DRN-4956684

The complaint

Mr X complains that London & Colonial Services Limited ('L&C') didn't undertake sufficient due diligence on a regulated advisory firm who I will refer to as 'Firm A' – Firm A advised Mr X to transfer his previous pension plan to a L&C self-invested personal pension ('SIPP'). Mr X also complains L&C didn't undertake sufficient due diligence on investments he made through his SIPP post-transfer. He says as a result of L&C's failings, this has caused him financial loss.

To protect the consumers anonymity, I have used a different initial to that of his real name and anonymised other information in this decision.

What happened

<u>Involved parties (anonymised where relevant)</u>

L&C

L&C is a regulated pension provider and administrator. It's authorised to arrange deals in investments, deal in investments as principal, establish, operate or wind-up a personal pension scheme and to make arrangements with a view to transactions in investments.

Firm A

In 2009, Firm A, an Independent Financial Adviser ('IFA') firm, was authorised by the Financial Services Authority ('FSA'), which later became the Financial Conduct Authority ('FCA') – I'll refer to both bodies as the 'regulator' or by their respective initials. Firm A was authorised to arrange deals in investments, make arrangements with a view to transactions in investments, and to advise on pension transfers and opt-outs. In 2017, Firm A went into liquidation and was subsequently dissolved in 2020. The registered director of Firm A was an IFA. I will refer to him as 'Mr C' or the 'IFA'.

Company A – the investment

Mr X invested in the unquoted shares of a United Kingdom private limited company, who I will refer to as 'Company A' or the 'investment'. Company A was incorporated in May 2009 and it was an unregulated business which was founded by Mr C. Mr C was also listed as the sole shareholder (subscriber) of the 100 shares issued on incorporation. Company A initially had two directors but the second director resigned in October 2009. From this point (October 2009) up until November 2015, Mr C remained the sole director of Company A. Mr C resigned as director in March 2020.

On incorporation in May 2009, records at Companies House for Company A included an 'Information Memorandum' ('IM')', which set out some detail about its proposed trading activities. Amongst other things, the IM set out the following information:

- *"…the Company's principal activity will be to carry on business as an unquoted trading company whose main, but not sole activities, are secured* *lending and property development."* And: *"The Company has been created with an unlimited share capital."*

- *"It is the intention of the Directors to distribute all trading profits of the Company (subject to the redemption of shares from time to time on a pro rata basis as a means of returning cash to Shareholders following realisation of an investment) by way of dividends."*
- Company A intended to appoint a management company to provide investment and management advice as well as management and development services.
- Under the heading 'Summary Investment Objective and Policy' the IM stated:

  "The company will lend money for a known purpose with the loan secured against an asset of a much greater value. This asset is always secured; usually against land and/or property. The Company will also look to develop property potential development sites will be acquired in most cases with at least outline planning permission already granted."

- Under 'Risk Factors' the IM document stated:

  "An investment in the Company is only suitable for investors who are capable of evaluating the merits and risks of such an investment and who have sufficient resources to be able to bear any losses (which may be equal to the whole amount invested) which may result from such an investment. And: *"Prospective investors should be aware that the value of the Ordinary Shares and the income from them may go down as well as up and that they may not realise their initial investment. In addition, it is possible that the market price of Ordinary Shares in the Company may be less than the underlying Net Asset Value* ['NAV'] *per Ordinary share."*

- Under 'Investment objective', the IM document noted there was: *"…no guarantee that the investment objective of the Company will be achieved. Any dividend growth on the Ordinary Shares will depend on the growth in the value of the underlying assets."*

- 'Minutes of a General Meeting' from November 2009, showed that Mr C was named as the 'Chairman and Director' of Company A. A resolution was passed at the General Meeting in order to remove the authorised share capital so that more shares could be issued as and when required.

In 2018, L&C notified clients who had invested in Company A that it (Company A) was entering into Administration. The Joint Administrators' report summarised the background of Company A as follows:

- It was incorporated in May 2009 and commenced trading in June of that year.
- Its principal trading activity was that of equity and debt investments in a wide range of companies and projects.
- Following its incorporation the company immediately began seeking investment from third parties, the majority of which were members of SIPPs.
- By October 2011, the company had received investments equating to £8,001,733 of which, £6,417,842 was introduced as equity and £1,583,891 as loan (debt) capital.
- All funds raised from investors were re-invested by the company in a number of connected and third party companies. Short term loans were also provided to third parties following due diligence carried out by the

company's management team.
- Company A continued to obtain third party investment over the following years at a significant rate. By October 2013, it'd raised a total of £14,081,085 through a combination of debt and equity sources. The company suffered a loss of £858,678 in that financial year. The company had accrued losses year on year since 2012 and had a total of retained losses of £4,629,422 by April 2016.
- The company continued to raise funds at a slower rate up until 2016, by which time it had equity and loan investments totalling £17,048,876.
- In January 2018, a winding-up petition was lodged by HM Revenues & Customs ('HMRC') and this was shortly followed by a second winding up petition lodged by two investors who were the former auditors of the company. The auditors had been granted a debenture to secure unpaid audit fees. It should be noted that the auditors were also the firm of valuers who had valued the shares of Company A referred to in L&C emails, extracts of which are set out below.
- In February 2018, the company entered into Administration.

A progress report was issued by the Administrators' later in 2018 which, amongst other things, noted:

- The majority of the company's assets comprised of equity investments in private limited companies. These assets were very illiquid and difficult to realise.
- There were a number of assets believed to hold value but the realising of these assets was expected to be protracted and take a significant period to resolve.
- Most of the investments held by Company A were in companies that had either been dissolved, were subject to insolvency proceedings or were otherwise performing poorly. This had led to further complications in realising the investments.
- The company had around fifteen equity investments and ten outstanding loans, the majority of which were subject to complex arrangements.
- In terms of returns of unsecured creditors the Administrators' said: *"Whilst there is anticipated to be a return to unsecured creditors, due to the nature of the Company's assets the quantum and timing of any such return remains uncertain…".*
- A company which I will refer to as 'L' of which Mr C had been a director since 2007, was reported in the Administrators' report as being loaned £1million by Company A. And Company A owned almost 28% shareholding in L which it acquired for almost £250,000. The Administrators' report described L's business as owning freehold property abroad. L was dissolved in 2018 at Companies House following a compulsory strike off application for failure to submit accounts. The Administrators' said because L had been dissolved, there was little prospect of recovering either the outstanding loan balance due from L to Company A, or any value for its (Company A's) shareholding in L.
- Company A entered into voluntary liquidation in 2020.

Company B

On 11 June 2009, Mr C set up another limited business which I will refer to as 'Company B'. This company also sold unquoted shares to investors at the same time as Company A.

Whilst Mr X did not invest in Company B, it is referred to by L&C in its correspondence with Mr C, so I have referred to it here for reference only.

Mr X's SIPP and investments

What happened in Mr X's case

On 17 September 2010, Mr X signed a client agreement with Firm A for it to act as his financial adviser. It was Mr C who signed this document as the 'IFA' for Mr X. At the time, Mr X had personal pensions with two providers totalling around £360,000. Mr X said it was Mr C of Firm A who advised him (Mr X) to transfer both his pensions into a SIPP with L&C. And then to invest in Company A post-transfer.

On 27 September 2010, L&C wrote to Mr X to confirm that it had received his SIPP application form. A letter dated 7 October 2010 from L&C confirmed to Mr X that his SIPP was now in force. And L&C enclosed various documents including a Key Features document and a transaction/asset valuation statement.

The initial source of the funds paid into Mr X's SIPP on 7 October 2010, was from one of his pension plans' which had a total value of £364,463.54. On 29 November 2010, L&C wrote to Mr X to let him know a further £61,859.33 from the same provider had been received into his SIPP. In its submissions to the Financial Ombudsman, L&C said it believes this payment was paid in error. However, following my provisional decision, Mr X says, as far as he is aware, this was not the case.

On 2 February 2011, a transaction statement shows funds of £300,000 being transferred to Company A. Mr X's SIPP as of 26 October 2011, was valued at £427,451.41. At this point, he had 309,875 shares in Company A valued at £1 each. In a letter dated 6 July 2012, L&C wrote to Mr X to let him know that a payment of £10,173 from his second pension provider had been received into his SIPP. A statement dated 9 January 2018, shows that Mr X held a total of 319,116 unquoted shares in Company A valued at £1 per share.

As of 9 January 2018, Mr X's SIPP statement was still showing Company A's unquoted shares as valued at £430,689.41. However, as noted above, in February 2018, Company A appointed Joint Administrators. Mr X, along with other creditors of Company A, was notified of this in a letter from the Administrators dated 9 February 2018.

Shortly after receiving the notice of the Administration of Company A, Mr X wrote to L&C to complain on 12 February 2018. Amongst other things, he said: *"This is catastrophic news and I do not comprehend how you can confirm value in my pension a month earlier…Exactly what do you do for your fees? I hold you responsible for this fiasco and advising me to place my pension with* [Company A] *in the first place. I will be advising the FSA and seek full recompense from your firm."* L&C acknowledged this letter, in writing, on 20 February 2018 but didn't provide a final response letter.

L&C wrote to Mr X on 13 March 2018 advising him it would keep him informed of the progress of the Administration of Company A. And it sent a further letter dated 3 October 2018 with an update on his pension which valued his shares at nil. L&C sent an update to Mr X on 29 March 2019 enclosing the latest update from the Administrators.

Company A subsequently went into liquidation in January 2020 and is no longer trading. As such, Mr X says his investment is worth nothing. Firm A has also been dissolved with no successor and a separate claim was made by Mr X to the Financial Services Compensation Scheme ('FSCS'). He was awarded £50,000 which was the most the FSCS could pay him. His calculated loss was £560,716.27.

The SIPP application/investment application forms

Neither Mr X nor L&C has provided a copy of Mr X's L&C SIPP application form. Nonetheless, in its submissions to the Financial Ombudsman, L&C has referred to parts of Mr X's SIPP application. Amongst other things, it noted that another employee (i.e. not Mr C) of Firm A was stated to be Mr X's IFA in the SIPP application. And that Mr X confirmed he wished to manage the fund himself.

I also note from other L&C SIPP applications it has the following statement in the declaration section of the application: *"I hereby agree to be responsible for any, claims, losses, costs, charges, or expenses which may be raised against London & Colonial or incurred by London & Colonial in consequence of London & Colonial acting on instructions received by facsimile or email from the address stated on this application form and/or provided by me."* I think it's likely this statement was in Mr X's SIPP application.

L&C has not provided a copy of the investment instruction form Mr X would have completed (or had completed for him). But again it has referred to sections of this form in its submissions to us. The L&C investment form I've seen in other similar cases, was entitled 'Open Pension Unquoted Shares Purchase Application' (the 'investment form'). In an example I've seen, the investment form was submitted by, or on behalf of, the relevant SIPP member less than a month after the establishment of their respective SIPP. The investment application included the following information:

- To the question: *"Are the shares being purchased at market value"*. The SIPP member answered *"NO – Par Value new shares created"*. This was the same situation in Mr X's case (i.e. the shares were purchased at par value of £1 each).
- Under 'Declaration' heading, it said: *"I understand and agree that:- There could be a delay in selling the shares if a purchaser cannot be found. This means that the Scheme Administrator may not be able to crystallise that part of the fund for lump sum or pension purposes.*"
- And: *"The shares will need to be valued when they are bought or sold by the Scheme Administrator. The Scheme Administrator will usually accept the last valuation obtained subject to confirmation that nothing significant has happened to the company in the interim and that the shares have not been traded at any other price. The cost of any valuation will need to be borne by either myself or by the company whose shares are being purchased."*

Following the completion of the investment application, the process appeared to be that L&C would contact Company A letting it know about the unquoted shares application. L&C would then forward the funds to Company A's bank account on behalf of the relevant client.

<u>L&C's due diligence</u>

The Intemediary Application and Agreement

In early March 2009, L&C accepted an Intermediary Application from Firm A. In summary, this application contained the following information:

- Mr C signed and dated the application on 6 March 2009 on behalf of Firm A, who in this context was the 'applicant'. As Mr C was the sole director of Firm A no other signatures were needed.
- Firm A was a private limited company and had been authorised by the regulator

since 2002. Firm A had been registered at Companies House since 1999.

- Under the question *"Please give details of all individuals who will sell or supervise sales of annuities or pensions",* Mr C put his own name and noted several relevant qualifications he held. He also said he had 22 years' experience with providing advice in both annuities and pensions.
- Details of Firm A's accountant was provided.
- Firm A hadn't been subject to any judgment debts and an appointment of an Administrator or Administrator Receiver had never been made.
- Firm A hadn't been the subject of any criminal/civil proceedings or arbitration.
- Under the heading of 'First Director', Mr C put his name and personal details. He also put his profession as *"IFA/Managing Director"* and gave details of a professional body he belonged to.
- To the question: *"Has the director been employed solely by the applicant company throughout the last five years?",* this was answered 'No'. As Mr C answered 'no', he was required to answer a follow-up question: *"If no, please provide details overleaf of other employment or directorships during the last five years?,* Mr C listed only one other company that he was a director of within the last five years. This was a non-regulated sister business (a description used by Mr C), who I will refer to as 'Firm B' He had been a director of this latter business from 2005.
- The application required Mr C to agree to several declarations including:

    - The applicant confirmed the information given in the application was true and complete to the best of their knowledge and belief.
    - The applicant agreed L&C could request and/or give further information from/to any person or organisation shown in the application.
    - The applicant authorised L&C to take up such references and to make such enquiries as might be considered necessary in connection with the application.
    - The applicant understood L&C could decline the application in which event, no reason for declinature needed to be given.
    - The applicant agreed to notify L&C of any insolvency/disciplinary proceedings being instituted against it and/or upon them ceasing to be an authorised Intermediary.
    - The applicant acknowledged and undertook that if the application was accepted by L&C, business would be transacted in accordance with the agency terms.
    - The application ended by stating: *"A false statement may lead to termination of any appointment."*

As I've indicated above, at the time of the Intermediary Application, Mr C said he was only the director of two registered companies (Firm A and Firm B) within five years of the application. But he was, in fact, a director of another three companies during that five year period up to the date of the application. So, in total Mr C was the director of five registered companies at the time of the Intermediary Application within the five year period which included Firm A, Firm B, L and two other registered companies..

Within a few days of the intermediary Application, L&C sent an Intermediary Agreement to Firm A – Firm A was the Intermediary in the context of this agreement. Amongst other things, the Intermediary Agreement said:

- *"The Insurer* [L&C] *enters into agreement with persons who comply with the requirements of the UK Financial Services and Markets Act 2000* ['FSMA'] *for the purpose of providing advice to and introducing suitable persons as customers in connection with the products and services that it offers".*

- And: *"The Intermediary wishes in appropriate circumstances to be able to offer to its own clients the products and services supplied by the Insurer and wishes to agree a basis for introducing prospective clients to the insurer."*
- Intermediaries had to be regulated. And were obliged to notify L&C if their authorisation lapsed, was suspended, or was withdrawn.
- L&C could cease to accept business from the Intermediary without giving any reasons. And could terminate the agreement if the Intermediary committed a material breach of the provisions of the agreement; and/or any misconduct which was prejudicial to L&C's business or reputation; and/or if the Intermediary stopped, or was intending to stop, operating as an authorised entity.
- The Intermediary was able to offer to its own clients the products and services supplied by L&C and had agreed a basis for introducing prospective clients to the SIPP provider.
- The Intermediary could act as principal or as agent for L&C only to the extent it was permitted to do so.
- The Intermediary would act as the agent for their own clients.
- The Intermediary would be remunerated in line with a 'Schedule of Remuneration' by L&C in respect of products and services provided to, or for the benefit of, clients introduced by them to L&C.
- Under the heading 'Documentation' the agreement said, amongst other things:

> *"You agree to pass to your client immediately and without any amendment all documents supplied by us for the information of or completion by the client and you agree to pass to us immediately any documents provided by the client for that purpose.*
> *…*
> *You acknowledge that we may from time to time be obliged to send documents of various kinds direct to the client to comply with regulatory obligations but in all such circumstances we shall, unless required not to do so, notify you of the content of the communication to the client. We also reserve the right to communicate directly with a client if we believe that for any reason the client may not otherwise receive information or documents sent to you for onward transmission to the client but in all such circumstances we shall notify you of the content of the communication to the client."*

Information request from L&C about Company A and Company B

On 8 July 2009, the then L&C Product Development Manager ('PDM'), sent Mr C a request for information about Company A and Company B. Amongst other things, the PDM requested the following (the 'four bullet points'):

- *"Confirmation that the companies' main activities were the carrying on of a trade, profession or vocation.*
- *A pension scheme either alone or together with associated persons did not have control of the company.*
- *Neither a pension scheme member nor a person connected to such a member was a controlling director of the vehicle, or any other vehicle which holds an interest in the vehicle directly or indirectly.*
- *A pension scheme does not directly or indirectly hold an interest in the vehicle for the purposes of enabling a pension scheme member, or a connected person of such a member, to occupy or use the property."*

In addition to the four bullet points, the PDM said:

- The auditor of Company A and Company B needed to confirm the subscription price of £1 per share.
- The PDM requested that the subscription price of £1 would remain in place for a minimum of six months so as to avoid the need for additional letters for each SIPP member.
- The auditor needed to confirm the companies satisfied bullet point one of four bullet points (i.e. main trading activities of the companies), as well as provide a breakdown of the existing shareholders and shareholdings in order to satisfy the connection and control test.
- On an ongoing basis the company secretary and auditor would need to confirm adherence to the four bullet points together with an updated share price (annually) and a copy of the accounts as and when they become available.
- Non-adherence to the four bullet points would lead to an unauthorised payment charge against the relevant member if any of the conditions weren't met.

On 9 July 2009, Company A's accountant, who did not refer to Company B in his response to L&C's questions, stated that following discussions with the directors (of Company A), he (the accountant) could confirm the subscription price was set at £1 per share. And that this price would remain the same for at least six months. The accountant noted the directors intended that Company A's principal trading activity would be: *"…secured lending and property development trading."*

The accountant went on to say that Company A had one shareholder which he named as a limited company but Companies House records shows Mr C as the sole shareholder of Company A from incorporation up until 7 December 2009. Even at this point, it is unclear whether the company named by the accountant had become a shareholder as it wasn't listed from the then 27 shareholders (including Mr C) in the first annual returns issued in June 2010.

In an email dated 10 July 2009, L&C asked the accountant, or Mr C, to let it know in the future if Company A should be treated, or taxed, as an investment company by HMRC. On the same day (10 July), the accountant confirmed to L&C that he would do as requested. The accountant added that in relation to Company A, its profits would be deemed as trading activities by HMRC. And he added: *"This opinion is given to the best of my knowledge but if you have any doubts as to the nature of the company's proposed activities I would suggest that you obtain a third party opinion. It should not be seen as taxation or investment advice to you or to potential investors."*

Company A's sales brochure

L&C has provided us with a copy of Company A's sales brochure which included the following information:

- *"…everything we* [Company A] *do is designed to maximise returns whilst focusing on mitigating risk."*
- *"When profits are realised via loan interest or sale of property they will be passed on to shareholders by way of dividends. This allows individual shareholders the choice of either receiving the dividend as income or reinvesting the dividend to purchase more shares."*

- "[Company A] *is working towards its goal of a listing on the Channel Islands Stock Exchange by the end of 2010."*
- "[Company A] *specialises in seeking out opportunities that offer rates of return in excess of those available on deposit. Our objective is to provide these returns using asset backed lending and property development."*
- "[Company A] *does not buy assets on the assumption that they will go up in value. There are two basic ways* [Company A] *make returns for our shareholders.* It went on to say this was through 'Secured Lending' which included by way of 'Internal Margin.'
- 'Internal Margin' was described in the sales brochure as: *"…building sites are normally acquired with planning permission received, this results in reducing the risk to shareholders. Once a property has been built, its value would normally be higher than the cost of the land and also the cost of construction. This means that even if there is no increase in value during the construction period, there is still a profit. Another important factor to consider is that should property prices fall during construction, the original capital is protected up to the internal profit margin."*
- Company's A's 'Exit Strategy' was: *"When full planning permission is granted the developers can refinance through an institution. The developers already have in place a commitment letter from an institution that, when full planning permission is granted, will allow the developer to draw down substantial funds at a cheaper rate. It is therefore in the developers interest to repay* [Company A] *as soon as cheaper funds become available. The funds will be used to repay* [Company A] *and complete the project."*
- Under the heading 'Security' the brochure said: *"In this situation* [Company A] *obtained a first charge on a different site owned by the developer which had already been granted full planning permission. If the developer had been unable to gain full planning permission on the site* [Company A] *was funding,* [Company A] *would have been able to realise the capital invested by selling the second site. The loan to value on this site was less than 40%."*
- Under the heading 'The Outcome' the brochure said: *"The developer obtained full planning permission and was able to drawdown the funds promised by the institution. This allowed the developer to repay* [Company A] *its capital and also pay* [Company A] *the interest due."*

It should be noted Mr C had also told L&C that he was intending to carry out similar activities through Company B.

Company A's annual accounts

L&C has provided a copy of draft full annual accounts for Company A. The accounts are for the year ended 2011 but cover the period 2010 and 2011. In summary, the draft accounts state:

- For 2010 and 2011, the company operated at a profit of £281,609 and £84,138 respectively.
- The company's main asset in terms of value, was listed as 'investments'.
- Called up share capital in 2010 was £2,634,791 and in 2011 it was £6,417,842.
- All turnover was due to investments. Turnover for the year 2010 was £612,751 and for the year 2011 it was £274,556.
- Mr C was named as the director of the company.
- Under Related Disclosures - there were several statements relating to companies that Mr C was the director of. These statements included the following:

- Company A and Company B had an agreement to share investment returns on their individual investments.
- Firm A owed Company A £10,000.
- Company A owed Firm B £331,000.
- Another company of which Mr C had been a director since 2007 and which was not declared in the Intermediary Application, owed Company A £146,130.
- Mr C was a director of L since 2007 and this was not declared in the Intermediary Application. The accounts showed that L owed Company A £565,372 in 2010 and £735,323 in 2011.

- Company A had made investments in several companies including the companies referred to above. In total, the accounts for year ending 2011, showed that the number of investments was in five businesses where Company A had shareholdings ranging from 33% to 80%.
- The companies invested in by Company A were described as 'subsidiaries' or 'associated companies' or 'joint ventures'.
- The types of business activities the companies carried out included the sale of environmentally friendly materials; boat chartering and maintenance' services; and leisure travel technology services.

<u>Ongoing monitoring of Firm A/Company A by L&C</u>

L&C's continued monitoring the activities of Company A after its initial due diligence. The first emails we have received, from L&C in relation to another similar complaint, are from 2011. At that time, emails between key employees of L&C appeared to start expressing some concerns about the investment in Company A by its SIPP members. In summary, these emails included the following:

- *11 September 2011*

An L&C internal email sent by the then Head of Compliance and Governance (the 'Head of Compliance') to both the then Corporate Governance Director ('Governance Director') and the then Chief Executive Officer ('CEO') which said: *"There are a number (at least two) companies that our clients have invested in. They are* [Company A and Company B]*. I have acquired some documentation from Companies House which seems to confirm that each time there is an investment into one of these companies there is new share capital created. I have had confirmation from* [name redacted] *that every acquisition has been for the same class of share at a price of £1 per share."*

The Head of Compliance went on to say: *"…these two aspects seem to be incompatible to me."* And that: *"…if I may make to be so bold, why would an investor retain a shareholding of this nature when then is no capital growth and no dividend policy?"* And: *"I am concerned that there is more than £4 million held in assets directly associated with* [Firm A]*. I feel that there needs to be some action taken whereby we as trustee feel satisfied that all of these holdings are "safe" investments and are being properly valued on acquisition and ongoing."* And that: *"We have no absolute detail of what the monies for the clients have been used for and nothing to confirm that the funds are being used for the purpose we believe the monies to be used for."*

The CEO responded to the Head of Compliance as follows: *"Yes I agree we should have more info – I believe these investments are related to property developments/investments of some kind (hence the mezzanine funding with the loans) and it may well be the case that different companies are used for different projects – I* *think the explanation for the share price may be that, rather like LCH and P1, shares are issued at a fixed issue price until all required capital has been raised and there will be no change in share price until progress is made with the project in question. Still – we shall delve and confirm more detail – perhaps we start with the share prospectus and any other detail* [the then L&C Investment Support Manager ('ISM')] *picked up when these started."*

- *6 October 2011*

An email from the Governance Director noted the Head of Compliance had some concerns about the total amount of cash being invested by L&C SIPP members in Company A and Company B. The Governance Director wanted to find out the amount of the latest four unquoted share purchases' and details of which company these were being invested in. It was noted one had been referred to L&C for £28,800 to be invested in unquoted shares in Company A – and that these shares were still being valued at par value (i.e. £1), with new shares created to match the purchase amount (in pounds).

The Governance Director went on to say L&C probably needed to positively approve these latest investments since it (L&C) had now got this issue on its *"radar"*. The Governance Director noted there wasn't anything specific to prevent L&C from doing anything with the cases which had been highlighted. However, they went on to say L&C could consider requesting some further information from Company A about its accounts and share values. They also noted L&C could get an opinion from a 'legal person' and this could be done in parallel with processing the new application forms until such point as L&C *"discovers anything concerning."*

- *18 October 2011*

An email from the Head of Compliance said: *"I really must get into the* [Company A] *situation. I am still not satisfied with the static share price of £1*." They went on to say L&C needed to approach Company A's accountant and ask for justification of this. And if L&C asked the accountant for a proper assessment of a value for the shares, then the accountant would be professionally liable for this assessment. The Head of Compliance noted, it could be possible that L&C may have recourse to the accountant in the event of default/problems. The Head of Compliance went on to say*:*

> *"If we do not ask for these valuations perhaps it could be levelled at us that we are not performing sufficient due diligence as Trustee on behalf of the beneficial interests in the trust monies and therefore carry potential liability ourselves. Also, without the information we have no method of identifying if the investors are over or under paying for the shares. Overall, I think that asking the accountants for a current estimate of the share price makes for good practice. The investors that are lending to these companies, rather than buying shares, are at least accruing interest, albeit being rolled up to the end of the loan period and then rolled over for the time being into further loans."*

The Governance Director asked another L&C employee what management information ('MI') L&C were collecting on Company A. The Governance Director said they were told there was reporting on the overall totals of members' funds invested but not the percentage of funds on a member by member basis. It was noted there might be an HMRC limit *"(possibly 90%?)"* on funds invested into unquoted shares. The L&C employee undertook to check this. The email went on to ask whether L&C should consider applying a maximum percentage of funds, either on unquoted shares alone, or into either Company A or Company B as a whole, including loans and/or unquoted shares. The Governance Director concluded by saying:

"I'm a bit uncomfortable about the connection between the IFA and the investment companies. IFAs advising their clients to put their money into our SIPP and then invest in their associated companies might be the sort of trend that the FSA are expecting us to identify, monitor and possibly also report on? I'm not saying I think there's anything untoward going on but we should probably consider, decide and document etc etc".

- *12 May 2012*

The Head of Compliance emailed the Governance Director about Company A and Company B. The then Head of Compliance said:

> *"We need to discuss this.*
>
> *However, as a little background, you will know that I attempted to obtain accounts from* [Firm A] *relating to both* [Company A and Company B] *where monies have been directed to share purchase or loans. This request brought the wrath of* [Mr C] *to bear on* [the name of the ISM] *as I was not in the office at the time.*
>
> *As a consequence of threatening to remove the* [Firm A] *portfolio business from us, I had a meeting with* [two named L&C employees] *why* (sic) *I felt it necessary to have ongoing due diligence and monitoring of these cases. Nothing satisfactory was concluded from the meeting, but I understood that* [L&C employee] would be approaching [Mr C] for previously requested accounts. *To my knowledge nothing has been forthcoming and I have been at fault for not pursuing this more rigorously."*

- *29 August 2012*

The Governance Director emailed the Head of Compliance saying L&C had a second payment on this day following one from the day before to invest in unquoted shares in Company A. The Governance Director noted a check of Company A's credit rating showed there was *"a problem."* The Governance Director asked the Head of Compliance if the latter was happy for L&C to continue to send further monies for investment in Company A. L&C at this point was proposing to have a new investment criterion and the Governance Director wanted to know whether they should wait for this before allowing any further investments to be made in Company A.

The Governance Director continued by saying L&C could take the view the second payment of that day was just another application for an unquoted shares purchase. And it wasn't for L&C to take any stance on the merits of the investment. The Governance Director questioned whether, in fact, the credit rating was significant. They then noted that whilst a credit check was part of L&C's current vetting process, they (the Governance Director) weren't sure if an adverse rating should effect L&C's willingness to accept the investment application. The Governance Director ended by saying*: "Should we be releasing more funds without further investigations into the state of* [Company A]*? If not, we need a strategy and a message to go to* [Firm A]*. Could you let me know what you think before I go back to* [names of two L&C employees].

- *30 August 2012*

In response to the credit rating issue, the Head of Compliance said the credit rating of Company A should at least cause L&C to ask some questions, particularly with the overall amounts that had been placed from this company from L&C SIPP members. The Head of Compliance went on to say they didn't think it would be good practice to allow Company A to place more money with L&C if the latter suspected there may be *"issues"*. And that: *"After all, would you continue to make a personal investment in any asset if there were notified doubts about the auspices of the organisation being invested into?"*.

An employee at L&C reported shortly after this email, that L&C had not authorised a further payment of £900,000 pending further information. The then CEO confirmed this was the case and that the payment was to be discussed the next day.

- *3 September 2012*

The Head of Compliance wrote to Firm A referring to the £900,000 proposed investment in unquoted shares in Company A. They asked for a number of documents including Companies House documents. The Head of Compliance also asked for other documents relating to both Company A and Company B including:

- Share certificates.
- Confirmation of the number of shares that L&C holds.
- The percentage this represented of the total shares in issue.
- Details of any Annual General Meetings ('AGM') notices.
- Confirmation of the dividend policy.
- Copies of audited account since 2009.
- Confirmation of the then names of the directors and company secretary.

The Head of Compliance said the correspondence received in respect of one of the prospective investors who had wanted to invest £900,000 in Company A, seemed to suggest the returns on the shares are related, or linked in some way to, specific assets rather than the profits of the Company as a whole. L&C wanted Firm A's comments on this.

An internal L&C email set out some sample members dividend payments. Some of the dividends were being paid in cash and some were paid in more shares. However, the email ended with the then ISM saying they had not been able to trace any dividends being received by clients in 2012.

In a response letter from Firm A to L&C's Head of Compliance, Company A's 'Operations Manager' in summary said:

- Copies of the requested Companies House records were provided.
- The ordinary shares did carry voting rights and the total authorised share capital was not applicable as there was no limit.
- The number of shares held by L&C was 6,099,366 relating to 93 individuals and the percentage held by L&C was 70% (in Company A). The total number of other ordinary shares was 25.
- No AGM's had been held to date but Firm A's Operations Director said, as had been previously discussed with the then CEO of L&C, that *"on a regular basis"*, Company A was seeking authorisation from the FSA to become an Authorised Corporate Director to run its own regulated funds. It was noted it had always been Company A's intention to run as an authorised business and this would require an AGM.
- The current dividend policy was to distribute a percentage of the profits made and it was noted a dividend payment for the year (2012) was due to be announced imminently.

- The current business was to be revalued by independent and regulated auditors who would revalue the shares for Company A once the latter became regulated. The letter noted the valuer had said this should be completed by the end of September 2012 and a revised share price would be launched by 1 November 2012.
- Some clarification was given around the investor who wanted to invest £900,000. It was noted this investor was not a client of Firm A and that they had, in fact, approached Company A via their own IFA which was in turn sent via an email to the then CEO of L&C. It was noted that Company A didn't know how the confusion arose but the client referred to had now instructed Firm A to sell his shares for him.
- Full audited accounts for the years May 2009 and October 2010 were attached. These accounts have not been provided to the Financial Ombudsman. Only abbreviated accounts are registered at Companies House for this period.
- The name of the current director was Mr C and it was noted there was no company secretary as this wasn't a requirement at that time.

- *13 November 2012*

L&C's ISM wrote to Mr C asking questions about loans that had been provided to Firm B from L&C members. In terms of Company A, the ISM asked for a copy of the latest company accounts and also stated in relation to Company A that: *"I would also confirm that as we discussed earlier, a temporary hold on all loan / loan roll-overs or unquoted share applications we are in receipt of or receive is in force and we will work with you to ensure the disruption to normal day to day business is minimized."*

- *21 November 2012*

Mr C, in his capacity as 'Chairman and Chief Investment Officer' of Company A responded to the email from the ISM dated 13 November 2012. In short, Mr C said that a company I will refer to 'V', was in the business of developing land in Cape Verde. But after developing around 80 sales, it was found that no one was buying on this site. Mr C said himself, and another individual, decided on a way to allow the clients of L&C to access the investment, which he explained was for the pension schemes to loan the funds to Firm B. Firm B would purchase the land plots in accordance with the clients instructions and without L&C having to spend a large amount of money doing *"DD"*. Mr C predicted investors would receive their monies back either if the plots were sold, or legal action was taken.

It should be noted that the company Mr C was referring to was also a creditor in the Administration of Company A. The Administrators report made reference to V's outstanding debt to Company A. The Administrators said that V was an Argentinian based company, which had an outstanding loan owed to Company A. They noted this was originally entered into in February 2010 to provide a £1million loan facility for the use of developing a hotel and resort in Argentina. V defaulted on the terms of the loan and when Company A commenced action to recover the balance owing, V's directors began to dissipate the assets of the business. The Administrators said no money was recovered from V despite a judgement of £1.43million in Company A's favour being awarded by the Court.

- *26 and 27 November 2012*

On 26 November, the ISM asked Mr C further questions about Firm B and Company A.

In terms of Company A, the ISM asked what financial year the dividends to shareholders were being paid for; whether Company A was an Unregulated Collective Investment Scheme ('UCIS'); and whether Mr C had legal opinion (a copy of which was requested if applicable).

Mr C responded the next day and made the following points:

- He said the dividend that is currently being paid is an interim dividend for the year ending October 2012.
- He confirmed that Company A was not, and had never been, an UCIS or any type of collective investment scheme. He said Company A was a holding/trading company and as such does not need to be regulated.
- He noted he was a director of Company A and the management of the assets was not a regulated activity under FSMA. But Mr C also noted he did, in fact, advise potential investors to invest in Company A via Firm A. Mr C went on to say this was a different issue (from Company A being, or needing to be, a regulated entity).

- *22 February 2013*

L&C's then ISM requested that Company A provide a copy of the accounts the professional valuers used to arrive at a value as of 2011, which appears to have been £1.09 per share – please note I have not seen a copy of the valuation report. The ISM noted that L&C: *"…can't quite see the logic in the price of £1.09 if the NAV is £1.15. Please would you confirm the reasoning behind this."* And: *"Please also confirm if the new issue shares will remain at £1 or if you are intending a new price."* On the same date, Firm A responded that as these were unquoted shares, the share price does not equate to a NAV as it is not an investment fund. It noted that all new shares would be issued at £1.09.

- *22 February 2013*

The L&C ISM noted to colleagues that Firm A had contacted them with a new share price for Company A of £1.09 which the ISM said they weren't entirely happy with as it seemed quite vague and they couldn't see any logic behind the price of £1.09. However, the CEO in response, said they had a valuation from an independent qualified firm of substance and that there may have been more to this valuation than 'meets the eye'. The CEO went on to say that the difference from £1.09 and £1.15 does not seem to be very significant (6%) and they didn't see any particular reason to question the valuers about the figure that they (the valuers) were putting their name to.

- *5 July 2013*

In an internal email between various L&C employees, the ISM said L&C's total percentage shareholding in Company A must not reach 75% *"under any circumstances"*. The ISM noted at this point L&C's shareholding in Company A was 73.5%.

The ISM said it had been confirmed with Firm A that L&C will proceed with the two unquoted share purchases which brought its (L&C's) shareholding up to 73.5% in Company A. And as a result, Firm A will need to refer all further cases to L&C before it (L&C) would accept the relevant investment request.

It should be noted Companies House records show the first L&C member to have purchased shares in Company A started at number 10. By the time Company A ceased to take any further shareholdings, 95 shareholders out of a total of 164 were L&C SIPP members. Investments in Company A from L&C members appears to have stopped in

2013. L&C SIPP members represented just under 60% in terms of value from the total number of shareholders of 164.

By around the same time as Mr X's investment, investments in Company A totalled (shareholdings only) £2,243,891 (statement of capital from October 2010). The vast majority of which were L&C SIPP members. And Companies House records show there were over 60 shareholders by the time of Mr X's investment.

It's further noted that Company B was dissolved in mid-2014. By this point, all of the paid up share capital in Company B of £609,450 was transferred to Company A.

<u>Mr X's complaint</u>

As noted above, Mr X complained to L&C about his investment on 12 February 2018. I've set out a summary of Mr X's initial complaint, so I won't repeat that again here. As I've said above, L&C did acknowledge Mr X's complaint in a letter dated 18 February 2018 but didn't provide him with a final response letter.

Following the liquidation of Company A and Firm A, Mr X sought advice about the matter. And referred his complaint to the Financial Ombudsman on 11 March 2021. Amongst other things, Mr X complained that L&C were aware (or ought to have been aware) of the obvious conflict of interest in that Mr C, who was an adviser employed by Firm A, was also the sole director of Company A.

Mr X added that L&C ought to have carried out adequate due diligence on Firm A prior to him investing in Company A. This was particularly so given the frequency and amount of new SIPP applications that Mr C, through Firm A, was submitting around the same time (as Mr X's application) to L&C, all of which were to be invested in Company A. And L&C ought to have carried out adequate due diligence into Company A.

On 6 August 2021, Mr X received notification of his FSCS award of £50,000 as this was the maximum it could award him. His total losses were calculated to be £560,716.27. The FSCS provided Mr X with a Reassignment of Rights in respect of L&C dated 8 December 2021, which allowed him to continue with his complaint with the Financial Ombudsman Service.

Our investigator recommended upholding the complaint. He concluded that L&C hadn't acted fairly or reasonably towards Mr X, because, in brief, he considered L&C did not carry out sufficient due diligence in relation to Mr X's investment in Company A. And/or in relation to the IFA. Our investigator concluded that if L&C had done so, it would have refused to accept Mr X's SIPP application in the first place, which would have avoided him (Mr X) suffering losses to his pension provision. Our investigator set out how this matter should be put right. This included a recommendation that L&C pay Mr X compensation of £500 for the distress and inconvenience it had caused him.

In response to the investigator's view, L&C said, in summary:

- There is no justification for using the regulator's Principles for Businesses (the 'Principles') as a basis for finding against L&C as a breach of these cannot give rise to any cause of action at law.
- The investigator failed to review the case in light of the Conduct of Business Sourcebook ('COBS') rules; the regulatory permissions that L&C holds; L&C's contractual arrangements with its clients and other parties; and the statutory objectives previously set out at FSMA, namely: *"the general principle that consumers should take responsibility for their own decisions".*

- L&C disputed the relevance of the regulatory publications quoted by the investigator such as the Thematic Review Reports. L&C said only the 2009 Thematic Review was issued prior to Mr X's transactions that form the subject matter of this complaint. So, in L&C's view, all the other publications have no relevance to the outcome of this case.
- The 2009 Thematic Review does little more than highlight some examples of measures that SIPP operators could consider in terms of good practice which the regulator observed in other cases. It is also mainly directed at firms providing advisory services rather than execution only services.
- The investigator disregards the findings in the Adams cases (full Court references below) particularly in regard to the duties imposed by COBS. The Court in Adams held that whilst COBS rules contain express provisions dealing with the need to advise clients on both the *"suitability"* (COBS 9) and *"appropriateness"* (COBS 10) of their investment, those rules did not apply to execution only SIPP providers such as L&C.
- The introducer in Adams was not a regulated adviser as with the present case.
- The view seems to have placed insufficient weight on the parties' contractual arrangements and consequently, the investigator has construed due diligence obligations for L&C to which it was not in fact subject. This was a point made in Adams.
- In deciding the complaint, the Financial Ombudsman must take into account the relevant case law and, if this is deviated from, it must set out why it has done so. The investigator only makes a limited attempt to distinguish this case from that of Adams.
- If, contrary to the contractual position, execution only SIPP providers are made liable for the poor investment choices of consumers, the execution only SIPP market will cease to exist. This is neither fair nor reasonable.
- If L&C had carried out the kind of enquiries suggested by the investigator, this could have put L&C in breach of its regulatory permissions as it would have amounted to assessing suitability of the SIPP and/or the investment.
- The SIPP application form did not confirm where Mr X intended to invest his pension funds. Therefore, his application could not have been rejected on the basis the investment was not appropriate to be held in a SIPP.
- L&C disagreed that unquoted shares in Company A presented any 'red flags' as the investigator has said. It was simply unquoted shares in a limited company.
- This complaint is about an alleged high risk investment and whether Mr X would have made that investment had he known it was high risk. This was not the responsibility of L&C.
- In any event, Mr X signed disclaimers confirming he knew of the high risk nature of the investment and that it was illiquid. But Mr X still went ahead with the SIPP/investments so, it's likely he would have done so with another SIPP provider if L&C had not accepted his application. Therefore, L&C was not the cause of Mr X's loss.
- It's accepted that Mr X received transfer and investment advice from Firm A - L&C has not been provided with a copy of that advice.
- If Mr X has been compensated by the FSCS then he should have his compensation reduced by the amount he was paid in compensation.
- L&C also has significant concerns as to the policy issues which are driving the Financial Ombudsman's considerations and findings of issues such as those raised in this complaint.
- L&C does not agree with the investigator's recommendation to use the FTSE UK Private Investors Income Total as a benchmark if a notional value cannot be obtained from Mr X's previous pension provider. It says

there is no evidence Mr X would have invested in this way.
- The investigator has provided no evidence that Mr X has suffered any distress or inconvenience warranting £500 in compensation.

I issued a provisional decision dated 28 June 2024. Both parties responded.

As noted above, L&C has said that the payment made on 29 November 2010 from Mr X's previous pension provider totalling £61,859.33 may have been paid by the ceding scheme in error. However, Mr X says he did question this payment with the ceding scheme at the time and he wasn't provided with a substantive response as to why it was an 'error'. So, he says he has no reason to believe that this transfer was made in error. Regarding Mr X's likely tax rate in retirement, he provided a copy of his P60 to show he was a basic rate taxpayer.

In summary, L&C said:

- The Ombudsman's reasons for upholding this complaint are entirely inconsistent with the terms of the contract between the parties, the relevant COBS rules, and the restrictions on L&C's permissions.
- No fair or reasonable reading of the Principles could require L&C to conduct due diligence of the nature suggested by the Ombudsman.
- The Ombudsman has failed to take account of the law as required under Dispute Resolution ('DISP') rule 3.6.4.
- The Ombudsman is creating new due diligence obligations in a way that is contrary to the FCA's own publications at the time.
- The Ombudsman's reliance on various FCA publications is misplaced and if anything, supports L&C's position.
- There is a real unfairness if L&C is held liable for the poor choices of consumers and the failures of other regulated entities. It is also unfair that L&C cannot rely on the express representations made by the consumer when signing the contractual documents.
- L&C, as an execution only entity, is structured to provide a service on an execution only basis. So, it cannot consider suitability and/or provide warnings or advice to clients.

The matter has been passed back to me to reconsider.

What I've decided – and why

Jurisdiction – time limits

Neither L&C nor Mr X has made any further submissions in relation to the time limits that apply. I remain of the view that this matter has been referred in time. In summary, I think this is for the following reasons:

- DISP 2.8.2 says:

  "The Ombudsman cannot consider a complaint if the complainant refers it to the Financial Ombudsman Service:

  (1) more than six months after the date on which the respondent sent the complainant its final response, redress determination or summary resolution communication; or

(2) more than:

(a) six years after the event complained of; or (if later)

(b) three years from the date on which the complainant became aware (or ought reasonably to have become aware) that he had cause for complaint;

unless the complainant referred the complaint to the respondent or to the Ombudsman within that period and has a written acknowledgement or some other record of the complaint having been received;"

- Mr X set up his SIPP in 2010 and he complained to L&C in February 2018. So, I think this matter has been brought outside of the six-year time limit.

- From what I can see, Mr X identified he had a problem with his pension (SIPP) when Company A went into Administration. Mr X was notified of the Administration on 8 February 2018 by L&C. He responded to this with a written complaint dated 12 February 2018. And whilst L&C sent Mr X a written acknowledgement of the complaint on 20 February 2018, it didn't send a final response letter. Mr X brought his complaint to the Financial Ombudsman on 11 March 2021 and by this point, no final response had been issued. So, I consider the matter has been referred to us within the six-month time limit.

- In terms of the three-year time limit the material points required for Mr X to have awareness of a cause for complaint include awareness of a problem, awareness that the problem had or may have caused him material loss, and awareness that the problem was or may have been caused by an act or omission of L&C (the respondent in this complaint).

- In January 2018, his investment regarding Company A, was showing its value at over £400,000. And I think it was not until he was notified of Company's A's Administration in February 2018, that there was an identifiable problem with the investment held in his SIPP. So, it was at the point he was notified of the Administration, on, or around, 8 February 2018, that Mr X became aware (or ought reasonably to have become aware) that he had cause for complaint. As he brought his complaint to L&C on 12 February 2018, I consider his complaint was made within the three-year time limit.

All in all, I remain satisfied that Mr X made his complaint within the relevant time limits that apply. And this is a complaint we can consider.

Merits

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

In reconsidering what's fair and reasonable in all the circumstances of this complaint, I need to take account of relevant law and regulations, regulator's rules, guidance and standards, codes of practice and, where appropriate, what I consider to have been good industry practice at the relevant time.

As a preliminary point, the purpose of this final decision is to set out my findings on what's fair and reasonable, and explain my reasons for reaching those findings, not to offer a point by point response to every submission made by the parties to the complaint. And so whilst I've carefully considered all the submissions made by both parties, I've focussed here on the points I believe to be key to my final decision on what's fair and reasonable in the circumstances.

Relevant considerations

Having carefully reconsidered all of the evidence, including the submissions in response to my provisional decision, I'm still of the view that the relevant considerations in this case are those that I'd previously set out in my provisional decision. As such, and while taking into account all of the submissions that have been made, I've largely repeated what I'd said about this point in my provisional decision.

In my view, the starting point is the regulator's Principles (the Principles for Businesses) which are of particular relevance to my decision. The Principles, which are set out in the FCA's handbook: *"…are a general statement of the fundamental obligations of firms under the regulatory system"* (PRIN 1.1.2G). I consider the Principles relevant to this complaint include 2, 3 and 6 which say:

> *"Principle 2 – Skill, care and diligence – A firm must conduct its business with due skill, care and diligence.*
>
> *Principle 3 – Management and control – A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.*
> *…*
> *Principle 6 – Customers' interests – A firm must pay due regard to the interests of its customers and treat them fairly."*

I've carefully considered the relevant law and what it says about the application of the Principles. In R (British Bankers Association) v Financial Services Authority [2011] EWHC 999 (Admin) ('BBA') Ouseley J said at paragraph 162: *"The Principles are best understood as the ever present substrata to which the specific rules are added. The Principles always have to be complied with. The specific rules do not supplant them and cannot be used to contradict them. They are but specific applications of them to the particular requirement they cover. The general notion that the specific rules can exhaust the application of the Principles is inappropriate. It cannot be an error of law for the Principles to augment specific rules."*

And at paragraph 77 of BBA, Ouseley J said: *"Indeed, it is my view that it would be a breach of statutory duty for the Ombudsman to reach a view on a case without taking the Principles into account in deciding what would be fair and reasonable and what redress to afford. Even if no Principles had been produced by the FSA, the FOS would find it hard to fulfil its particular statutory duty without having regard to the sort of high level principles which find expression in the Principles, whoever formulated them. They are of the essence of what is fair and reasonable, subject to the argument about their relationship to specific rules."*

In R (Berkeley Burke SIPP Administration Ltd) v Financial Ombudsman Service [2018] EWHC 2878 ('BBSAL'), Berkeley Burke brought a judicial review claim challenging the decision of an Ombudsman who had upheld a consumer's complaint against it. The Ombudsman considered the regulator's Principles and good industry practice at the relevant time. He concluded that it was fair and reasonable for Berkeley Burke to have undertaken due diligence in respect of the investment before allowing it into the SIPP wrapper. And that if it (Berkeley Burke) had done so, it would have refused to accept the investment. The Ombudsman found Berkeley Burke had, therefore, not complied with its regulatory obligations, and had not treated its client fairly.

Jacobs J, having set out some paragraphs of BBA including paragraph 162 which I've set out above, said (at paragraph 104): *"These passages explain the overarching nature of the Principles. As the FCA correctly submitted in their written argument, the role of the Principles is not merely to cater for new or unforeseen circumstances. The judgment in BBA shows that they are, and indeed were always intended to be, of general application. The aim of the Principles-based regulation described by Ouseley J. was precisely not to attempt to formulate a code covering all possible circumstances, but instead to impose general duties such as those set out in Principles 2 and 6."*

The BBSAL judgment also considered section 228 of FSMA and the approach an Ombudsman is to take when deciding a complaint. The judgment of Jacobs J in BBSAL upheld the lawfulness of the approach taken by the Ombudsman in that complaint, which I have described above, and included the Principles and good industry practice at the relevant time as relevant considerations that were required to be taken into account.

As outlined above, Ouseley J in BBA held that it would be a breach of statutory duty if I were to reach a view on a complaint without taking the Principles into account in deciding what's fair and reasonable in all the circumstances of a case. And Jacobs J adopted a similar approach to the application of the Principles in BBSAL. I, therefore, remain satisfied that the Principles are a relevant consideration that I must take into account when deciding this complaint.

On 18 May 2020, the High Court handed down its judgment in the case of Adams v Options SIPP [2020] EWHC 1229 (Ch). Mr Adams subsequently appealed the decision of the High Court and, on 1 April 2021, the Court of Appeal handed down its judgment in Adams v Options UK Personal Pensions LLP [2021] EWCA Civ 474. I've taken account of both these judgments and the judgment in Adams v Options UK Personal Pensions LLP [2021] EWCA Civ 1188 when making this decision in Mr X's case.

I've considered whether Adams means the Principles should not be taken into account in deciding this case and I'm of the view that it doesn't. I note that the Principles didn't form part of Mr Adams' pleadings in his initial case against Options SIPP. And HHJ Dight didn't consider the application of the Principles to SIPP operators in his judgment. The Court of Appeal also gave no consideration to the application of the Principles to SIPP operators. So, neither of the judgments say anything about how the Principles apply to an Ombudsman's consideration of a complaint. But to be clear, I don't say this means Adams isn't a relevant consideration at all. As noted above, I've taken account of the Adams judgments when making this decision.

I acknowledge that COBS 2.1.1R *('A firm must act honestly, fairly and professionally in accordance with the best interests of its client')* overlaps with certain of the Principles, and that this rule was considered by HHJ Dight in the High Court case. Mr Adams pleaded that Options SIPP owed him a duty to comply with COBS 2.1.1R, a breach of which, he argued, was actionable pursuant to section 138(D) of FSMA ('the COBS claim'). HHJ Dight rejected this claim and found that Options SIPP had complied with the best interests rule on the facts of Mr Adams' case.

The Court of Appeal rejected Mr Adams' appeal against HHJ Dight's dismissal of the COBS claim, on the basis that Mr Adams was seeking to advance a case that was radically different to that found in his initial pleadings. The Court found that this part of Mr Adams' appeal didn't so much represent a challenge to the grounds on which HHJ

Dight had dismissed the COBS claim, but rather was an attempt to put forward an entirely new case.

I note that in Adams v Options SIPP, HHJ Dight found that the factual context of a case would inform the extent of the duty imposed by COBS 2.1.1R. HHJ Dight said at paragraph 148: *"In my judgment in order to identify the extent of the duty imposed by Rule 2.1.1 one has to identify the relevant factual context, because it is apparent from the submissions of each of the parties that the context has an impact on the ascertainment of the extent of the duty. The key fact, perhaps composite fact, in the context is the agreement into which the parties entered, which defined their roles and functions in the transaction."*

I further note that there are significant differences between the breaches of COBS 2.1.1R alleged by Mr Adams and the issues in Mr X's complaint. The breaches were summarised in paragraph 120 of the Court of Appeal judgment. In particular, HHJ Dight considered the contractual relationship between the parties in the context of Mr Adams' pleaded breaches of COBS 2.1.1R that happened after the contract was entered into. And he wasn't asked to consider the question of due diligence before Options SIPP agreed to accept the store pods investment into its SIPP.

In Mr X's complaint, amongst other things, I'm considering whether L&C ought to have identified that the introductions from Firm A involved a significant risk of consumer detriment. And, if so, whether it ought to have ceased accepting introductions from Firm A, before it (L&C) entered into a SIPP contract with Mr X.

The facts of Mr Adams' and Mr X's cases are also different. I make that point to highlight there are factual differences between Adams v Options SIPP and Mr X's case. And I need to construe the duties L&C owed to Mr X under COBS 2.1.1R in light of the specific facts of his (Mr X's) case. So, I've considered COBS 2.1.1R, alongside the remainder of the relevant considerations, and within the factual context of his case, including L&C's role in the transaction.

However, I also think it's important to say that I must determine this complaint by reference to what is, in my opinion, fair and reasonable in all the circumstances of the case. In doing so, I'm required to take into account relevant considerations which include the law and regulations; regulators' rules; guidance and standards; codes of practice; and, where appropriate, what I consider to have been good industry practice at the relevant time. This is a clear and relevant point of difference between this complaint and the judgments in Adams v Options SIPP. That was a legal claim which was defined by the formal pleadings in Mr Adams' statement of case.

Additionally, and in response to L&C's submissions to my provisional decision, I want to emphasise that I don't say L&C was under any obligation to advise Mr X on the SIPP and/or underlying investments. As I said in my provisional decision, refusing to accept an application isn't the same thing as advising Mr X on the merits of the SIPP and/or the underlying investments. Overall, I remain satisfied that COBS 2.1.1R is a relevant consideration. However, I think it needs to be considered alongside the remainder of the relevant considerations, and within the factual context of Mr X's case.

The regulatory publications

The FCA, and its predecessor, the FSA, issued the following publications which reminded SIPP operators of their obligations and set out how they might achieve the outcomes envisaged by the Principles, namely:

- The 2009 and 2012 Thematic Review Reports (the ‘review’ or the ‘reviews’).
- The October 2013 finalised SIPP operator guidance.
- The July 2014 ‘Dear CEO’ letter.

I’ve reconsidered the relevance of these publications. And I’ve set out material parts of the publications here, although I’ve considered them in their entirety.

The 2009 review

The 2009 review included the following statement:

> *“We are very clear that SIPP operators, regardless of whether they provide advice, are bound by Principle 6 of the Principles for Businesses (‘a firm must pay due regard to the interests of its clients and treat them fairly’) insofar as they are obliged to ensure the fair treatment of their clients. COBS 3.2.3(2) states that a member of a pension scheme is a ‘client’ for COBS purposes, and ‘Customer’ in terms of Principle 6 includes clients.*
>
> *It is the responsibility of SIPP operators to continuously analyse the individual risks to themselves and their clients, with reference to the six TCF* [treating customers fairly] *consumer outcomes.*
> *…*
> *We agree that firms acting purely as SIPP operators are not responsible for the SIPP advice given by third parties such as IFAs. However, we are also clear that SIPP operators cannot absolve themselves of any responsibility, and we would expect them to have procedures and controls, and to be gathering and analysing management information, enabling them to identify possible instances of financial crime and consumer detriment such as unsuitable SIPPs. Such instances could then be addressed in an appropriate way, for example by contacting the member to confirm the position, or by contacting the firm giving advice and asking for clarification. Moreover, while they are not responsible for the advice, there is a reputational risk to SIPP operators that facilitate the SIPPs that are unsuitable or detrimental to clients.*
>
> *Of particular concern were firms whose systems and controls were weak and inadequate to the extent that they had not identified obvious potential instances of poor advice and/or potential financial crime. Depending on the facts and circumstances of individual cases, we may take enforcement action against SIPP operators who do not safeguard their clients’ interests in this respect, with reference to Principle 3 of the Principles for Business (‘a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems’).*
>
> *The following are examples of measures that SIPP operators could consider, taken from examples of good practice that we observed and suggestions we have made to firms:*
>
> - *Confirming, both initially and on an ongoing basis, that intermediaries that advise clients are authorised and regulated by the FSA, that they have the appropriate permissions to give the advice they are providing to the firm’s clients, and that they do not appear on the FSA website listing warning notices.*

- *Having Terms of Business agreements governing relationships, and clarifying respective responsibilities, with intermediaries introducing SIPP business.*

- *Routinely recording and reviewing the type (i.e. the nature of the SIPP investment) and size of investments recommended by intermediaries that give advice and introduce clients to the firm, so that potentially unsuitable SIPPs can be identified.*

- *Being able to identify anomalous investments, e.g. unusually small or large transactions or more 'esoteric' investments such as unquoted shares, together with the intermediary that introduced the business. This would enable the firm to seek appropriate clarification, e.g. from the client or their adviser, if it is concerned about the suitability of what was recommended.*

- *Requesting copies of the suitability reports provided to clients by the intermediary giving advice. While SIPP operators are not responsible for advice, having this information would enhance the firm's understanding of its clients, making the facilitation of unsuitable SIPPs less likely.*

- *Routinely identifying instances of execution-only clients who have signed disclaimers taking responsibility for their investment decisions, and gathering and analysing data regarding the aggregate volume of such business.*

- *Identifying instances of clients waiving their cancellation rights, and the reasons for this."*

The later publications

In the October 2013 finalised SIPP operator guidance, the regulator stated:

> *"This guide, originally published in September 2009, has been updated to give firms further guidance to help meet the regulatory requirements. These are not new or amended requirements, but a reminder of regulatory responsibilities that became a requirement in April 2007.*
>
> *All firms, regardless of whether they do or do not provide advice must meet Principle 6 and treat clients fairly. COBS 3.2.3(2) is clear that a member of a pension scheme is a "client" for SIPP operators and so is a customer under Principle 6. It is a SIPP operator's responsibility to assess its business with reference to our six TCF consumer outcomes."*

The October 2013 finalised SIPP operator guidance also set out the following:

> *"**Relationships between firms that advise and introduce prospective members and SIPP operators***
>
> *Examples of good practice we observed during our work with SIPP operators include the following:*
>
> - *Confirming, both initially and on an ongoing basis, that: introducers that advise clients are authorised and regulated by the FCA; that they*

have the appropriate permissions to give the advice they are providing; neither the firm, nor its approved persons are on the list of prohibited individuals or cancelled firms and have a clear disciplinary history; and that the firm does not appear on the FCA website listings for un-authorised business warnings.

- *Having terms of business agreements that govern relationships and clarify the responsibilities of those introducers providing SIPP business to a firm.*
- *Understanding the nature of the introducers' work to establish the nature of the firm, what their business objectives are, the types of clients they deal with, the levels of business they conduct and expect to introduce, the types of investments they recommend and whether they use other SIPP operators. Being satisfied that they are appropriate to deal with.*
- *Being able to identify irregular investments, often indicated by unusually small or large transactions; or higher risk investments such as unquoted shares which may be illiquid. This would enable the firm to seek appropriate clarification, for example from the prospective member or their adviser, if it has any concerns.*
- *Identifying instances when prospective members waive their cancellation rights and the reasons for this.*

Although the members' advisers are responsible for the SIPP investment advice given, as a SIPP operator the firm has a responsibility for the quality of the SIPP business it administers. Examples of good practice we have identified include:

- *conducting independent verification checks on members to ensure the information they are being supplied with, or that they are providing the firm with, is authentic and meets the firm's procedures and are not being used to launder money*
- *having clear terms of business agreements in place which govern relationships and clarify responsibilities for relationships with other professional bodies such as solicitors and accountants, and*
- *using non-regulated introducer checklists which demonstrate the SIPP operators have considered the additional risks involved in accepting business from non-regulated introducers"*

In relation to due diligence the October 2013 finalised SIPP operator guidance said:

*"**Due diligence***

Principle 2 of the FCA's Principles for Businesses requires all firms to conduct their business with due skill, care and diligence. All firms should ensure that they conduct and retain appropriate and sufficient due diligence (for example, checking and monitoring introducers as well as assessing that investments are appropriate for personal pension schemes) to help them justify their business decisions. In doing this SIPP operators should consider:

- *ensuring that all investments permitted by the scheme are permitted by HMRC, or where a tax charge is incurred, that charge is identifiable, HMRC is informed and the tax charge paid*
- *periodically reviewing the due diligence the firm undertakes in respect of the introducers that use their scheme and, where appropriate*

enhancing the processes that are in place in order to identify and mitigate any risks to the members and the scheme

- *having checks which may include, but are not limited to:*
    - *ensuring that introducers have the appropriate permissions, qualifications and skills to introduce different types of business to the firm, and*
    - *undertaking additional checks such as viewing Companies House records, identifying connected parties and visiting introducers*
- *ensuring all third-party due diligence that the firm uses or relies on has been independently produced and verified*
- *good practices we have identified in firms include having a set of benchmarks, or minimum standards, with the purpose of setting the minimum standard the firm is prepared to accept to either deal with introducers or accept investments, and*
- *ensuring these benchmarks clearly identify those instances that would lead a firm to decline the proposed business, or to undertake further investigations such as instances of potential pension liberation, investments that may breach HMRC tax-relievable investments and non-standard investments that have not been approved by the firm"*

The July 2014 Dear CEO letter provides a further reminder that the Principles apply and an indication of the regulator's expectations about the kinds of practical steps a SIPP operator might reasonably take to achieve the outcomes envisaged by the Principles. And it also sets out how a SIPP operator might meet its obligations in relation to investment due diligence. It says those obligations could be met by:

- *correctly establishing and understanding the nature of an investment*
- *ensuring that an investment is genuine and not a scam, or linked to fraudulent activity, money-laundering or pensions liberation*
- *ensuring that an investment is safe/secure (meaning that custody of assets is through a reputable arrangement, and any contractual agreements are correctly drawn-up and legally enforceable)*
- *ensuring that an investment can be independently valued, both at point of purchase and subsequently*
- *ensuring that an investment is not impaired (for example that previous investors have received income if expected, or that any investment providers are credit worthy etc)*

L&C's response to the application of the regulators' publications

In its response to my provisional decision, L&C said I had placed over-reliance on the regulator's publications. As I said in my provisional decision, I acknowledge the 2009 and 2012 reviews and the Dear CEO letter, aren't formal guidance (whereas the 2013 finalised guidance is). However, I remain of the view that the fact the reviews and the Dear CEO letter do not constitute formal guidance, doesn't mean their importance should be underestimated.

The publications provide a reminder that the Principles apply. And are an indication of the kinds of things a SIPP operator might do to ensure it is treating its customers fairly and produce the outcomes envisaged by the Principles. In that respect, the publications which set out the regulator's expectations of what SIPP operators should be doing, also go some way to indicate what I consider amounts to good industry practice. I, therefore, remain satisfied it's appropriate to take them into account.

It's relevant when deciding what amounted to good industry practice in the BBSAL case, the Ombudsman found: *"…the regulator's reports, guidance and letter go a long way to clarify what should be regarded as good practice and what should not."* And the judge in BBSAL endorsed the lawfulness of the approach taken by the Ombudsman.

L&C has also indicated the 2009 review didn't provide guidance in any meaningful sense. But as the review's introduction says: *"In this report, we describe the findings of this thematic review, and make clear what we expect of SIPP operator firms in the areas we reviewed. It also provides examples of good practices we found."* And as referenced above, the 2009 review goes on to provide: *"…examples of measures that SIPP operators could consider, taken from examples of good practice that we observed and suggestions we have made to firms."*

So, I consider the 2009 review is a reminder the Principles apply. It gives an indication of the kinds of things a SIPP operator might do to ensure it is treating its customers fairly and produce the outcomes envisaged by the Principles. The 2009 review sets out the regulator's expectations of what SIPP operators should be doing and, therefore, indicates what I consider amounts to good industry practice at the relevant time. Given this, I remain satisfied it's relevant and appropriate to take it into account.

L&C says that many of the matters which the 2009 review invites firms to consider are directed at firms providing advisory services. It's not specified which parts of the review it thinks are directed at such firms but, to be clear, I consider the 2009 review was also directed at firms like L&C acting purely as SIPP operators. The review says: *"We are very clear that SIPP operators, regardless of whether they provide advice, are bound by Principle 6 of the Principles for Businesses…"*.

Further, it's noted prior to the good practice examples quoted above that: *"We agree that firms acting purely as SIPP operators are not responsible for the SIPP advice given by third parties such as IFAs. However, we are also clear that SIPP operators cannot absolve themselves of any responsibility, and we would expect them to have procedures and controls, and to be gathering and analysing management information, enabling them to identify possible instances of financial crime and consumer detriment such as unsuitable SIPPs."*

The remainder of the publications also provide a reminder the Principles apply and are an indication of the kinds of things a SIPP operator might do to ensure it is treating its customers fairly and to produce the outcomes envisaged by the Principles. In this respect, these publications also go some way to indicate what I consider amounts to good industry practice at the relevant time. Therefore, I'm satisfied it's appropriate to take them into account.

I've carefully considered what L&C has said about the publications published after Mr X's SIPP was set up. But, like the Ombudsman in the BBSAL case, I don't think the fact the publications, (other than the 2009 review), post-date the events that took place in relation to Mr X's complaint, mean the examples of good practice they provide weren't good practice at the time of the relevant events. Although the later publications were published after the events subject to this complaint, the Principles that underpin them existed throughout, as did the obligation to act in accordance with them.

It's also clear from the text of the 2009 and 2012 reviews (and the Dear CEO letter in 2014) that the regulator expected SIPP operators to have incorporated the recommended good practices into the conduct of their business. And I think this is something that L&C understood. For example, in October 2011, the L&C Governance Director asked another L&C employee what management information L&C were collecting on Company A. The L&C employee undertook to check the information that was requested. In the meantime, the then Governance Director went on to say:

> *"I'm a bit uncomfortable about the connection between the IFA and the investment companies. IFAs advising their clients to put their money into our SIPP and then invest in their associated companies might be the sort of trend that the FSA are expecting us to identify, monitor and possibly also report on? I'm not saying I think there's anything untoward going on but we should probably consider, decide and document etc etc".*

So, in my view, I'm satisfied L&C, at around the time of the events under consideration here, thought the 2009 review and the good practice considerations as set out in the later publications were relevant. And whilst the regulators' comments suggest some industry participants' understanding of how the good practice standards shaped what was expected of SIPP operators changed over time, it's clear the standards themselves hadn't changed.

I've noted L&C's point the judge in the Adams case didn't consider the 2012 review, 2013 SIPP operator guidance and 2014 Dear CEO letter to be of relevance to his consideration of Mr Adams' claim. But it doesn't follow that those publications are irrelevant to my consideration of what's fair and reasonable in the circumstances of this complaint. As mentioned, the publications indicate what I consider amounts to good industry practice at the relevant time.

That said, this doesn't mean in considering what's fair and reasonable, I'll only consider L&C's actions with these documents in mind. The reviews, the Dear CEO letter and guidance, gave non-exhaustive examples of good practice. They didn't say the suggestions given were the limit of what a SIPP operator should do. As the annex to the Dear CEO letter notes, what should be done to meet regulatory obligations will depend on the circumstances.

To be clear, I don't say the Principles and/or the publications obliged L&C to ensure the transactions were suitable for Mr X. It's accepted L&C wasn't required to give advice to him and couldn't give advice under its permissions held at the time. And I accept the publications don't alter the meaning of, or the scope of the Principles. But they're evidence of what I consider to have been good industry practice at the relevant time, which, as I've said, would bring about the outcomes envisaged by the Principles.

L&C says the publications, or guidance, which post-dated the events subject of this complaint, doesn't help to clarify the type of good industry practice which existed at the relevant time. But I consider the 2009 review together with the Principles, provide a very clear indication of what L&C could and should have done to comply with its regulatory obligations that existed at the relevant time before accepting Mr X's introduction from Firm A.

It's important to keep in mind the judge in Adams v Options didn't consider the regulatory publications in the context of considering what's fair and reasonable in all the circumstances bearing in mind various matters including the Principles (as part of the regulator's rules), or good industry practice. It's my view, that in determining this particular complaint, I need to consider whether, in accepting Mr X's SIPP application from Firm A, L&C complied with its regulatory obligations: to act with due skill, care and diligence; to take reasonable care to organise and control its affairs responsibly and effectively; to pay due regard to the interests of its customers and treat them fairly; and to act honestly, fairly and professionally. In doing that, I'm looking to the Principles and the publications listed above to provide an indication of what L&C should have done to comply with its regulatory obligations and duties.

Submissions have been made about breaches of the Principles not giving rise to any cause of action at law, and breaches of guidance not giving rise to a claim for damages under FSMA. I've carefully considered these submissions but it's not my role to determine whether something that's taken place gives rise to a right to take legal action. I'm making a decision on what's fair and reasonable in the circumstances of this complaint – and for all the reasons I've set out above, I'm satisfied the Principles and the publications listed above are relevant considerations to this decision.

Taking account of the factual context of this case, it's my view in order for L&C to meet its regulatory obligations, (under the Principles and COBS 2.1.1R), amongst other things, it should have undertaken sufficient due diligence into Firm A and the business Firm A was introducing. And L&C should have done this both initially and on an ongoing basis before deciding to accept Mr X's application.

As I said above, ultimately, what I'll be looking at is whether L&C took reasonable care, acted with due diligence, and treated Mr X fairly, in accordance with his best interests. And what I think is fair and reasonable in light of that. And I think the key issue in Mr X's complaint is whether it was fair and reasonable for L&C to have accepted his SIPP application in the first place. So, I need to reconsider whether L&C carried out appropriate due diligence checks on Firm A before deciding to accept Mr X's SIPP application.

The contract between L&C and Mr X

In response to my provisional decision, L&C has reiterated its initial submissions about its contract with Mr X and I've carefully considered what has been said about this. To be clear, I don't say L&C should (or could) have given advice to Mr X, or otherwise have ensured the suitability of the SIPP and/or the investment for him. I accept L&C made it clear to him that it wasn't giving, nor was it able to give, advice. And that it played an execution only role in his SIPP investments. I also accept forms Mr X signed confirmed, amongst other things, that losses arising as a result of L&C acting on his instructions were his responsibility.

So, I've not overlooked or discounted the basis on which L&C was appointed. My decision on what's fair and reasonable in the circumstances of Mr X's case is made with all of this in mind. I've proceeded on the understanding that L&C wasn't obliged – and wasn't able – to give advice to Mr X on the suitability of the SIPP or the investment he went on to make. But I remain satisfied that, to meet its regulatory obligations when conducting its operation of SIPPs business, L&C had to decide whether to accept introductions of business with the Principles in mind. And I don't agree that it couldn't have rejected introductions or applications without contravening its regulatory permissions by giving investment advice.

What did L&C's obligations mean in practice?

In this case, the business L&C was conducting was its operation of SIPPs. And I'm satisfied that, to meet its regulatory obligations, when conducting its operation of SIPPs business, L&C had to decide whether to accept or reject particular investments and/or referrals of business with the Principles in mind. The regulator's reviews and guidance provided some examples of good practice observed by the FSA and FCA during their work with SIPP operators. This included being satisfied a particular introducer is appropriate to deal with and that a particular investment is appropriate to accept. That involves conducting checks – due diligence – on introducers and investments to make informed decisions about accepting business. This obligation was a continuing one.

As set out above, to comply with the Principles, L&C needed to conduct its business with due skill, care and diligence; organise and control its affairs responsibly and effectively; and pay due regard to the interests of its clients (including Mr X) and treat them fairly. Its obligations and duties in this respect weren't prescriptive and depended on the nature of the circumstances, information, and events on an ongoing basis. And I think that L&C understood this to some degree at the time too, as it did more than just checked the FSA entries for Firm A to ensure it was regulated to give advice. For example, it (L&C) also entered into an Intermediary Agreement with Firm A.

So, and well before the time of Mr X's application, I think L&C ought to have understood that its obligations meant it had a responsibility to carry out appropriate checks on Firm A to ensure the quality of the business it was introducing. And I consider L&C also ought to have understood that its obligations meant it had a responsibility to carry out appropriate due diligence on investments before accepting them into a SIPP. I think L&C's submissions on the fact it undertook some due diligence prior to allowing unquoted shares in Company A to be held on its platform, reflect this. Therefore, I'm satisfied that, to meet its regulatory obligations when conducting its business, L&C was also required to consider whether to accept or reject a particular investment(s) with the Principles in mind.

L&C's due diligence on Firm A

L&C's due diligence of Firm A before accepting introductions from it, consisted of it (L&C) asking Mr C, the director of Firm A, to complete an Intermediary Application which asked a number of questions. L&C then entered an Intermediary Agreement with Firm A following completion of the application. The FSA Register was also checked to ensure Firm A and Mr C were appropriately authorised (which they were).

From what I can see, in or around June 2009, Mr C told L&C that he (or Firm A) wanted to introduce prospective L&C SIPP clients to the investment in Company A. L&C then took some steps to carry out due diligence on Company A to ensure it could be held in a SIPP by meeting HMRC requirements.

So, for example, L&C was provided with Company A's sales brochure which outlined its proposed trading activities. And L&C requested, and received, information from both Mr C and Company A's accountant about its (Company A's) proposed business activities. The documents and information provided to L&C showed that Company A's principal trading activity was in 'secured lending and property development'. In practice, this meant that Company A would lend funds to businesses who were developing property either with, or without, planning permission.

From the information that has been provided on this complaint, in terms of due diligence, I'm satisfied L&C did take some steps towards meeting its regulatory obligations and good industry practice. However, I don't think the steps that I've seen went far enough, or were sufficient, to meet L&C's regulatory obligations and good industry practice.

I think L&C was aware of, or should have identified potential risks of, consumer detriment associated with the business Firm A was proposing to introduce. And I consider these risks should have been identified before L&C accepted Mr X's application in September 2010. As I explain below in more detail, based on the available evidence, I think it's more likely than not that the majority of SIPP business introduced to L&C by Firm A involved very high risk business, where clients' pension monies were ending up invested in an unregulated and non-standard investment post-transfer.

Further, I don't think there were sufficient systems and controls put in place to manage the clear conflict of interest between Mr C and the investment he was introducing clients to. Mr C was an IFA who was recommending clients to transfer their pension plans to a L&C SIPP. He then recommended that these same clients invest in the unquoted shares in a company he was the sole director of. He also owned shares in that company. L&C was aware of this set up from the outset. In Mr X's case, he was advised by Mr C to transfer two of his pensions to a L&C SIPP. He was then introduced to the investment in Company A.

In addition, as is evident from what I've already said in the background above, a significant amount of the investment monies going into Company A, was being used to invest in other companies associated with Mr C.

I consider L&C should have taken steps to address the potential risks, including the conflict of interest risk posed by the IFA introducing clients to an investment he had a financial interest in. And I think such steps should have included getting a fuller understanding of Firm A's business model. L&C could have done this by asking more questions of, and requesting information from, Firm A. For example, such questions could have included, but not limited to, how the conflict of interest between Mr C and Company A, would be managed. L&C could also have asked more about the investments that were being made via Company A.

I also think L&C could have carried out some independent checks on the contents of the Intermediary Application form Mr C completed. For example, L&C would have known that Mr C was a director of more companies than he declared in the Intermediary Application if it had undertaken checks at Companies House regarding Mr C's directorships. This was publicly available information. And would have shown that Mr C was a director of five companies including Firm A and Firm B. Mr C only declared the latter two companies. Draft accounts show at least three of the companies (including Firm A) financially benefited from investments monies that came via Company A. A check of Companies House records was given as an example of a due diligence check that could have been undertaken in the 2013 finalised SIPP operator guidance.

It should be noted the Intermediary Application and the agreement that followed, was set up, in part, to meet with L&C's due diligence duties in order to ensure its clients were being treated fairly and weren't put at risk of consumer detriment by those firms L&C chose to do business with. From what I can see, L&C was unaware that Mr C had given incorrect information in L&C's Intermediary Application form.

Having gone to the trouble of asking questions relevant to whether to accept or decline business from an IFA, in my view, the onus was on L&C in its capacity as the SIPP operator to have adequate systems and controls in place to check and monitor that the information provided in the application was accurate. I don't think it was reasonable for L&C to have just relied on what Mr C said in the Intermediary Application without carrying out some independent checks.

So, based on the evidence provided, I'm of the view L&C failed to conduct sufficient due diligence on Firm A before accepting Mr X's SIPP application, or to draw fair and reasonable conclusions from what it did know, or ought to have known, about the business introduced by Firm A, which in my view, was putting clients pension monies at significant risk of detriment. I've set out some more detail about this below, the points I make below overlap to a degree, and should have been considered by L&C cumulatively.

The type of investments being made by Firm A introduced clients

The investment

The majority of Firm A clients that were introduced to L&C, invested in Company A. The sale of unquoted shares in Company A from L&C members appears to have stopped in 2013. By this point L&C SIPP members represented just under 60% in terms of value from the total number of shareholders of 164. And as I noted above, by around the time of Mr X's investment, £2,243,891 (by October 2010) was invested in Company A by way of shareholdings, the majority of which were from investors introduced by Firm A.

As I've said above, in 2011, the then L&C Governance Director said at that time they were *"…a bit uncomfortable about the connection between the IFA and the investment companies. IFAs advising their clients to put their money into our SIPP and then invest in their associated companies might be the sort of trend that the FSA are expecting us to identify, monitor and possibly also report on?".* Given L&C knew this was the situation from the outset – the IFA advising clients to invest in an associated company – this is something L&C could have addressed before agreeing to accept business from Firm A.

What information was being provided to clients investing in Company A

Mr X says he can't remember whether a suitability report was prepared or given to him at the time of his transfer. But he said he was advised by Mr C to transfer his pensions to a L&C SIPP in order to invest in Company A. I note that L&C says there is a different named IFA in Mr X's SIPP application but I think it's more likely than not that Mr C was Mr X's adviser. Mr C had not long before advising Mr X, signed the Firm A client agreement as the IFA. Further, Mr X recollection is that it was Mr C who provided the advice. Even if I'm wrong about this, ultimately Firm A was under the control and management of Mr C. And the majority, if not all, of Firm A's clients who were introduced to L&C invested in the unquoted shares of Company A. This was something L&C was aware of which is evident from its emails I've set out above.

In the suitability reports, I've seen in other cases, clients of Firm A were being advised to invest the majority of their transferred pension funds in Company A. In Mr X's case, from what I can see, this followed a similar pattern in that he also invested the majority of his pension funds in Company A.

The risk warnings in the suitability reports were generic in nature. The suitability reports said in terms of risks in unquoted shares these included: there was no guarantee the proposed new funds will outperform the existing plan; past performance is no guarantee of future returns; the price of the shares and the income from them can fall as well as rise; the value of the investment is not guaranteed; and there remains the possibility that the client could lose income and/or growth following a rise in market conditions while the transfer remains pending.

The investment referred to in the suitability report was in unquoted shares in Company A, which had only been established for one year at this point and was an unlisted trading company. Its proposed business revolved around secured lending and in dealings in land/property development as well as 'Joint Venture Partnerships' with other unlisted companies. In my view, I don't think the risk warnings I've referred to above, went far enough for the client to understand the nature of the investment they were agreeing to buy and the type of risks associated with this type of investment. Whilst I have not seen a copy of Mr X's suitability report – neither he nor L&C has been able to provide this to me – I think it's more likely than not that he was being told similar information about investing in Company A and the type of risks this involved.

What fair and reasonable steps should L&C have taken in the circumstances?

L&C could simply have concluded that, given the potential risks of consumer detriment from the pattern of business being introduced to it by Firm A – which I think should have been clear and obvious at the time – it should not continue to accept applications from Firm A. That would have been a fair and reasonable step to take, in the circumstances. Alternatively, L&C could have taken fair and reasonable steps to address the potential risks of consumer detriment, such as those I've set out below.

Understanding Firm A's business model

Given the potential risk of consumer detriment I think that, as part of its due diligence on Firm A, L&C ought to have found out more about how Firm A was operating before it received Mr X's application. And, mindful of the type of introductions L&C was receiving from Firm A from the outset, I think it's fair and reasonable to expect L&C, in line with its regulatory obligations, to have made some specific enquiries and obtained information about Firm A's business model.

The October 2013 finalised SIPP operator guidance gave an example of good practice as: *"Understanding the nature of the introducers' work to establish the nature of the firm, what their business objectives are, the types of clients they deal with, the levels of business they conduct and expect to introduce, the types of investments they recommend and whether they use other SIPP operators. Being satisfied that they are appropriate to deal with."*

I think that L&C, and long before it received Mr X's SIPP application, should have checked with Firm A and asked about things like: how it came into contact with potential clients; what agreements it had in place with its clients; whether all of the clients it was introducing were being offered advice; how and why a significant proportion of retail clients were interested in making investments in Company A; how it was able to meet with or speak with all its clients; and what material was being provided to clients by it.

L&C has said in its submissions that introductions from Firm A didn't present any red flags as it was simply introducing clients who were investing in unquoted shares in a limited company. But it's clear that these were unquoted shares in a limited company in which the IFA was also the director of that company. And by the time of Mr X's investment, L&C clients were the majority shareholders in that company. I think this did present a risk of consumer detriment and more questions should have been asked of Mr C in line with those I've set out above. I also note that L&C itself, in 2011, expressed in one of its emails that the conflict of interest between Mr C and Company A was a matter of concern. I consider this is a view L&C could have reached much earlier and certainly prior to Mr X's investment being made.

Making independent checks

I think, in light of what I've said above, it would have been fair and reasonable for L&C, to meet its regulatory obligations and good industry practice, to have taken independent steps to enhance its understanding of the introductions it was receiving from Firm A. As noted above, it could have asked for copies of correspondence in which applicants were being offered advice. The 2009 review said: *"…we would expect (SIPP operators) to have procedures and controls, and to be gathering and analysing management information, enabling them to identify possible instances of financial crime and consumer detriment such as unsuitable SIPPs. Such instances could then be addressed in an appropriate way, for example by contacting the members to confirm the position, or by contacting the firm giving advice and asking for clarification."*

The 2009 review said that an example of good practice was: *"Requesting copies of the suitability reports provided to clients by the intermediary giving advice. While SIPP operators are not responsible for advice, having this information would enhance the firm's understanding of its clients, making the facilitation of unsuitable SIPPs less likely."* So I think it would have been fair and reasonable for L&C to speak to some applicants, like Mr X, directly and/or to seek copies of the suitability reports.

As noted above, Mr X says he dealt with Mr C as his IFA only but he cannot remember receiving a suitability report. However, looking at the suitability reports being provided to other clients of Firm A these gave generic information about the risks involved in the type of investment that was being recommended. And failed to make clear Mr C's role as the director of that company. There was a clear conflict of interest between Mr C and the clients he was recommending invest in one of his companies, which in my view, given there were no systems and procedures in place to manage this conflict, presented a clear risk of consumer detriment.

I appreciate L&C might say it couldn't comment on advice without potentially being in breach of its permissions. Again, I confirm I accept L&C couldn't give advice. But it had to take reasonable steps to meet its regulatory obligations. And in my view such steps included addressing a potential risk of consumer detriment by speaking to applicants and/or having sight of advice letters, as this could have provided L&C with further insight into Firm A's business model. This was a fair and reasonable step to take in reaction to the clear and obvious risk of consumer detriment I've mentioned.

I also note that Mr C was a director of several companies when he completed the Intermediary Application. And as I've also noted one of these questions asked him about other directorships. Mr C didn't declare three of the five companies of which he was a director. A simple independent check of Companies House would have shown that he had not declared the correct directorships and as I've said, one of the company's went on to borrow £1m from Company A, money which came directly from investments made by SIPP members of L&C as well as other investors.

The regulator said in its October 2013 finalised guidance that in line with Principle 2, firms should consider, for example, undertaking additional checks such as viewing Companies House records and identifying connected parties. Given relevant questions were asked, it seems to me that if L&C was carrying out sufficient due diligence checks, undertaking some independent checks on what the IFA had declared in the Intermediary Application, would have been something it could have done. And by doing so, reassured itself the IFA was acting in a way which was expected by someone in his position.

So, I think if L&C after asking the question, independently verified the information which was in the Intermediary Application, it would have known, or ought to have reasonably known, that Mr C hadn't declared all the directorships as he should have done. I think this called into question his competency and integrity. And I would have expected L&C to ask him further questions about these companies and to establish why these other directorships were not declared by Mr C. I would have expected L&C to have appropriate systems and controls in place to monitor any further information Mr C provided was accurate as well as up to date.

Volume of business

It's clear from the L&C email chains I've set out above, that L&C was continuing its due diligence by monitoring Firm A on an ongoing basis. L&C was keeping management information about the business it was receiving from Firm A. For example, the Governance Director said in several emails that L&C was reporting on the overall totals of L&C members' funds invested through Firm A. And L&C was able to provide (internally) the level of holdings its clients held in Company A which, by 2011, was just over 73%. It was at this point that L&C put a limit on the amount it would accept in terms of its SIPP members ownership of Company A, which it set at 75%.

So, L&C could see from what it was recording most clients of Firm A introduced to L&C were predominantly from applicants intending to invest in high risk non-standard holdings, which in this case was in unquoted shares where the company itself was investing in high risk esoteric investments. I think it's fair to say that such investments are highly unlikely to be suitable for the vast majority of retail clients. They will generally only be suitable for a small proportion of the population. I consider the risks are multiplied where the investment company was investing in businesses that were themselves high risk. And the IFA was the director of the investment vehicle which in turn was investing in other companies which the IFA had a financial interest in.

From the information provided, it appears that L&C started to have concerns about the volume of business and the way Company A was operating from late 2011. On 11 September 2011, an email from the then Head of Compliance to the then CEO stated that: *"There are a number (at least two) companies that our clients have invested in. They are* [Company A and Company B]. *I have had confirmation from* [name redacted] *that every acquisition has been for the same class of share at a price of £1 per share."*

The Head of Compliance went on to say: *"I am concerned that there is more than £4 million held in assets directly associated with* [Firm A]*. I feel that there needs to be some action taken whereby we truly feel satisfied that all of these holdings are "safe" investments and are being properly valued on acquisition and ongoing.*"

And that: *"We have no absolute detail of what the monies for the clients have been used for and nothing to confirm that the funds are being used for the purpose we believe the monies to be used for."* In response the then CEO stated that: *"Yes I agree we should have more info – I believe these investments are related to property developments/investments of some kind (hence the mezzanine funding with the loans) and it may well be the case that different companies are used for different projects…"*

A month after this it was noted that L&C would require further information from Company A about its accounts and share values. And they could get legal opinion but that new applications forms would still be processed until L&C 'discovered anything concerning'. It's unclear whether legal opinion was sought at this point but at this time (late 2011), as the email says, more than £4million held in assets were directly associated with Firm A. And this continued to escalate. In September 2012, following questions to Company A from L&C, Company A's Operations Manager, confirmed the number of shares held by L&C members was 6,099,366 relating to 93 individuals. And the percentage of overall shares in Company A held by L&C SIPP members was 70%.

From what I can see it's clear that L&C didn't have a clear understanding about the business model of Company A at that time (2012) other than in the most general terms. This is despite by this point taking over £6million. And by the time it accepted Mr X's application in September 2010, L&C had taken over £2million and would have had the same or less knowledge about how Company A was using investors funds.

The conclusions that L&C should have reached through carrying out due diligence in accordance with good industry practice.

I consider from the outset or certainly by the time of Mr X's SIPP application in September 2010, that L&C could simply have concluded, given the potential risks of consumer detriment from the pattern of business being introduced to it by Firm A – which I think should have been clear and obvious at the time – it should not continue to accept applications from Firm A. That would have been a fair and reasonable step to take, in the circumstances. Alternatively, L&C could have taken fair and reasonable steps to address the potential risks of consumer detriment, such as those I've set out below.

In my view, L&C should have concluded by the time of Mr X's application that Company A's business model carried a significant risk of consumer detriment. The initial due diligence actually carried out by L&C amounted to assessing technical issues and the business risk to itself. And there is not enough evidence to show adequate consideration was given to the risk of consumer detriment associated with accepting Company A's unquoted shares into its members SIPPs.

L&C should reasonably have concluded that Company's A's unquoted shares were a high-risk investment; there was not enough evidence to show the investment was liquid because although it said it would be listed on a recognised exchange at some point, this did not in fact happen. For the most part, it was L&C SIPP members who were the buyers of the unquoted shares in Company A. These funds were then used to invest in high risk and speculative investments, with a significant proportion of funds being used to invest in companies Mr C had a financial interest in.

Given the potential risk of consumer detriment I think that, as part of its due diligence on Firm A, L&C ought to have found out more about how Firm A was operating before it received Mr X's application. And, mindful of the type of introductions L&C was receiving from Firm A from the outset, I think it's fair and reasonable to expect L&C, in line with its regulatory obligations, to have made some specific enquiries and obtained information about Firm A's business model.

As set out above, the 2009 review explained that the regulator would expect SIPP operators to have procedures and controls, and for management information to be gathered as well as analysed, so as to enable the identification of, amongst other things: *"…consumer detriment such as unsuitable SIPPs".* Further, that this could then be addressed in an appropriate manner: *"…for example by contacting the members to confirm the position, or by contacting the firm giving advice and asking for clarification."*

And as I've said, the October 2013 finalised SIPP operator guidance also gave an example of good practice as: *"Understanding the nature of the introducers' work to establish the nature of the firm, what their business objectives are, the types of clients they deal with, the levels of business they conduct and expect to introduce, the types of investments they recommend and whether they use other SIPP operators. Being satisfied that they are appropriate to deal with."*

From the information L&C received from the outset, I think the following conclusions could have been drawn:

- The documents provided to L&C about Company A at the outset, made it clear this was not a standard investment meant for ordinary retail clients.
- Company's A's Information Memorandum (IM) warned that: *"An investment in the Company is only suitable for investors who are capable of evaluating the merits and risks of such an investment and who have sufficient resources to be able to bear any losses (which may be equal to the whole amount invested) which may result from such an investment."*

- The IM made it clear that the unquoted shares had a higher risk of loss and the investments were speculative in nature, again showing these weren't a standard investment.
- The IM and sales brochure identified a broad range of potential shareholders and that the purpose of the lending was so borrowers could 'build sustainable revenue streams' but there as a lack of information about what Company A was actually doing with clients money and about the security.

I think it is fair and reasonable to have expected L&C in the circumstances to have concluded from the above that the unquoted shares were a non-standard, speculative, and illiquid investment which wasn't appropriate for most retail client pensions, or at least not in any significant proportion. The nature of the investment - a non-standard, speculative, and illiquid investment which wasn't appropriate to be held in most retail client pensions - should have led L&C to consider carefully Firm A's proposed use of the unquoted shares it was recommending for clients opening a L&C SIPP account.

A significant proportion of Mr X's pension funds was invested in unquoted shares and is hard to justify in any retail pension portfolio. But to give such a weighting to securities of the risk and liquidity characteristics I've described in respect of the unquoted shares in Company A, isn't reasonable and was an obvious red flag.

L&C should have realised it was unlikely that Firm A was acting in the best interests of its clients when it (L&C) was first made aware it (Firm A) intended to recommend they invest a significant amount of their pension funds in Company A. The picture only became clearer as Mr C had a vested interest in making this recommendation given he was the director of both the advisory firm and the investment he was recommending. This presented an obvious risk that Mr C might put his own interests before Firm A's clients when making decisions about what recommendation to make. In the circumstances L&C shouldn't have simply relied on Mr C and his advisory firm, Firm A, to comply with its own regulatory responsibilities.

The SIPP operator guidance indicated that as part of their obligations under Principle 6, firms should have procedures and controls in place that enable them to gather and analyse management information that in turn will enable them to identify possible instances of consumer detriment. From what I can see, these questions were only being asked *after* Mr X had been advised to transfer his pension, open his L&C SIPP and invest in the Company A investment.

Had it taken these fair and reasonable steps, what should L&C have concluded?

The matters I've mentioned did carry a significant risk of consumer detriment. Each of these in isolation is significant, but cumulatively I think they demonstrate that there was a significant risk of consumer detriment associated with introductions from Firm A. In my view, L&C ought to have concluded Firm A had a complete disregard for its consumers' best interests and wasn't meeting many of its regulatory obligations. Had L&C carried out the due diligence I've mentioned above, I think it should have identified that consumers introduced by Firm A, who were investing mainly in Company A, were at significant risk of consumer detriment.

By the time of Mr X's SIPP application, Company A had received more than £2million from investors, with the vast majority of them being from L&C SIPP holders. And the IFA advising clients to invest in this company, had his own financial motivations for doing so. I, therefore, conclude that it's fair and reasonable in the circumstances to say that L&C shouldn't have accepted Mr X's application from Firm A. In my view, L&C didn't act with due skill, care and diligence, organise and control its affairs responsibly, or treat Mr X fairly by accepting his application from Firm A. To my mind, L&C didn't meet its regulatory obligations or good industry practice at the relevant time and allowed Mr X to be put at significant risk of detriment as a result.

Due diligence on the underlying investments

L&C had a duty to conduct due diligence and give thought to whether an investment itself is acceptable for inclusion into a SIPP. That's consistent with the Principles and the regulators' publications as set out earlier in this decision. It's also consistent with HMRC rules that govern what investments can be held in a SIPP. I accept that the unquoted shares in Company A doesn't appear to be fraudulent or a scam, although some of the investments it made left it open to fraud/theft which is clear from the Administrators reports.

Nonetheless, given what I've said about L&C's due diligence on Firm A and my conclusion that it (L&C) failed to comply with its regulatory obligations and good industry practice at the relevant time, I don't think it's necessary for me to also consider L&C's due diligence on the Company A. I'm satisfied L&C wasn't treating Mr X fairly or reasonably when it accepted his introduction from Firm A, so I've not gone on to consider the due diligence it may have carried out on the unquoted share investments and whether this was sufficient to meet its regulatory obligations. And I make no findings about this issue.

Was it fair and reasonable in all the circumstances for L&C to proceed with Mr X's application?

For the reasons previously given above, I think L&C should have refused to accept Mr X's application from Firm A. So, things shouldn't have gone beyond that. L&C's referred to forms Mr X signed. In my view it's fair and reasonable to say that just having Mr X sign indemnity declarations or relying on a waiver form he signed wasn't an effective way for L&C to meet its regulatory obligations to treat him fairly, given the concerns L&C ought to have had about his introduction.

L&C knew that Mr X had signed forms intended to indemnify it against losses that arose from acting on his instructions. And, in my opinion, relying on such indemnities when L&C knew, or ought to have known, Mr X's dealings with Firm A were putting him at significant risk wasn't the fair and reasonable thing to do. Having identified the risks I've mentioned above, it's my view that the fair and reasonable thing to do would have been to refuse to accept Mr X's application in the first place. The Principles exist to ensure regulated firms treat their clients fairly. And I don't think the paperwork Mr X signed meant that L&C could ignore its duty to treat him fairly.

To be clear, I'm satisfied the indemnities contained within the contractual documents don't absolve, nor do they attempt to absolve, L&C of its regulatory obligations to treat customers fairly when deciding whether to accept or reject business. I'm satisfied Mr X's SIPP shouldn't have been established and the opportunity to execute investment instructions, or proceed in reliance on an indemnity, shouldn't have arisen at all. And I'm firmly of the view that it wasn't fair and reasonable in all the circumstances for L&C to proceed with Mr X's application.

COBS 11.2.19R

L&C argues it was reasonable to proceed with Mr X's application because of the disclaimer he signed and that it was obliged to carry out his instructions under COBS 11.2.19R. L&C says it complied with its obligations under COBS 11.2.19R in acting on its client's written instructions to switch his pension rights and transfer funds to a L&C SIPP which were subsequently invested as set out above. L&C says to decline to do so would have been akin to assessing suitability requiring it to investigate the full extent of Mr X's financial circumstances. And L&C did not have regulatory permission to carry on such work. I do not agree with this argument. L&C could have refused Mr X's application without giving advice or acting in a way that was akin to giving advice. And such a refusal would have been consistent with its role as a non-advisory SIPP operator.

As the Court made clear in the BBSAL case, COBS 11.2.19R is concerned with the method of execution of a client's order. It does not regulate the question of whether or not an order should be accepted in the first place. As I consider that L&C should not have accepted Mr X's application, I do not think it fair and reasonable for L&C to rely on the disclaimer Mr X signed saying he instructed L&C to make the investment and that it would not be responsible for any losses based on those instructions. Things should never have reached that stage. If L&C had acted in its clients best interests Mr X would never have been put in the position where he was asked to sign that disclaimer.

So, I don't think that L&C's argument on this point is relevant to its obligations under the Principles to decide whether to accept Mr X's business from Firm A.

Is it fair to ask L&C to pay Mr X compensation in the circumstances?

<u>The involvement of other parties</u>

In this decision I'm considering Mr X's complaint about L&C. However, I accept that there was another regulated party involved in the transactions complained about which in this case was Firm A. L&C's contended that it's Firm A that's really responsible for Mr X's losses. And in response to my provisional decision, it reiterated that it's unfair that it, rather than Firm A, is being held accountable.

The DISP rules set out that when an Ombudsman's determination includes a money award, then that money award may be such amount as the Ombudsman considers to be fair compensation for financial loss, whether or not a Court would award compensation (DISP 3.7.2R). As I set out above, in my opinion it's fair and reasonable in the circumstances of this case to hold L&C accountable for its own failure to comply with its regulatory obligations, good industry practice and to treat Mr X fairly. The starting point, therefore, is that it would be fair to require L&C to pay Mr X compensation for the loss he's suffered as a result of its (L&C's) failings.

I've carefully reconsidered if there's any reason why it wouldn't be fair to ask L&C to compensate Mr X for his loss, including whether it would be fair to hold another party liable in full or in part. I accept that it may be the case that Firm A might have some responsibility for initiating the course of action that led to Mr X's loss. However, I remain satisfied that it's also the case that if L&C had complied with its own distinct regulatory obligations as a SIPP operator, the arrangement for Mr X wouldn't have come about in the first place, and the loss he's suffered could have been avoided.

I want to make clear that I've carefully taken everything L&C's said into consideration. But it remains my view that it's appropriate and fair in the circumstances for L&C to compensate Mr X to the full extent of the financial losses he's suffered due to L&C's failings. To be clear, I'm not making a finding that L&C should have assessed the suitability of the SIPP or the unquoted shares in Company A for Mr X. I accept that L&C wasn't obligated to give advice to Mr X, or otherwise to ensure the suitability of the pension wrapper or investments for him. Rather, I'm looking at L&C's separate role and responsibilities – and for the reasons I've explained, I think it failed in meeting those responsibilities.

Mr X taking responsibility for his own investment decisions

It's been submitted that in construing L&C's obligations, regard should be had to section 5(2)(d) of FSMA (now section 1C). This section requires the FCA, in securing an appropriate degree of protection for consumers, to have regard to, amongst other things, the general principle that consumers should take responsibility for their own investment decisions. I've considered this point carefully and I'm satisfied that it wouldn't be fair or reasonable to say Mr X's actions mean he should bear the loss arising as a result of L&C's failings.

In my view, if L&C had acted in accordance with its regulatory obligations and good industry practice it shouldn't have accepted Mr X's application from Firm A to open a SIPP at all. That should have been the end of the matter – if that had happened, I'm satisfied the arrangement for Mr X wouldn't have come about in the first place, and the loss he's suffered could have been avoided.

As I've made clear, L&C needed to carry out appropriate due diligence on Firm A and reach the right conclusions. I think it failed to do this. And just having Mr X sign forms containing declarations wasn't an effective way of L&C meeting its obligations, or of escaping liability where it failed to meet its obligations.

I've carefully considered what L&C's said about Mr X being aware of the risks. But, from the evidence I've seen I've no reason to doubt Mr X when he says that he didn't receive a full explanation of the risks involved. I don't agree with L&C that Mr X's submissions on this point run contrary to the available evidence. And I wouldn't consider it fair or reasonable for L&C to have concluded that Mr X had received an explanation of the risks involved with the overall proposition from Firm A given what L&C knew, or ought to have known, about Firm A's business model which included the IFA being a director of that investment vehicle.

Firm A was a regulated firm with the necessary permissions to advise on the transactions this complaint concerns. I'm satisfied that Mr X's dealings with Firm A meant he trusted it to act in his best interests. Mr X also then used the services of a regulated personal pension provider in L&C. So, overall, I'm satisfied that in the circumstances, for all the reasons given, it's fair to say L&C should compensate Mr X for the loss he's suffered. I don't think it would be fair to say in the circumstances that Mr X should suffer the loss because he ultimately instructed the transactions to be effected.

Had L&C declined Mr X business from Firm A, would the transactions complained about still have been affected elsewhere?

L&C's contended that Mr X would likely have proceeded with the transfer and investments regardless of the actions it took. L&C's highlighted that other SIPP providers were accepting such investments at the time, and it's most likely the transactions would have been effected with another provider. But I don't think it's fair and reasonable to say that L&C shouldn't compensate Mr X for his loss on the basis of speculation that another SIPP operator would have made the same mistakes as I've found it did.

I think it's fair instead to assume that another SIPP provider would have complied with its regulatory obligations and good industry practice, and therefore wouldn't have accepted Mr X's application from Firm A. I'm not satisfied that Mr X had shown any interest in transferring his pension before being introduced to Company A by Firm A. I don't think there is anything to show that Mr X was so keen on investing in unquoted shares or other higher risk investments that he'd have sought to submit his application through a different regulated firm.

In Adams v Options SIPP, the judge found that Mr Adams would have proceeded with the transaction regardless. HHJ Dight says (at paragraph 32): *"The Claimant knew that it was a high risk and speculative investment but nevertheless decided to proceed with it, because of the cash incentive."* But, in this case, I'm not satisfied that Mr X proceeded knowing that the investments he was making were high risk and speculative. And that he was determined to move forward with the transactions in order to take advantage of a cash incentive.

I've not seen any evidence to show Mr X was paid a cash incentive. It therefore cannot be said he was *"incentivised"* to enter into the transaction. And, on balance, I'm satisfied that Mr X, unlike Mr Adams, wasn't eager to complete the transaction for reasons other than securing the best pension for himself. So, in my opinion, this case is very different from that of Mr Adams. And having carefully considered all of the circumstances, I'm satisfied it's fair and reasonable to conclude that if L&C had refused to accept Mr X's application from Firm A, the transactions this complaint concerns wouldn't still have gone ahead.

Overall, I do think it's fair and reasonable to direct L&C to pay Mr X compensation in the circumstances. While I accept that Firm A might have some responsibility for initiating the course of action that's led to Mr X's loss, I consider that L&C failed to comply with its own regulatory obligations and didn't put a stop to the transactions proceeding by declining Mr X's application from Firm A when it had the opportunity to do so. And I'm satisfied that Mr X wouldn't have established the SIPP, transferred monies in from his pensions or invested in unquoted shares in Company A if it hadn't been for L&C's failings.

In conclusion

Taking all of the above into consideration, I think that in the circumstances of this case it's fair and reasonable for me to conclude that L&C shouldn't have accepted Mr X's application from Firm A. For the reasons I've set out, I also think it's fair to ask L&C to compensate Mr X for the loss he's suffered. I say this having given careful consideration to the Adams v Options judgment but also bearing in mind that my role is to reach a decision that's fair and reasonable in the circumstances of the case having taken account of all relevant considerations.

Putting things right

I'm upholding this complaint. My aim in awarding fair compensation is to put Mr X back into the position he would likely have been in had it not been for L&C's failings. Had L&C acted appropriately, I think it's *most likely* that Mr X would've remained a member of the pension plans he transferred into the SIPP.

In light of the above, L&C should:

- Obtain the notional transfer value of Mr X's previous pension plans.
- Obtain the actual transfer value of Mr X's SIPP, including any outstanding charges.
- Pay a commercial value to buy any illiquid investments (or treat them as having a zero value).
- Pay an amount into Mr X's SIPP so as to increase the transfer value to equal the notional value established. This payment should take account of any available tax relief and the effect of charges.

- If the SIPP needs to be kept open only because of the illiquid investment/s and is used only or substantially to hold that asset, then any future SIPP fees should be waived until the SIPP can be closed.
- If Mr X has paid any fees or charges from funds outside of his pension arrangements, L&C should also refund these to Mr X. And interest at a rate of 8% simple per year from date of payment to date of refund should be added to this.
- Pay Mr X an amount of £500 to compensate him for the distress and inconvenience he's been caused.

I've set out how L&C should go about calculating compensation in more detail below.

Treatment of the illiquid assets held within the SIPP

I think it would be best if any illiquid assets held could be removed from the SIPP. Mr X would then be able to close the SIPP, if he wishes. That would then allow him to stop paying the fees for the SIPP. The valuation of the illiquid investment may prove difficult, as there is no market for it. For calculating compensation, L&C should establish an amount it's willing to accept for the investment as a commercial value. It should then pay the sum agreed plus any costs and take ownership of the investment.

If L&C is able to purchase the illiquid investment then the price paid to purchase the holding will be allowed for in the current transfer value (because it will have been paid into the SIPP to secure the holding). If L&C is unable, or if there are any difficulties in buying Mr X's illiquid investment, it should give the holding a nil value for the purposes of calculating compensation.

If L&C doesn't purchase the investment, and as the total calculated redress in this complaint is greater than £160,000 and if L&C does not pay the recommended amount as set out below, Mr X should retain the rights to any future returns from the investment until such time as any future benefit he receives from the investment together with the compensation paid by L&C (excluding any interest) equates to the total calculated redress amount in this complaint. L&C may ask Mr X to provide an undertaking to account to it for the net amount of any further payment the SIPP may receive from the investment thereafter. That undertaking should allow for the effect of any tax and charges on the amount Mr X may receive from the investment from that point, and any eventual sums he would be able to access from the SIPP. L&C will need to meet any costs in drawing up the undertaking.

Calculate the loss Mr X has suffered as a result of making the transfer

L&C should first contact the providers of Mr X's pension plans which were transferred into the SIPP and ask them to provide notional values for the policies as at the date of my final decision. For the purposes of the notional calculation the providers should be told to assume no monies would've been transferred away from the plans, and the monies in the policies would've remained invested in an identical manner to that which existed prior to the actual transfer.

Any contributions or withdrawals Mr X has made will need to be taken into account whether the notional values are established by the ceding providers or calculated as set out below. Any withdrawal out of the SIPP should be deducted at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. The same applies for any contributions made, these should be added to the notional calculation from the date they were actually paid, so any growth they would've enjoyed is allowed for.

If there are any difficulties in obtaining notional valuations from the previous providers, then L&C should instead arrive at a notional valuation by assuming the monies would have enjoyed a return in line with the following:

- For half the Investment: FTSE UK Private Investors Income Total Return Index.
- For the other half: average rate from fixed rate bonds.

I think this is a reasonable proxy for the type of return that could have been achieved over the period in question.

I note L&C disagrees that this is the correct benchmark to use if the notional value cannot be established by the ceding provider/s. It says that Mr X would not have invested in the way the benchmark suggests. But by using this, I'm not saying Mr X would have invested 50% of his money in fixed bonds and 50% in some kind of index tracker. Rather, as our investigator said, I consider this a reasonable compromise that broadly reflects the sort of return Mr X could have obtained from investment suited to someone willing to take a small amount of risk with his money. At the time of the transfer and/investment, Mr X was nearing retirement age. And on balance, I think it's unlikely he would have been willing to take a higher level of risk.

I note L&C has said that the payment made on 29 November 2010 from Mr X's previous pension provider totalling £61,859.33, may have been paid by the ceding scheme in error. But Mr X says he did question this with the ceding scheme at the time and he didn't receive a substantive response. And as far as I know, the ceding scheme hasn't taken any action to recover this payment. So, I don't have sufficient evidence to support that the payment was made in error.

I acknowledge that Mr X has received a sum of compensation from the FSCS, and that he has had the use of the monies received from the FSCS. The terms of Mr X's Reassignment of Rights require him to return compensation paid by the FSCS in the event this complaint is successful, and I understand that the FSCS will ordinarily enforce the terms of the assignment if required. So, I think it's fair and reasonable to make no *permanent* deduction in the redress calculation for the compensation Mr X received from the FSCS. It will be for Mr X to make the arrangements to make any repayments he needs to make to the FSCS.

However, I do think it's fair and reasonable to allow for a *temporary* notional deduction equivalent to the payment Mr X actually received from the FSCS for a period of the calculation, so that the payment ceases to accrue any return in the calculation during that period. As such, if it wishes, L&C may make an allowance in the form of a notional withdrawal (deduction) equivalent to the payment Mr X received from the FSCS following the claim about Firm A, and on the date the payment was actually paid to Mr X.

Where such a deduction is made there must also be a corresponding notional contribution (addition) at the date of the final decision equivalent to all FSCS payment notionally deducted earlier in the calculation. To do this, L&C should calculate the proportion of the total FSCS payment that it's reasonable to apportion to each transfer into the SIPP - this should be proportionate to the actual sums transferred in. And L&C should then ask the operator of Mr X's previous pension policies to allow for the relevant notional withdrawal in the manner specified above.

The total notional deduction allowed for shouldn't equate to any more than the actual payment from the FSCS that Mr X received. L&C must also then allow for a corresponding notional contribution (addition) as at the date of my final decision, equivalent to the accumulated FSCS payment notionally deducted by the operator of Mr X's previous pension plans.

Where there are any difficulties in obtaining notional valuations from the previous operator(s), L&C can instead allow for both the notional withdrawal(s) and contribution(s) in the notional calculation it performs, provided it does so in accordance with the approach set out above.

The notional value of Mr X's existing plans if monies hadn't been transferred less the current value of the SIPP (as at the date of the final decision) is Mr X's loss.

L&C must also provide the details of its redress calculation to Mr X in a clear, simple format.

Pay an amount into Mr X's SIPP so that the transfer value is increased by the loss calculated above

If the redress calculation demonstrates a loss, the compensation should if possible be paid into Mr X's pension plan. The payment should allow for the effect of charges and any available tax relief. The compensation shouldn't be paid into the pension plan if it would conflict with any existing protection or allowance.

If a payment into the pension isn't possible or has protection or allowance implications, it should be paid directly to Mr X as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid. Typically, 25% of the loss could have been taken as tax-free cash and 75% would have been taxed according to his likely income tax rate in retirement – presumed to be 20%. So, making a notional deduction of 15% overall from the loss adequately reflects this. Neither party has disagreed with the presumed income tax rate and Mr X has provided evidence of being a basic rate taxpayer.

SIPP fees

If the investments can't be removed from the SIPP, and because of this it can't be closed after compensation has been paid, then it wouldn't be fair for Mr X to have to continue to pay annual SIPP fees to keep the SIPP open. So, if the SIPP needs to be kept open only because of the illiquid investment and is used only or substantially to hold that asset, then any future SIPP fees should be waived until the SIPP can be closed.

Interest

The compensation resulting from this loss assessment must be paid to Mr X or into his SIPP within 28 days of the date L&C receives notification of his acceptance of my final decision. The calculation should be carried out as at the date of my final decision. Interest must be added to the compensation amount at the rate of 8% per year simple from the date of my final decision to the date of settlement if the compensation is not paid within 28 days.

Income tax may be payable on any interest paid. If L&C deducts income tax from the interest, it should tell Mr X how much has been taken off. L&C should give Mr X a tax deduction certificate if he asks for one, so he can reclaim the tax from HMRC if appropriate.

Distress & inconvenience

As noted above, Mr X discovered in less than one month after a statement showed his holdings in Company A was valued at more than £400,000 that his investment was likely to be valueless. Mr X has explained he is around 70 years old and he has lost nearly all of his pension provision as a result of the investment in Company A. So, whilst L&C says it doesn't think this issue would have caused Mr X upset, I disagree. And I think the award of £500 to compensate him for the distress and inconvenience it has caused him, is a fair and reasonable amount under the circumstances.

My final decision

Where I uphold a complaint, I can make an award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs/ interest on costs that I consider appropriate. If I think that fair compensation exceeds £160,000, I may recommend that London & Colonial Services Limited pays the balance.

Determination and award: I'm upholding the complaint. I think that fair compensation should be calculated as set out above under 'Putting things right'. My final decision is that London & Colonial Services Limited should pay Mr X the amount produced by the calculation – up to a maximum of £160,000 plus any interest.

Recommendation: If the amount produced by the calculation of fair compensation is more than £160,000, I recommend that London & Colonial Services Limited pays Mr X the balance. This recommendation is not part of my determination or award. London & Colonial Services Limited doesn't have to do what I recommend. It's unlikely that Mr X can accept my decision and go to court to ask for the balance. Mr X may want to get independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr X to accept or reject my decision before 6 September 2024.

Yolande Mcleod
Ombudsman