DRN-4528097

The complaint

Mr B says Tier One Capital Wealth Management Limited ('Tier One'), previously Carrick Financial Management, gave him unsuitable advice in 2021 to switch funds in his pension. He also says it's advice was motivated by its attempt to offset an increase in its ongoing advice service fee and that it committed a specific regulatory breach in this respect. Their client relationship ended in 2023. He seeks compensation for financial loss and a refund of fees paid to Tier One between 2021 and 2023.

Tier One disputes the complaint and the alleged regulatory breach, it also says treatment of the latter is outside our jurisdiction.

What happened

One of our investigators looked into the complaint and concluded it should be upheld. He mainly said:

- Mr B's client relationship with Tier One existed for many years. Regular/annual portfolio reviews, risk profile assessments and updated signed terms of agreement took place as part of its ongoing service to him (and his wife).

- His complaint arises from the 2021 review advice, and Tier One's notice to him at the time that its ongoing service fee was to increase from 0.5% to 0.6%. The fund switch was recommended during this review and his allegations are that the fund switch was unsuitable, that it was recommended by Tier One in order to offset its fee increase and that such action breached the regulator's Conduct of Business Sourcebook ('COBS') rules, from the regulator's *Handbook*, at COBS 6.1A.14A R (which prohibits recommendations that present product charges as offsetting adviser charges).

- Evidence of the following is noteworthy – Mr B had a low medium risk profile and, before the 2021 recommendation, his pension was split equally, half held in the Prudential Growth Portfolio ('PGP') and the other half in the Prudential Cautious Portfolio ('PCP'); he sought and agreed an active investment management style/strategy and was prepared to pay additional fund management charges for it; he sought and agreed the use of smoothed funds, for their additional stability and predictability of returns, and was prepared to pay additional fund management charges for it; the 2020 review confirmed his pension portfolio remained suitable and had experienced strong and very consistent performances; and the 2021 review confirmed that the portfolio's performance had fallen, but that it still remained suitable and cost effective (and gave access to a wide range of multi asset investment strategies).

- Despite reconfirming the portfolio's suitability, the 2021 review proceeded to recommend the fund switch – using £75,000, each, from the PGP and PCP holdings to invest in the Vanguard Lifestrategy 40% equity fund (the 'VL40' fund). Tier One said the VL40 fund had returned 6.74% in the preceding year and 17.70% in the preceding three years, that it had significantly lower charges and a lower risk profile than the PGP. Notice of its ongoing advice fee increase was also given in the review, in relation to which Tier One said – "… *we have researched the marketplace on your behalf, to reduce where possible, the product and fund management costs associated with your portfolio, with a view to offsetting some of the above fees increase*. *As you can see in the charge summary comparison table provided, the overall costs associated with your portfolio following the planned fund switch will only increase by £33 pa (based on the current fund values)*".

- However, Tier One's performance comparison between the pre-existing pension portfolio and the VL40 fund was not presented on a like for like basis. It compared the former's performance at one specific point in time with the latter's performance over the previous 12 months. It is true that the Prudential portfolios had large losses in March 2020 but the VL40 fund was also negatively affected at the same time, and in the six months leading to the 2021 review the Prudential portfolios had outperformed the VL40 fund.

- The VL40 fund may well have been more diversified (with lower risk) than the Prudential portfolios but Tier One's review had also confirmed that Mr B's existing PGP and PCP holdings were already well diversified. Furthermore, his risk profile had not changed.

- Available evidence suggests Tier One's recommendation potentially breached COBS 6.1A.14A R, because it made a comparison between its ongoing advice fee and the reduction of fund charges in the fund switch. However, it is beyond our remit to categorically declare that Tier One breached the rule, that is a matter for the regulator.

- The complaint should be upheld. The fund switch was recommended on flawed and insufficient grounds and was unsuitable. Mr B should be compensated by Tier One for financial loss arising from the unsuitable fund switch (with the premise that but for the recommendation he would have retained the PGP and PCP as they were). It should also pay him £100 for the distress and inconvenience the matter has caused him.

Mr B accepted this outcome, but asked us to note the following about his tax position – until 2028 he will receive no taxable income other than from his pension; he has no spare capacity in his pension to add new money (without incurring a tax charge) so compensation should be made directly to him (not into his pension); any payment from Tier One should have no tax consequences for him and Tier One should hold liability for any associated tax; for the last three to four years, and as arranged by Tier One, he has taken his full tax allowance plus 25% as income from his pension (without any tax liability), the same will apply for the next five years so any compensation payment under the total of the tax-free withdrawals for those five years should not be subjected to a nominal tax reduction.

He also asked for interest if Tier One forces the case to go to an Ombudsman's decision.

Tier One disagrees with the investigator's view and has asked for an Ombudsman's decision. Overall, it said the investigator's findings were seriously impaired and, in some respects, lacked evidence and basis; and that the fund switch was suitable for Mr B due to the lower costs, better diversification and better performance in the VL40 fund at the time of advice. It also argued that the real reason behind his complaint, given documentary evidence that he was happy with the fund switch at the time and thereafter, is that he is retaliating for its refusal to waive, upon his request (for him and his wife), the firm-wide fee increase that applied in 2023.

It submitted rebuttals to specific findings by the investigator, and mainly said –

- The investigator failed to address the contents of its complaint response and the facts, evidence and grounds presented within it which defeat Mr B's allegations.

- There was no contradiction in its recommendation of the fund switch whilst reconfirming that the Prudential portfolios remained suitable. This is evident in the fact that its recommendation resulted in two thirds of the pension remaining within the Prudential portfolios after switching a third of it to the VL40 fund. Mr B largely remained invested in the PGP and PCP, but costs and diversification could be improved upon, hence the VL40 fund recommendation.

- Contrary to the investigator's comments on its performance comparisons, performance graph evidence shows that the VL40 fund outperformed the Prudential portfolios throughout the annual periods between January 2019 and January 2021, and the same applied starting from October 2017.

- The VL40 fund provided the opportunity to diversify the pension in terms of product providers. Previously, the entire pension relied on Prudential provided funds. The fund switch achieved diversification of that, to include Vanguard as a product provider. Vanguard also tended to use some external funds, whereas Prudential tended to use its own funds, so further diversification was achieved in this respect. In addition, the fund switch enabled diversification of investment strategies, because the Prudential portfolios were actively managed but the VL40 fund was a passively managed fund.

- The fund switch was suitable regardless of its ongoing advice service fee increase. The increase would have applied whether Mr B accepted the recommendation or not. Its suitability stood on the grounds of diversification, costs and performance, so it is wrong to say it was recommended solely to offset the increased ongoing advice fee.

The matter was referred to an Ombudsman.

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.

<u>*Regulatory Breach (of COBS 6.1A.14A R)*</u>

COBS 6.1A.14A R says –

"*A firm must not make a personal recommendation to a retail client in relation to a retail investment product or P2P agreement if it knows, or ought to know, that:*

(1) the product's charges, the platform service provider's charges or the operator of the electronic system in relation to lending's charges are presented in a way that offsets or may appear to offset any adviser charges or platform charges that are payable by that retail client …"

The following are undisputed facts – Mr B was Tier One's retail client in 2021; the 2021 fund switch was its recommendation to him; and within its recommendation Tier One explicitly said "… *we have researched the marketplace on your behalf, to reduce where possible, the product and fund management costs associated with your portfolio, <u>with a view to offsetting</u>*

some of the above fees increase" [my emphasis]. The 'fee increase' it referred to was the increase in its ongoing advice and administration service fee from 0.5% to 0.6%, as was presented within the same 2021 review document that conveyed the fund switch recommendation. With these facts, it is quite clear why Mr B has been prompted to allege a regulatory breach.

As the investigator accepted, allegations about regulatory breaches are beyond our powers to determine. Such allegations are for the regulator to consider/address.

However, we cannot reasonably be expected to turn a blind eye to the undisputed and relevant facts summarised above. The same applies to the fact that Mr B has made the regulatory breach allegation a part of his complaint about unsuitable advice. He is entitled to define his complaint as he wishes and he has done so, inclusive of that allegation. Whilst we cannot determine the regulatory breach allegation, in itself, we cannot reasonably ignore evidence about it that directly relates to the complaint about unsuitable advice.

Mr B says the alleged breach was a reason behind the alleged unsuitable advice. Without going to the extent of determining the former – which I do not – I can reasonably conclude that the facts summarised above (and supported by documentary evidence) shows that Tier One *did* present the fund switch (and the VL40 fund) to Mr B as its proposal to him *with a view to offsetting* some of the 0.5% to 0.6% ongoing fee increase. I can also reasonably conclude that suitability of its recommendation was arguably compromised by this motive. In other words, the implication potentially arising from a sole or main objective to offset the fee increase is that, but for the fee increase, the fund switch would not have been recommended – so, it was not recommended for suitability, instead it was recommended for the purpose of offsetting the fee increase.

The above sets the context for the considerations that follow below. I am mindful of the case that Tier One has submitted, with strength of feeling, about how and why suitability of the fund switch stands independently and regardless of the fee increase. It is an argument that it is entitled to pursue. However, for the reasons given in the next sub-section, it is an argument defeated by the facts and the balance of available evidence.

Suitability Of The Fund Switch

Both parties agree that nothing within Mr B's pension portfolio was deemed *un*suitable in 2021 (and/or during the 2021 review). There is no evidence that he wanted anything changed or that he was unhappy with the suitability of the PGP and PCP holdings within the pension.

As the investigator noted, Tier One affirmed suitability of the pension portfolio as it was at the time of the January 2021 review. In its response to the investigator's view, it maintained this position and made the point that the fact it recommended the retention of the PGP and PCP holdings for 75% of the pension after the fund switch shows that it still considered them to be suitable despite the recommended fund switch. Its response to the complaint is therefore distilled to the argument that its recommendation sought to achieve a *more* suitable pension portfolio for Mr B.

As summarised in the previous section (above), Tier One says the VL40 fund did this by providing him/his pension with the prospects of better diversification, better performance and with lower fund/investment costs. It has mentioned that the VL40 fund had a slightly lower risk profile, but it has also said that risk was not a factor in the matter, so I do not consider it necessary to include risk as something its recommendation sought to improve upon.

Evidence supports the conclusion that the VL40 fund was indeed cheaper, in terms of fund/investment costs, than the Prudential portfolios. This does not appear to be a point in dispute, nor should it be. However, with specific regard to Mr B and his profile (of which Tier One was aware), there is an inherent and significant problem in arguing that this aspect supports suitability of the fund for him.

The March 2020 review document shows that Mr B sought active fund management and a smoothed investment strategy, that each resulted in additional charges and that he agreed with those additional charges in order to achieve both. Tier One knew this, or ought reasonably to have known this, from the previous (2020) review as it embarked on the 2021 review.

There does not appear to be evidence that Mr B changed this objective at the time of the 2021 review. The 2021 review document confirms there were no changes in his circumstances at the time, and its list of objectives is almost identical to the list of objectives in the 2020 review document – and neither mentions a change to Mr B's need for active fund management and a smoothed investment strategy.

The 2021 document includes the following statement – "*As you wish to balance the on-going management costs, with a degree of tactical investment, I recommend the use of a combination of 'Active and 'Passive' investment strategies*". This confirms that the combination of active and passive strategies was the adviser's recommendation, but the reason given is unclear and, it appears, unsupported. What is clear and supported is that Mr B wanted only active fund management in March 2020, that there is no evidence he wanted something different in January 2021, and that he was prepared to pay the additional costs in order to get such management.

Available evidence is that a notable part of the reason why the VL40 fund was cheaper than the Prudential portfolios was because it was a passively managed fund and it did not apply the smoothed investment strategy that Mr B wanted. As such, the additional costs that came with active fund management and with the smoothed investment strategy did not exist.

Tier One presents the reduction in fund charges as a point supporting suitability of the VL40 fund but, on balance, I find the opposite. Its recommendation went against Mr B's requirements for active management and smoothed funds. Both were essentially dismissed in the recommendation. The reduction in charges came at that cost. However, the additional charges (for both requirements) had already been confirmed as acceptable to him in order for him to achieve them. Therefore, the recommendation gave Mr B a cheaper product that did not match his requirements.

An additional conclusion to draw is that Tier One was probably aware the VL40 fund did not match his requirements, but it reduced fund costs and that fed into the motive it expressly declared in the review document – that being to reduce product and fund management costs in order to offset some of its service fee increase. This illustrates what I said earlier about the offsetting motive compromising the need to ensure the recommendation was suitable. The mismatch established above shows that suitability was indeed compromised.

In light of the above, the points made by Tier One about performance and diversification are redundant.

I repeat, all agree that the PGP and PCP remained suitable for Mr B's pension in 2021, and Tier One's only argument for the fund switch is that it was recommended because of the reduction in fund charges and the potential of *better* diversification and *better* performance in the VL4 fund. For the reasons given above, the reduction in fund charges in the VL40 fund came with a mismatch between that fund and Mr B's specific investment requirements.

Recommendation of it was therefore an unsuitable outcome. Given the absence of evidence that he had abandoned those requirements for any prospects of better diversification and performance in the VL40 fund – and given that his pension portfolio was already suitably diversified – the fund would have still been unsuitable for him even if such prospects existed.

As the investigator said, but for Tier One's unsuitable fund switch recommendation in 2021 it is more likely (than not) that Mr B would have retained the PGP and PCP holdings as they were (in his pension). He did the same (that is, retained the holdings) in the 2020 review, where he had no cause to change them, and he had no cause to change them in 2021 so it is unlikely he would have done so.

For the above reasons, I uphold Mr B's complaint.

Motive For The Complaint

As I said above, Mr B is entitled to define his complaint as he wishes, and he has done that. I acknowledge what Tier One has said about what it believes is his true motive in complaining. However, primarily, the complaint is to be addressed as presented and on its merits – which is what I have done. On merit, the complaint is upheld. Furthermore, and as I said in the first sub-section above, Mr B's claim that Tier One's recommendation was made in order to offset its increased service fee is supported by Tier One's statement in the 2021 review. In this context, the complaint has stood and succeeded on its own merit, so whether (or not) Mr B had/has another motive for pursuing it is irrelevant.

Tier One's Complaint Response

Tier One has stressed the need to address the points it made in its complaint response. I have given due consideration to the response document, but it does not alter the conclusions I have reached above.

Within it, and in broad terms, Tier One provides its commentary and interpretation of some of the relevant evidence, but I have also considered the same evidence directly; it makes submissions that I have already reflected, and addressed, in the findings above; it makes some submissions that are not supported by the evidence it refers to; it presents the argument that Mr B wilfully accepted the fund switch recommendation and was happy with the switch thereafter, but that had/has nothing to do with its regulated responsibility to ensure its advice was suitable – unsuitable advice does not become suitable just because it is accepted by the client; and it presents the argument that Mr B was happy with its service up to the point he terminated it, but that also has nothing to do with its regulated responsibility to provide suitable advice.

Refund Of Fees, Tier One's Request For A Decision, And Mr B's Tax Position

Mr B's complaint has been upheld on the basis of the unsuitable advice given to him by Tier One. I set out below the redress that Tier One must calculate and pay him in this respect. I also endorse, and order, the investigator's award of £100 (to be paid to him by Tier One) for the trouble and upset the matter has caused him. Beyond these aspects, I have not seen evidence that Tier One did not provide the ongoing service he received payment for. Indeed, the reviews it conducted and its ongoing engagement with Mr B up to the point its service was terminated illustrates that it provided the ongoing service it was paid for. As such, I do not find grounds for the return of ongoing service fees that Mr B has asked for.

Parties in our process are entitled to ask for an Ombudsman's decision, so it would neither be fair nor reasonable to take a punitive measure against Tier One for doing so. For this reason, I do not accept Mr B's claim for an interest payment if Tier One asks for an

Ombudsman's decision. Instead, and to address any possibility that it delays in paying redress, I will provide for an interest payment if it does not settle redress on the terms, and within the time, I will set out below.

I have noted Mr B's comments about his tax position and will reflect them in the provisions I set out below.

Putting things right

Fair compensation

My aim is that Mr B should be put as closely as possible into the position he would probably now be in if he had been given suitable advice. For the reasons given above, I conclude that but for the unsuitable fund switch advice from Tier One in 2021 Mr B would have kept his pension invested as it was up to the 2021 review – invested equally between the PGP and PCP. Therefore, these funds provide the natural benchmark for redress, and I have used them in my orders below.

On 2 March 2023 Mr B wrote to Tier One to give notice of termination of its service. In the email he also mentioned his dissatisfaction with the 2021 fund switch and gave notice that he intended to submit a complaint about it.

In the investigator's view, the redress calculation end date of 23 March 2023 was used, on the basis that by this date responsibility for the matter ought reasonably to have passed from Tier One to Mr B, whereby he could have instructed another firm to reverse the fund switch. I agree, and I have used the same end date in my orders below. The date is three weeks from his termination notice. That was a reasonable period for him to have addressed the unsuitable fund switch through another adviser (especially as his termination notice confirmed his awareness of the problem), so Tier One's responsibility should not continue after this date.

What must Tier One do?

To compensate Mr B fairly, Tier One must:

- Compare the performance of Mr B's investment with that of the benchmark shown below. If the actual value is greater than the fair value, no compensation is payable. If the fair value is greater than the actual value there is a loss and compensation is payable to him. Tier One should also add any interest, on the terms set out in the table below, to the compensation payable.

- Ordinarily I would have ordered Tier One to pay the compensation into Mr B's pension plan to increase its value by the total amount of the compensation and any interest; that the amount paid should allow for the effect of charges and any available tax relief; and that the compensation should not be paid into the pension plan if it would conflict with any existing protection or allowance.

- However, as summarised in the background section above, Mr B has confirmed the reasons for which payment should not be made into his pension. As he has requested – and unless he subsequently states otherwise to Tier One – the compensation should be paid directly to him. If he subsequently states otherwise to Tier One then the orders I would have ordinarily made, as stated above, apply.

- In terms of the direct payment of compensation to Mr B, I would ordinarily have ordered that the total compensation amount should be reduced to *notionally* allow for any income tax that would otherwise have been paid by him, because had it been possible to pay the compensation into his pension it would have provided a taxable income. This adjustment would have been to ensure the compensation is a fair amount that reflects his income tax liability.

- However, as summarised in the background section above, Mr B says his income in the past three to four years has not been subject to income tax and that the same will apply to his future income up to 2028. For this reason, he says that if the redress due to him is below his total tax-free income up to 2028 the aforementioned notional reduction should not apply. He has referred to Tier One's familiarity with his income arrangements. I order both parties to engage meaningfully and cooperatively with each other, in a timely fashion, in order to verify his claim and to clarify whether (or not) the compensation amount would have produced a taxable income had it been paid into his pension. If it is determined that it would not have produced a taxable income, then the notional deduction does not apply. Otherwise, the notional deduction applies.

- The *notional* allowance, if it applies, should be calculated using Mr B's actual or expected marginal rate of tax at his selected retirement age. For example, if he is likely to be a basic rate taxpayer at the selected retirement age, the reduction would equal the current basic rate of tax. However, if he would have been able to take a tax-free lump sum, the reduction should be applied to 75% of the compensation.

- Pay to Mr B £100 for the distress and inconvenience that the matter has caused him.

Income tax may be payable on any interest paid. If Tier One deducts income tax from the interest it should tell Mr B how much has been taken off. Tier One should give him a tax deduction certificate in respect of interest if he asks for one, so he can reclaim the tax on interest from HM Revenue & Customs if appropriate.

Investment Name	Status	Benchmark	From ("start date")	To ("end date")	Additional Interest
Vanguard Lifestrategy 40% Equity Fund	Still exists and liquid	50% Prufund Cautious Fund Series E; and 50% Prufund Growth Fund Series E	Date of investment	23 March 2023	8% simple per year from the date of this final decision to the date of settlement (if redress is not settled within 28 days of Tier One receiving Mr B's acceptance of this decision)

Actual value

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

Fair value

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

Any additional sum paid into the investment should be added to the *fair value* calculation from the point in time when it was actually paid in.

Any withdrawal, income or other distributions paid out of the investment 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. If there is a large number of regular payments, to keep calculations simpler, I will accept if Tier One totals all those payments and deducts that figure at the end.

Why is this remedy suitable?

- The redress benchmark used above is the natural benchmark arising from the conclusion that, but for the unsuitable fund switch advice from Tier One in 2021, Mr B would have kept his pension invested (in the funds used as the benchmark) as it was up to the 2021 review.

- Earlier, I explained the end date used in the calculation.

- The additional interest is only to compensate Mr B if Tier One unduly delays in settling redress and compensation owed to him, following its receipt of confirmation that he has accepted this decision. It has been given 28 days before the interest provisions are triggered, and I consider this a reasonable period to resolve the payment of redress.

Compensation limit

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, £160,000, £170,000, £190,000, £350,000, £355,000, £375,000 or £415,000 (depending on when the complaint event occurred and when the complaint was referred to us) plus any interest that I consider appropriate. If fair compensation exceeds the compensation limit the respondent firm may be asked to pay the balance. Payment of such balance is not part of my determination or award. It is not binding on the respondent firm and it is unlikely that a complainant can accept my decision and go to court to ask for such balance. A complainant may therefore want to consider getting independent legal advice in this respect before deciding whether to accept the decision.

In Mr B's case, the relevant complaint event occurred in 2021, after 1 April 2019, and the complaint was referred to us in May 2023, after 1 April 2023, so the applicable compensation limit would be £415,000.

Decision and award

I uphold Mr B's complaint on the basis stated above. Fair compensation should be calculated as I have also stated above. My decision is that Tier One must pay him the amount produced by that calculation, up to the relevant maximum.

Recommendation

If the amount produced by the calculation of fair compensation is more than the relevant maximum, I recommend that Tier One pays Mr B the balance. This recommendation is not part of my determination or award. Tier One does not have to do what I recommend.

My final decision

For the reasons given above, I uphold Mr B's complaint. I order Tier One Capital Wealth Management Limited to calculate and pay him redress and compensation as set out above, and to provide him with a copy of its calculation in a clear and simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 12 February 2024.

Roy Kuku
Ombudsman