DRN-4344127

The complaint

Mr S complains that an appointed representative ("AR") of Share In Ltd ("Share In") failed to disclose that his investment into a development project promoted on AR's platform was at risk of fraud.

What happened

AR was an appointed representative of Share In between 16 November 2016 and 20 July 2020. AR promoted investment opportunities on its crowdfunding platform, by way of investment memorandums ("IM"). Investments are made in companies set up as special purpose vehicles ("SPVs") which own and develop properties. The intention is that in return for their investments, investors have their shares purchased back at a higher rate on completion of the development.

Mr S invested £2,500 in a company I'll refer to as "Company A" in August 2018, through AR's platform. Company A's property development was expected to be completed by April 2019. However Mr S was provided with a developer update in October 2022 advising that the project was unable to be completed and there would be no exit for investors. As such, Mr S lost all of his investment. The update explained that the project failed due to the following:

- The actions of the financing bank who had appointed an receiver on site and refused several repurchase offers.
- Failures by the company appointed to oversee construction, including unexplained cost overruns and failure to complete works in timescales agreed, as well as excessive charges for works.
- Company A's former finance manager had been collaborating with the contractor to embezzle monies from group companies and the associated time and legal costs had affected the project.
- The impact of the Covid-19 lockdowns on works and related labour and material shortages.

Mr S complained to Share In November 2022. In summary, he said:

- If Share In had made it clear that fraud or any kind of misappropriation of investment funds was a significant risk factor for crystallised loss of his investment - made via an AR of an FCA authorised and regulated firm - then he would not have invested.
- The promotion of the investment was inherently misleading as the invested funds were not in fact used for the promoted purposes.
- There was no effective monitoring of this investment by the platform.

Share In considered Mr S's complaint but didn't uphold it. In summary, it said:

- The IM was reviewed and approved by Share In as a financial promotion to ensure these met the regulatory requirement to be fair, clear and not misleading.
- The list of risks to an investment project are not and. by their very nature, cannot be an exhaustive list. However, the key investment risk in relation to non-readily realisable securities, namely the risk that you can lose all of the capital that you have

invested, was prominently disclosed in the IM and on AR's website, alongside other key risks.
- Mr S confirmed his understanding of this risk of loss as part of the appropriateness test which he needed to pass before being able to invest.
- At the time of the approval of the offer financial promotion, there was no reason to believe that the recent unsubstantiated allegations of fraud in the developer update posed an identifiable material risk to the investment project at that point in time.

Mr S remained unhappy as he felt his investment ought to have been subject to a higher level of protection due to AR being regulated by virtue of their AR relationship with Share In. So he referred his complaint to this service for an independent review.

One of our investigators considered the complaint but didn't think Share In had acted unfairly. In summary, they said:

- AR had carried out an appropriate standard of due diligence on the development before promoting it on its platform.
- They hadn't seen any evidence that Share In was aware that fraud posed a material risk to the development. Nor had they seen any evidence to suggest Share In was presented with material which ought to have flagged to it that any party connected with the development was engaging in fraudulent activity or would do so in future.
- There is no requirement on firms to state that investors could theoretically lose their investment due to fraud.
- Share In had provided key risk warnings which included capital being at risk.
- They weren't persuaded that a generalised risk warning to the effect that 'fraud could hypothetically affect this investment in the future' would have prevented Mr S from investing.
- Fraud can hypothetically affect any investment and Mr S self-certified himself as a high net worth investor – accepting the high risk nature of crowdfunding and having significant prior investment experience.
- They were persuaded that Share In did carry out some ongoing monitoring of aspects of the investment but it was never claimed at the outset that it would directly manage the development.
- It's also important to note that AR ceased to be an appointed representative of Share In in July 2020. So Share In's liability for any acts or omissions committed by AR would have stopped by this point.

Mr S didn't accept the investigator's findings and so the complaint has been passed to me to decide.

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.

I hope Mr S doesn't take it as a discourtesy that I won't be responding to each submission or every point he has raised. The purpose of my decision isn't to do that, but rather to explain my findings on the key issues. The crux of Mr S's complaint is that Share In failed to perform sufficient due diligence on his investments and as such, failed to disclose that fraudulent activity could effect his investment.

For ease of reference, I shall only refer to Share In going forwards as it is the respondent for this complaint. Any mention of Share In throughout my findings will also include AR.

To be clear I can only consider the obligations Share In had towards Mr S as an investor when promoting the investments. I can't consider any actions of Company A. With this in mind, I've considered Share In's obligations.

At the time of promoting the investment opportunity, Share In was authorised and regulated by the FCA. The relevant rules and regulations FCA regulated firms are required to follow are set out in the FCA's Handbook of rules and guidance. The FCA Principles for Business ("PRIN") set out the overarching requirements which all authorised firms are required to comply with. PRIN 1.1.1G, says "The Principles apply in whole or in part to every firm". The Principles themselves are set out in PRIN 2.1.1R. The most relevant principles here are:

- PRIN 2.1.1R (2) "A firm must conduct its business with due skill, care and diligence."
- PRIN 2.1.1R (6) "A firm must pay due regard to the interests of its customers and treat them fairly."
- PRIN 2.1.1R (7) "A firm must 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."

Share In was also required to act in accordance with the rules set out in the Conduct of Business Sourcebook (COBS). And the most relevant obligations here are:

- COBS 2.1.1R (1) "A firm must act honestly, fairly and professionally in accordance with the best interests of its client."
- COBS 4.2.1R (1) "A firm must ensure that a communication or a financial promotion is fair, clear and not misleading."

So before approving the IM, Share In needed to satisfy itself that the information contained within it was fair, clear and not misleading. And it also needed to be satisfied that by approving the promotion and allowing Mr S to invest in Company A, it would continue to be acting in his best interests.

In order to satisfy itself of the fair, clear and not misleading nature of the claims or assertions made in the IM, Share In would need to carry out reasonable checks. What these reasonable checks involve, or indeed what they might be in any given case, is something which is very much left to each platform to determine and would vary according to the particular circumstances. It's clear that it wasn't the regulator's intention to provide a set of tick boxes which needed to be completed for a promotion to be approved.

I note that in its policy statement PS14/4 the FCA said of the due diligence expected of crowdfunding firms:

> *"we expect sufficient detail to be provided to give a balanced indication of the benefits and the risk involved, including whether or not any due diligence has been carried out on an investee company, the extent of the due diligence and the outcome of any analysis."*

In 2015 the FCA issued a review of the regulatory regime for crowdfunding where it said:

> *"Firms need to provide investors with appropriate information, in a comprehensive form, so that they are reasonably able to understand the nature and risks of the investment, and, consequently, to make investment decisions on an informed basis".*

One of the areas of concern the FCA identified was a situation where a platform provided:

"insufficient, omitted or the cherry-picking of information, leading to a potentiality misleading or unrealistically optimistic impression of the investment."

So Share In needed to ensure any information it gave Mr S about Company A was fair, clear, and not misleading, and enabled him to make an informed decision whether to invest, armed with the knowledge of the nature and risks of an investment into the SPV.

Share In says it has a three-step due diligence process which it followed for Mr S's investments. Share In says it:

"… examined the overall funding package available to the developer; reviewed the project finances to ensure that there were reasonable and acceptable levels of resources to overcome reasonable cost over-runs; and reviewed all statements made in the developer's marketing statements."

Share In has provided evidence of the due diligence that it undertook, and I'm satisfied it supports that Share In did follow these steps.

It's clear to me that the issue which underpins Mr S's complaint is about the allegations of fraudulent activity which he strongly believes have led to his investments failing. I appreciate the developer update in October 2022 explained that one of the contributing factors which led to the project failing was Company A's former finance manager had been collaborating with the contractor to embezzle monies from group companies. However, it's not my role to determine whether fraudulent activity occurred. Regardless, I don't think it would be fair or reasonable to find Share In responsible for any mismanagement by Company A or its contractors. I say this as I don't think Share In could have reasonably foreseen this happening.

I appreciate that hearing of the possibility of such fraudulent activities contributed to the project failing would have caused Mr S to question the quality of due diligence checks carried out by Share In, but as I've explained, I haven't seen anything to suggest Share In knew or ought to have known this was an identifiable material risk at the time of promoting the investment.

I understand Mr S believes Share In should have provided an explicit warning regarding the possible risk of fraudulent activity effecting his investment. However, I don't think Share In were obligated to do so. The relevant rules at the time explained:

"COBS 4.2.4G – A firm should ensure that a financial promotion:
(1) For a product or service that places a client's capital at risk makes this clear;"

[…]

"COBS 4.5.2R – A firm must ensure that information:

[…]

(2) is accurate and always gives a fair and prominent indication of any relevant risks when referencing any potential benefits of relevant business or a relevant investment."

A list of risk warnings wasn't prescribed by the rules beyond that capital is at risk. Firms were instead required to provide relevant risks. Having looked at the IM provided to Mr S, I can see that the following risks were provided throughout the document:

- That his capital was at risk.
- The value of his investment could go down as well as up.
- The investment wasn't covered by the Financial Compensation Scheme.
- Company A could sell the development property at a loss if developments costs were higher than the projected costs.

I'd consider these to be relevant risks that needed to be highlighted to Mr S before he invested. Whilst I accept that there may have been a possibility that fraudulent activity could affect his investment, I wouldn't consider this to be a relevant or material risk that Share In needed to disclose to Mr S. Especially considering there was nothing discovered through its due diligence process to make Share In aware of any fraudulent activity at the time of promoting the investment. Furthermore, I'm satisfied Mr S was fully aware of the high-risk nature of this investment as he had self-certified himself as a high net worth investor - accepting the high risk nature of crowdfunding and having significant prior investment experience.

On a final note, I understand Mr S believes Share In should have done more to continually monitor the development project and had it done so it could have prevented his loss. Whilst the IM doesn't explain what ongoing monitoring it would undertake, the Risk Statements provided by Share In note that it would carry out some monitoring activities depending on the circumstances of each investment opportunity. The most relevant activity here is having all financial accounts audited periodically which could be found at Companies House, but I'm not persuaded Share In said it would directly manage the development or the SPV itself.

There's also no evidence to suggest that the financial accounts registered at Companies House would have alerted Share In to any fraudulent activity. Share In ceased to be the principal firm in July 2020 and so I don't think it would have been required to monitor Mr S's investment beyond this date. It's important to note that the developer's update with reference to fraudulent activity was given over two years after Share In ceased to be the principal firm and so I think it's more likely than not that this discovery was made some time after Share In was monitoring the investment.

My final decision

My final decision is that I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 29 February 2024.

Ben Waites
Ombudsman