DRN-4515002

The complaint

Mr M complains that London Stone Securities Limited (LSS) arranged for him to buy high risk and illiquid investments which weren't right for him. He's suffered financial losses as a result for which he'd like to be compensated.

What happened

One of our investigators looked into Mr M's complaint, and provided a detailed factual background. She said that Mr M had been in contact with LSS for some time prior to his investment, and in 2018 invested £20,000 in:

- The Audley Funding bond
- Panacea Ventures Limited bond
- Bentley Global bond.

The investigator noted that LSS disputed arranging the sale of the Panacea Ventures bond and the Bentley Global bond and said that it had no information about Mr M came to invest in these bonds.

Mr M recalled being asked to sign a lot of documents including one which classed him as a sophisticated high net worth investor, which he was not. He said that if he had fully understood the paperwork he was being asked to sign at the outset, he never would have done so. He said that due to his age, personal circumstances and lack of experience investing in these types of assets, they weren't suitable for him.

Mr M said that if LSS had been clear about the risks of these investments, he would never have gone ahead with them. Since investing he has a lost a substantial portion of the £60,000 he put in, and this has caused him financial difficulties, worry and stress and has impacted his health.

As part of her investigation, the investigator obtained the following evidence:

- An email from LSS to Mr M from May 2018 which provided him with application forms for the Panacea and Bentley Global bonds. The email also explained that he'd need to send the forms and the money directly to the bond providers and that LSS could not provide Mr M with advice. However, there was a *'1% fee chargeable for the introduction of these investments on an execution only basis'*.
- A welcome letter from Panacea Ventures in June 2018 which referred Mr M to LSS for any questions that might arise, or that he provide details of any family member or friend he'd like to refer to LSS.
- An email from LSS to Mr M from April 2018 asking him to provide identification documents and the payment of £20,000 towards the Bentley Global bond. A further email confirming the payment was received, advising Mr M to send identification

documents to Bentley Global and advising Bentley Global to contact it if anything further was required.

- Emails to Mr M and Panacea in June and September 2018 letting Mr M know that LSS hadn't received his completed application forms, and later asking Panacea to resend these to Mr M.

- An email from Mr M to LSS in February 2020 in which he discussed the Panacea bond and the missing coupon payments which confirmed that Panacea had spoken to LSS about the missing payments and that there had been an error. The email also made references to previous incidents in which LSS had worked 'magic' and payments had been received.

- An email from LSS to Mr M in June 2020 in which it accepted that its involvement in the sale of the Panacea bond to Mr M and felt a moral obligation to put matters right for him – therefore offering him £10,000 as a gesture of goodwill.

As a result of this evidence and Mr M's testimony, the investigator concluded that all three bonds were likely arranged by LSS. These investments were considered non-readily realisable securities and the Financial Conduct Authority (FCA) deemed them high risk. So she concluded that selling these investments to Mr M, LSS needed to comply with the rules set out in the Conduct of Business Rules (COBS) 10A - appropriateness.

In summary, the investigator thought that the Mr M should not have been classified as one of the types of investors to whom the above investments could be promoted. In considering appropriateness, she also concluded that given the information Mr M provided to LSS, it wasn't fair and reasonable for it to have concluded that he had the necessary knowledge and experience to understand the risks involved in investing in these assets. In summary Mr M had told LSS:

- Although he had some assets, he told LSS that he only had a 'basic' level of understanding of the stock market, and a 'basic' level of understanding of general financial and economic affairs.

- He told it he only had a 'medium' attitude to risk, and furthermore, that whilst he was open to reasonable investment opportunities, he didn't want to 'speculate' or risk his capital.

- There were a number of inconsistencies in the information LSS had available to it, including some which Mr M denied completing or providing.

The investigator concluded that LSS ought to have warned Mr M that these investments were not appropriate for him as he did not have sufficient knowledge and experience to understand the risks they carried. She said that taking all the evidence into account, including the degree to which LSS had promoted and encouraged Mr M to invest in these bonds, if it had properly warned him not to do so that warning would've dissuaded Mr M and convinced him not to proceed. She therefore recommended compensation.

Mr M agreed with the investigator, but LSS disagreed.

In summary it said:

- It wasn't convinced Mr M actually made the investments he said he made, and wanted to see evidence of that.

- It wanted to see evidence that Mr M hadn't received any coupon payments or information from Bentley Global or Panacea, or any explanations for why they couldn't pay. It also wanted to see evidence that Mr M's initial investment wasn't returned to him.

- In terms of the Audley bond, it didn't agree with the investigator's conclusions. It said Mr M received some coupon payments for the bond and didn't raise any concerns with the investment until after it defaulted. It said this was normal investment risk which Mr M accepted, and Mr M only complained because the bond defaulted.

- It said the Audley bond was 'suitable for all retail clients'. It said it therefore wasn't relevant whether Mr M should've been treated as a sophisticated investor.

- Mr M had invested in the Audely bond 'as part of an overall larger balanced portfolio, which included FTSE100 and FTSE250 dividend paying shares'. It provided evidence of some of these investments.

- The Audley bond was in administration and there could be pay-outs in future – it would be unfair for Mr M to receive compensation now and a future pay-out.

- In October 2019, before Audley filed for bankruptcy, LSS offered to buy the bond back from Mr M and he declined. It said that Mr M took the investment risk, and whilst it was unfortunately that the risk materialised, Mr M was 'prepared for and recognised' the risk and therefore accepted in.

LSS concluded by saying that Mr M invested only 2% of his net assets in a 'retail bond', that was made on an execution-only basis and without advice, and 'was part of a diversified, balanced portfolio, using capital that the client confirmed he could afford to lose/put at risk'. It said Mr M was aware of the risks, and was happy with the investment for a number of years. It said Mr M was given the opportunity to return the investment and chose not to, therefore it was unfair for LSS to be held liable.

As there was no agreement, the case was passed to me to decide. Before it did, Mr M provided some additional evidence about his investments into the various bonds.

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 and for many of the same reasons. In this case, there are two key issues which I will deal with in turn:

- Whether LSS arranged the sale of all three bonds to Mr M;

- What its obligations to Mr M were when arranging these sales.

Did LSS arrange the sale of the bonds to Mr M?

When looking at whether a firm has been involved in the regulated activity of 'arranging deals in investments', I've taken into account what the FCA has said about this activity in its

Perimeter Guidance Manual (PERG). In it, the FCA says:

'The activity of arranging (bringing about) deals in investments is aimed at arrangements that would have the direct effect that a particular transaction is concluded (that is, arrangements that bring it about). The activity of making arrangements with a view to transactions in investments is concerned with arrangements of an ongoing nature whose purpose is to facilitate the entering into transactions by other parties. This activity has a potentially broad scope and typically applies in one or two scenarios. These are where a person provides arrangements of some kind:

(1) To enable or assist investors to deal with or through a particular firm (such as the arrangements made by introducers); or
(2) To facilitate the entering into transactions directly by the parties (such as multilateral trading facilities of any kind other than those excluded under article 25 (3) of the Regulated Activities Order, exchanges, clearing houses, and service companies (for example, persons who provide communication facilities for the routing of orders or the negotiation of transactions)).

PERG 8.32 specifies that in the FCA's view, '*a person brings about or would bring about a transaction only if his involvement in the chain of events leading to the transaction is of enough important that without that involvement it would not take place*'.

In this case, it's clear that the transaction was brought about – so I've focused on Article 25(1) and whether LSS's actions amounted to arranging.

Having reviewed the evidence, I don't have much to add to what the investigator has already said. The evidence available persuasively demonstrates that LSS was key to Mr M investing in the relevant bonds, and I'm satisfied that without its involvement those sales would not have taken place.

The emails from LSS at the time demonstrate that LSS was involved in collecting key information to do with Mr M's application, payments, identity and other liaising with the relevant bond providers. The fact that it also charged Mr M a fee for its services demonstrates persuasively that it was carrying on this regulated activity at the time.

To be clear, this does not mean that it was necessarily providing advice to Mr M to invest in these bonds, and I've not been provided with sufficient evidence to conclude that this happened. But I'm satisfied that it was clearly involved in arranging the deals for Mr M.

It isn't in dispute that the Audley bond was sold to Mr M by LSS.

What rules and guidance are relevant to the sale of these investments to Mr M?

In May 2018, COBS 2.1 said:

'A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule)'.

In May 2018, COBS 10A applied to '*a firm which provides investment services in the course of MiFID or equivalent third country business*'.

COBS10A.2 said:

'When providing a service to which this chapter applies, a firm must ask the client to provide information regarding that client's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded to enable the firm to assess whether the service or product envisaged is appropriate for the client'.

COBS10A.2.3 said:

'Investment firms shall determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded when assessing whether an investment service […] *is appropriate for a client'*.

COBS10A.2.4 said:

'Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

(a) The types of service, transaction and financial instrument with which the client is familiar;

(b) The nature, volume and frequency of the client's transactions in financial instruments and the period over which they have been carried out;

(c) The level of education and profession or relevant former profession of the client or potential client'.

In the event that a client failed the appropriateness assessment, COBS10A.3.1 said:

'If a firm considers, on the basis of information received to enable it to assess appropriateness, that the product or service is not appropriate for the client, the firm must warn the client'.

COBS10A.3.3 provided the following guidance:

'If a client asks a firm to go ahead with a transaction, despite being given a warning by the firm, it is for the firm to consider whether to do so having regard to the circumstances'.

In 2019 the FCA provided additional guidance about the sale of mini-bonds to retail investors. Although this guidance post-dates the sale, I consider it relevant in that it didn't create new rules or give new information – it simply summarised the FCA's position on what mini-bonds were and the risk they represented.

It said that minibonds '*typically offer high yields but this reflects the much higher risks involved'.* It said that mini-bonds were '*typically offered by small or start-up companies, or companies that find it difficult to raise capital from institutional investors*'. It also said that issuers *'could face cash flow problems that delay interest payments, or* […] *could fail altogether and be unable to repay the money investors have lent it*'.

It said mini-bonds were '*also highly illiquid'* because, unlike ordinary retail bonds, '*mini-bonds do not have a secondary market'*. It said that minibonds typically offered high returns, reflecting much higher risks involved in the investment – and this was the case the investments Mr M bought.

Pausing here – I'd like to be clear with LSS, therefore, that these investments were not 'retail bonds', quite the opposite. LSS admitted as much to Mr M when it wrote to him and explained that these were 'unregulated' and therefore it could not 'advise' him to invest in them – although it was going to charge him a fee for arranging them. These were illiquid and non-tradeable investments, which carried specific risks that the regulator, as I've outlined above, has been clear are not right for the majority of retail investors. The purpose of the rules I've quoted above, as well as the FCA's updates and reviews on these investments, clearly demonstrate this.

Were these investments appropriate for Mr M

The investigator has comprehensively addressed Mr M's circumstances at the time, including the inconsistencies between the various forms which LSS used to satisfy itself that these investments were appropriate for him.

On one form, which Mr M doesn't not recall filling out, it was noted that:

- His overall knowledge of investing was 3 out of 5, average;
- His overall experience of investing was 4 out of 5, high.
- He had demonstrated a very high understanding of the risks involved.
- But his knowledge wasn't applicable, because he only wanted FTSE100 or 250 – no AIM shares, T20s or CFDs.

According to these answers, LSS concluded the minibonds were appropriate for Mr M.

But the Private Client Profile form which Mr M completed, and which he recalls filling out, shows that he only had a 'basic' level of understanding of the stock market, and a 'basic' level of understanding of generic financial and economic affairs. His attitude to risk is described as 'medium' on this form. It specifically identified the fact that he didn't want to speculate or place his capital at significant risk, and he had no previous experience in similar investments – in other words, he'd not invested in mini-bonds before.

In considering this evidence, I've taken into account Mr M's testimony and his correspondence with LSS after the investments were arranged. I'm satisfied he didn't understand the high risks involved in these investments, including the real possibility that he'd never receive his capital. Furthermore, in addition to the risk, I'm satisfied he didn't fully appreciate the specific risks involved in essentially lending money to companies of this nature, in this way – i.e. via an essentially illiquid investment that was not tradeable. I've seen insufficient evidence to persuade me that LSS took steps to properly explain the high risks involved in these transactions.

In my view, taking all the information LSS had about Mr M into account, including his previous investment experience with it, it wasn't fair and reasonable for it to conclude that these mini-bonds were appropriate for him because I'm persuaded he didn't have sufficient knowledge and experience to understand the risks involved.

This means that, in line with COBS10A, LSS should have warned Mr M that these investments were not appropriate for him. In my view, when considering what would've happened had Mr M received this warning, it's likely that Mr M would've decided not to go ahead. His attitude to risk and experience as recorded by LSS at the time indicates that Mr

M was not keen on taking significant risks with his capital, and he was only considering these mini-bonds as a result of his conversations with LSS. The high return and the lack of a full explanation by LSS, the expert, that there was a high risk of capital loss when investing in bonds of this nature in my view encouraged Mr M to invest.

If LSS had warned him that, on further consideration of his particular circumstances, knowledge and experience, it no longer considered these investments were appropriate for him, I'm satisfied it's more likely than not that Mr M would've decided not to proceed. This means I'm satisfied these investments would not have taken place.

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put Mr M as close to the position he would probably now be in if he had not been sold these investments.

I take the view that Mr M would've invested differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr M's circumstances and objectives when he invested, as well as his previous investment experience.

I have also slightly changed the way the redress is set out – this is because Mr M was not sold all of the mini-bonds at the same time. The method of calculating, and the benchmark used is the same, but I've separated out the calculation for each mini-bond he was sold. This will make it easier for LSS to take into account the relevant start dates, as well as any coupon payments Mr M actually received.

LSS has said that this compensation isn't fair because it offered Mr M the opportunity to buy his investments, and he declined. But at that stage, it didn't give Mr M any indication that it thought the investments were not appropriate for him. It did not suggest to Mr M that he ought to accept its offer because it had incorrectly assessed those investments as appropriate, and had now decided they were not. Doing so would've alerted Mr M to the risk of these investments, and to the fact that they were likely not right for him.

So whilst I've carefully considered whether Mr M declining LSS's offer at the time means Mr M shouldn't receive compensation, I'm satisfied, for the reasons I've given above, that this wouldn't be fair and reasonable.

What should LSS do?

To compensate Mr M fairly LSS must:

- Compare the performance of Mr M's investments in each bond with that of the benchmark shown below, and pay the difference between the *fair value* and the *actual value* of the investment.

- LSS have provided a list of payments for the Audley Funding bond but have said they don't have a record of payments for the other bonds. Mr M has said that he never received any payments from the Panacea Ventures Limited bond, but has provided a list of payments he received from the other two bonds (Bentley and Audley). These payments can be taken into account in the calculation as I've set out below.

- Pay Mr M £500 for the distress and inconvenience caused over the years for not knowing or understanding what he had invested in and what risks were actually involved.

- Provide the details of the calculation to Mr M in a clear, simple format.

Investment name	**Status**	**Benchmark**	**From (“start date”)**	**To (“end date”)**
Audley Funding bond	Illiquid or not in force	FTSE UK Private Investors Income Total Return Index	Date of investment	Date of settlement
Panacea Ventures Limited bond	Illiquid or not in force	FTSE UK Private Investors Income Total Return Index	Date of investment	Date of settlement
Bentley Global bonds	Illiquid or not in force	FTSE UK Private Investors Income Total Return Index	Date of investment	Date of settlement

Actual value

This means the actual amount paid from the investment at the end date. My understanding is that all the bonds are illiquid (meaning that they cannot be surrendered or readily sold on the open market) or otherwise not in force, so it may be difficult to work out what their actual value is. In such a case the actual value should be assumed to be zero. This is provided Mr M agrees to LSS taking ownership of the investment, if it wished to. If it is not possible for LSS to take ownership, then it can request an undertaking from Mr M that he repays to LSS any amount he might receive from the investment in future.

Fair value

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

Any withdrawal or payment from the mini-bonds should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. Mr M can provide the details of the payments he received from the Bentley and Audley bonds to LSS. If, in relation to each individual investment, there are a large number of regular payments, to keep calculations simpler, I’ll accept if LSS totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically. This should be done for each investment.

Why is this remedy suitable

I have chosen this method of compensation because:

- Mr M wanted income with some 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 a mix of diversified indices representing different asset classes, mainly UK equities and government bonds.

  It would be a fair measure for someone who was prepared to take some risk to get a higher return.

- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr M's circumstances and risk attitude.

My final decision

My final decision is that I uphold Mr M's complaint. London Stone Securities Limited must pay the compensation I've outlined above within 28 days of when we tell it Mr M has accepted this final decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 20 February 2024.

Alessandro Pulzone
Ombudsman