, it can provide an indication of the degree of success the DFM might have in future. If it didn’t have a track record this would reasonably have increased the enquiries PFL should’ve made.

Mr J had limited investment experience, but he wasn’t a sophisticated investor. He had a modest personal pension fund of around £120,000 which he’d built up over many years. PFL hasn’t done enough to demonstrate the recommendations it made to Mr J to establish a SIPP, with a DFM facility, investing in vehicles he had no experience of, in a company with little track record, which also required its ongoing advice service, was suitable.

The arrangements PFL put in place were over-engineered, complicated, untested, relatively expensive and it wasn’t clear they were reasonably likely to be able to produce a better return than his personal pension.

Flexibility

One of the arguments RPC has advanced is that Mr J required flexibility and that this couldn’t be delivered by his existing plans. In responding to my provisional decision it said:

“The FOS argues that Mr J shouldn’t have switched pensions on the basis that his "investment horizon was limited – he had less than five years until retirement", but this misses the point that one of Mr J's key objectives was to have flexible drawdown, which was not available with his existing providers (notwithstanding that he had expressed disappointment with the service and performance of his existing arrangements and so he wanted a fund management that had a more hands on approach). The advice provided allowed such flexibility.

Given the case for switching hasn’t been made in terms of cost, potential returns, existing benefits, risk and fund management, there’s not a good argument for Mr J switching his pension when he did. Although he may have required more flexibility in how he could take the benefits from his pension pot, he had another five years to decide on the right arrangements for his retirement.

Where does PFL’s liability end and MCL’s begin?

In responding to the Investigator’s view RPC said:

“Mayfair's email dated 6 April 2020 to our client states: "In terms of specific PI clients we have direct contractual relationship with all clients. They are required to complete our documentation and have direct access to MCL should they need". [Mr J] was therefore Mayfair Capital's client. As our client has already explained, the responsibility and the liability for the suitability of [Mr J] portfolio construction both initially and ongoing lies solely with Mayfair Capital.”

“This is confirmed by the email dated 23 January 2017 from Mayfair Capital to our client regarding due diligence, which states: "Mayfair are responsible for all investment advice for clients who hold accounts with ourselves" and so they are responsible for the advice provided regarding the investments within the SIPP (in relation to the portfolios Mayfair advise on and establish).”

Firstly, I’d note that Mr J’s complaint was made in broader terms than RPC implies here. Nevertheless, I’ve considered the point it makes carefully.

Where a firm concludes that it may be jointly liable along with another firm for the investor’s loss then *generally* the firm that gave the first advice should review the whole period (including the period after the other firm became involved) and then seek to obtain redress from the other entity, as appropriate. But where a firm believes the causal link between the advice it gave and any ongoing loss has been broken, then the first firm *may* need only consider the period up to the second advice.

I’ve already highlighted some failings in the approach PFL took with Mr J given his circumstances and objectives. These are around basic rationale, charging, loss of benefits; risk appetite assessment and fund management arrangements and therefore the overall responsibility to switch.

Regarding the role of the DFM it recommended, PFL has provided more information to show it undertook due diligence on MCL. But given it was a new provider, without a track record, it’s not clear why it recommended such a firm to Mr J who had no experience of DFMs. And it hasn’t done enough to show why he even needed such an arrangement.

PFL didn’t obtain a current detailed breakdown of assets to understand how Mr J’s funds would be invested. I can’t see it was aware of how its assessment of risk mapped to MCL’s approach. More generally, it’s not clear how the seemingly separate information gathering, assessments and processes of PFL and MCL were reconciled and areas of difference and contradiction examined.

In responding to my provisional decision RPC said:

“…as explained above and in the May Submissions, Mayfair Capital has a "direct contractual relationship with all clients". As such, Mr J was Mayfair Capital's client and so it was for Mayfair Capital to carry out an independent fact finding and to make an assessment of Mr J's risk profile.”

“Therefore, as previously explained, the responsibility and liability for the suitability of Mr J's portfolio construction both initially and ongoing lies solely with Mayfair Capital; it was for Mayfair Capital to advise on and establish Mr J's attitude to risk. It was not for our client to "reconcile" any differences in risk profiling.”

Mr J had signed up to an ongoing service from PFL for which it charged him 1% of the value of his fund in advance. In return it said he would receive an offer of an annual review and a 6-month interim desk-top review. It said this would encompass an assessment of his circumstances; a review of his objectives; a review of investment performance and holdings; valuations and investment commentary; and reassessment of risk profile and asset allocation. I think this makes clear it needed to be across MCL’s approach and performance.

Indeed, PFL has provided a copy of one review that it carried out for Mr J from June 2018. In the letter it noted what MCL had said about his portfolio performance to date:

“Below is the current valuation of your portfolio with advisory stockbroker Mayfair Capital and their associated commentary:

Initial Investment: £123,172.85

IFA Fees: £6,035.15

Withdrawals: £129.39

Current Value: £96,673.23"

"[Mr J] was unfortunately one of our clients that had invested into Carillion, a UK construction company and a constituent of the FTSE 250, that disastrously collapsed at the beginning of the year. This had significant consequences on the account which we have been working on recovering ever since. We have had moderate success in making back these losses, and again, if the indices we have and in future will be gaining exposure to, meet the end of year forecasts, we should be a considerable way to bringing this account back to its initial value.

Should [Mr J] want a more in depth description about how we plan on accomplishing this, we are available at any time during the day to have a telephone conversation with him."

PFL went on to record:

"Feedback from your review call with me, which we have duly noted:

- Naturally, you are concerned regarding the losses on your account as described above, and I have suggested we look at this again early 2019 - to which you were receptive.

- You have a house valued at £180k with no mortgage. Your work situation is secure.

- Your risk profile remains 'Cautious'.

Based on the above, we do not see the need to make any changes to your current set up at this stage and will of course keep the portfolio under review going forward. As per our ongoing review process, we will diarise a further review in the new year as discussed and will contact you in due course."

MCL's investment strategy appears to have been pitched at a medium risk appetite – PFL had assessed him as with a cautious outlook. The section of Mr J's MCL application which identifies the preferred product classes and asset allocations is significantly at odds with what was indicated in the suitability report. For example, the SIPP application showed 15% of his funds would be allocated to high risk investments and there would be a smaller proportion of lower risk investments.

PFL needed to have understood how Mr J's SIPP funds would be invested from the outset. It was supposed to be regularly reviewing the DFM's approach and performance. From the documents available it's clear it effectively endorsed the investment strategy again in June 2018. And the pattern of investments appears consistent over time.

So, given PFL's initial and ongoing role which has seen Mr J switch his personal pension into a SIPP with his funds being invested through a DFM in funds that were said to be a match for his risk appetite, it's fair and reasonable for it to provide compensation for any losses arising in this case.

Of course, it is a matter for PFL if it wishes to pursue MCL for any acts and omissions which it believes gave rise to any element of the redress costs it now faces.

Putting things right

Mr J can't benefit from double recovery of losses and compensation in respect of substantively the same case. As such, if he accepts this decision, he'll need to give an undertaking to assign any rights he has to take action against MCL and any associated redress, over to PFL.

I'm upholding Mr J's case. So, he needs to be returned to the position he would've been in now - or as close to that as reasonably possible – had it not been for the failures which I hold Pi Financial Ltd responsible for.

If PFL had provided suitable advice, I don't think Mr J would've switched either his OMW or Prudential personal pensions into a SIPP. It follows that I don't think he'd have taken on a DFM facility. However, proper advice would've identified that he was over-exposed according to his assessed risk appetite on his OMW plan, and so should've switched some of these funds into investments more aligned to his cautious attitude to risk.

So, Pi Financial Ltd needs to provide redress as follows.

1. Calculate a notional loss Mr J has suffered as a result of making the switch of his personal pensions

In respect of Mr J's former Prudential pension, PFL should obtain its notional value as at the date of calculation. So, as if it hadn't been transferred to the Intelligent Money SIPP. It will need to obtain the value of the plan as previously invested.

In respect of Mr J's former OMW personal pension, PFL will need to calculate a notional value using a benchmark. For half the investment the FTSE UK Private Investors Income Total Return Index; for the other half the average rate from fixed rate bonds.

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 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.

I consider that Mr J's risk profile was in between these measures, 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 him into that position. It doesn't mean he would've invested 50% of his money in a fixed rate bond and 50% in some kind of index tracker investment. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mr J could have obtained from investments suited to his objective and risk attitude.

PFL should then find the current (*actual*) value of his SIPP, including investments and any cash held. Concerning the valuation here – the approach to be taken is set out in step 2.

Information I've seen from July 2020 appears to indicate a total value of Mr J's SIPP at that time of around £68,000.

I'm not aware if Mr J made further contributions to his SIPP. Nor whether he's taken any benefits from it. After confirming the detailed position, then the value PFL obtains or the calculations it makes should assume these adjustments would still have occurred and on the same dates.

The adjusted, as appropriate, like for like difference between the notional value of Mr J's former personal pensions and the current value of his SIPP will be his basic financial loss that PFL needs to redress.

2.Pay a commercial value to buy any investments which cannot currently be redeemed

To close Mr J's SIPP and avoid ongoing fees, the investments need to be crystallised.

If, at the date of settlement, any residual investment is illiquid (meaning it can't be readily sold on the open market), it may be difficult to find the *actual value* of the investment. So, the *actual value* should be assumed to be nil to arrive at fair compensation. PFL should take ownership of the illiquid investment by paying a commercial value acceptable to the pension provider. This amount should be deducted from the compensation and the balance paid as above.

If PFL is unable to purchase the residual investment the *actual value* should be assumed to be nil for the purpose of calculation. It may wish to require that Mr J provides an undertaking to pay it any amount he may receive from the investment in the future. That undertaking must allow for any tax and charges that would be incurred on drawing the receipt from the pension plan. PFL will need to meet any costs in drawing up the undertaking.

Had PFL done what it ought to have done then there wouldn't have been a SIPP. So, it wouldn't be fair if Mr J continued to have to pay SIPP fees because of illiquid holdings preventing it from being closed. Ideally, PFL would take over any illiquid holdings, thus allowing the SIPP to be closed. But third parties are involved, and I can't tell them what to do.

So, to give certainty to all parties, if there are illiquid holdings and PFL is unable to buy them from the SIPP, then it's fair that it should pay Mr J an upfront lump sum equivalent to five years of SIPP fees (calculated using the previous year's fees). This gives a reasonable period to arrange for the SIPP to be closed.

3. Pay an amount into Mr J's pension pot so the value is increased by the loss calculated (resulting from 1 and 2) or pay him an equivalent cash sum notionally adjusted for tax.

If compensation is paid into Mr J's SIPP, payment should allow for the effect of charges and any available tax relief, so that he is in the same position as if he'd stayed in his original personal pension scheme.

If paying compensation into Mr J's SIPP would conflict with any existing protection or allowance and / or the plan is closed and PFL takes on his investments, then it should pay his compensation as a cash sum. In doing so it should make a notional deduction to allow for income tax that would otherwise have been paid.

If Mr J hasn't yet taken any tax-free cash from his plan, 25% of the loss would be tax-free and 75% would've been taxed according to his likely income tax rate in retirement – presumed to be 20%. So making a notional reduction of 15% overall from the loss adequately reflects this. If Mr J is a higher rate taxpayer, the notional allowance would reduce the amount payable accordingly.

PFL must pay the compensation within 28 days of the date on which this Service informs it that Mr J accepts my final decision. If it pays later than this it must also pay interest on the compensation from the date of my final decision to the date of payment at 8% a year simple.

Income tax may be payable on any interest paid. If PFL considers that it's required by HM Revenue & Customs (HMRC) to deduct income tax, it should tell Mr J how much has been taken off. It should also give him a tax deduction certificate if he asks for one, so he can reclaim the tax from HMRC if appropriate.

PFL should provide the details of the calculation to Mr J in a clear, simple format.

Further information

There is guidance on how to carry out calculations available on our website, which can be found by typing ‘compensation for investment complaints’ into the search bar on our website: www.financial-ombudsman.org.uk.

My final decision

For the reasons I’ve already set out, I’m upholding Mr J’s complaint, and require Pi Financial Ltd to put things right in the way I’ve directed.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr J to accept or reject my decision before 1 November 2022.
Kevin Williamson
Ombudsman