DRN-5193587

## The complaint

Mr C has complained about the investment advice he was given by Fairstone Financial Management Limited ('Fairstone'). He says the advice was unsuitable for him as it exposed him to a portfolio that was too high risk. He wants his initial investment returned to him with interest.

## What happened

Mr C held ISA investments valued at £334,934 and a General Investment Account ('GIA') valued at £71,736 which he agreed to transfer to Fairstone along with cash of £200,000 in November 2021. The funds were to be managed on an advisory basis by Fairstone.

Mr C later decided to retain the GIA funds, so the revised investment amount was £534,934. In April 2023 Mr C complained to Fairstone as the value of the investments had fallen by such an extent that Mr C questioned whether he had been invested within the agreed risk profile. In its response, Fairstone didn't uphold the complaint. It said;

- At the outset of the relationship with Fairstone, Mr C's attitude to risk was established as well as him having a 20% capacity for loss.
- Markets had been volatile, and Mr C had been kept updated.
- Fairstone had offered to reduce Mr C's investment risk, but he had declined.
- Fairstone wasn't responsible for market volatility and the adviser had considered Mr C's long-term goals.

Our investigator who considered the complaint thought it should be upheld. He said;

- He was satisfied that Mr C's adviser was qualified to provide advice.
- Mr C's agreed attitude to risk was recorded as being six out of ten (ten being the highest risk) and the investigator agreed that Mr C had the capacity to invest some of his money in risk-based investments within that risk profile.
- Mr C had investable assets of £1.2m which were equally split between cash and investments. The investigator concluded that Mr C had sufficient held in cash and had a capacity for loss.
- Fairstone hadn't provided a copy of its risk profile questionnaire, only the asset allocations for a risk profile of six. The investigator thought Mr C's portfolio asset allocation differed to the agreed risk profile asset allocation. It had more exposure to international equities which increased the risk.
- In particular, the total US equity exposure stood at 31.32% rather than the 22% in the agreed asset allocation as well as having some derivative exposure.
- To put the matter right, the investigator recommended that the performance of Mr C's portfolio be compared to that of the FTSE 100 Private Investors Income Total Return Index for the period of investment. Any loss should be paid to Mr C plus interest.

Fairstone didn't agree. It said;

- To say that Mr C wanted a low to medium risk profile was incorrect as his risk profile questionnaire responses showed a risk profile of six was appropriate for him.
- A lot of funds hedged and had derivative exposure which would reduce risk.
- It didn't agree with the 16% 'other' in the actual allocation of assets being made up purely of equities. That was speculation and 'other' was currently down to 2.6%.
- The investigator hadn't commented on the much lower weighting in Asian equities than the intended asset allocation, and it believed it was incorrect to suggest total amounts held in equities came to 69%. The figure was a lot lower and suited a risk profile of six.
- It didn't agree the portfolio was unsuitable for Mr C.

As the complaint remained unresolved, it was passed to me for a decision in my role as ombudsman. I was thinking of reaching a different conclusion to the complaint than the investigator so issued a provisional decision to allow the parties to provide me with any further information or evidence they wanted me to consider before I issued my final decision. Here's what I said;

> 'We provide an informal complaint handling service, and this is reflected in the way I've approached the complaint. It's part of my role to identify and concentrate on the core issues I need to address in order to reach a fair outcome. This means I won't necessarily mention everything Mr C has brought to my attention, and I've expressed some of his concerns in my own words. But I will comment on everything that makes a difference to what I consider to be a fair and reasonable outcome to the complaint.
>
> When giving investment advice Fairstone had regulatory obligations to assess the suitability for Mr C. The regulator, the Financial Conduct Authority's ('FCA') and the Conduct of Business Sourcebook provides detail of the information that a business should consider before giving investment advice;
>
> > '**Assessing suitability: the obligations**
> >
> > **COBS 9.2.1R** (1) A firm must:
> >
> > (a) take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client; and
> >
> > (b) ensure that any life policy proposed is consistent with the client's insurance demands and needs.
> >
> > (2) When making the personal recommendation or managing the investments, the firm must obtain the necessary information regarding the client's:
> >
> > (a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;
> >
> > (b) financial situation; and
> >
> > (c) investment objectives;

> so as to enable the firm to make the recommendation, or take the decision, which is suitable for the client and for a life policy, to propose a contract that is consistent with the client's insurance demands and needs.'

I have borne this in mind throughout my provisional decision.

<u>Mr C's circumstances</u>

I've considered Mr C's circumstances at the time the advice was given and as recorded in Fairstone's fact find documents and the December 2021 Investment Planning Recommendation Report.

It's recorded that Mr C was;

- 75 years of age,
- married with no dependents,
- retired,
- owned his own home and in receipt of a pension income.
- He also received rental income from other properties he owned.
- His income exceeded his expenditure.
- Mr C had property and capital assets in excess of £1m, substantial cash and premium bonds of around £686,000 plus his investments valued at around £406,000.
- He didn't have any liabilities.

<u>Mr C's age</u>

Mr C has questioned whether the investment advice was right for him bearing in mind his age. Fairstone has told us that it has a policy in place for clients aged over 71 years who would be offered a third party to be present at meetings. And I can see from the 'fact find' documents that it was recorded Mr C didn't want anyone else present. And even though Mrs C didn't receive any investment advice I can see she attended the initial meeting.

I note the 2022 Annual Review report confirmed the above and the adviser recorded

> '…I understand that you feel you are perfectly able to manage your affairs and have a broad understanding of investments, having held them for many years.'

And it was Mr C who was proactive in contacting Fairstone as he wasn't happy with his current provider because of the service he had received and was recommended Fairstone by mutual friends. This suggests to me Mr C was taking an active interest in his investments and was engaged with their performance etc. So, I don't think Fairstone's recommendation – in itself – that Mr C should continue to make investments – was wrong. Mr C had investment experience and had sufficient assets so as to allow him to take some risk with his capital.

<u>Mr C's attitude to risk</u>

In November 2021 it was recorded that Mr C's portfolio was managed by another provider with a balanced/medium risk level. Using Fairstone's risk ratings it said that Mr C's then current portfolio was in line with its risk level four which it said was 'lower than your agreed risk tolerance' that had been discussed and agreed with Fairstone.

So, in transferring his portfolio to Fairstone, Mr C's exposure to risk was increasing according to Fairstone's own risk profiles. And the above commentary suggests Mr C was aware of this. I note in correspondence with Fairstone, Mr C referred to his investments as being low to medium risk, but I don't think this is right for his investments with Fairstone – it wasn't the risk profile that was agreed with Fairstone at the outset.

I see from the Investment Planning Recommendation Report it's recorded that investment risk had been discussed. And I think it's likely that Mr C's agreed risk profile came about partly as a result of his responses to Fairstone's attitude to risk questionnaire, which Mr C completed on 19 November 2021;

> Mr C 'Disagreed' with the following –
>
> People who know me would describe me as a cautious person
> I generally look for the safer investments, even if that means lower returns
> I generally prefer bank deposits to riskier investments
> I'm willing to take substantial investment risk to earn substantial returns
> I tend to be anxious about the investment decisions I've made
> I'd rather take my chances with higher risk investments than have to save more
> I'm not comfortable with the ups and downs of stock market investments
>
> He 'Agreed' with the following –
>
> I feel comfortable about investing in the stock market
> Usually it takes me a long time to make up my mind on financial matters
> I find investment matters easy to understand
> I've little or no experience of investing in stocks, shares, or investment funds

While Mr C's response about having little or no experience of investing seems at odds with his evident investment experience, overall, the responses suggest to me that Mr C wasn't cautious, was happy to accept some risk, was comfortable with stock market investments –which he understood. It's also recorded that Mr C was looking for long term investment. The Investment Planning Recommendation Report that came about as a result of the meeting and discussions Mr C had with Fairstone referred to Mr C's risk profile which had been established as follows;

> 'Bearing in mind your overall asset position and objectives for long term capital growth we have agreed to establish your new investments in line with a Risk Level 6 – Balanced Growth approach. I am comfortable that this is suitable as you will not be reliant on your investment for income or capital, and you would like to invest in funds that have the potential to match or even exceed the rate of inflation.'

The Report outlined the risk implicit in the Risk Profile 6 category;

> 'Risk Profile 6 – Balanced Growth
>
> Typically, Balanced Growth investors do not see themselves as cautious individuals and have no strong positive or negative associations with the notion of taking risk. People who have experience of investments and a degree of understanding of financial matters may be suited to a Balanced Growth approach to investing.
>
> Balanced Growth investors also tend to make investment decisions reasonably quickly and don't tend to be particularly anxious about those decisions. Balanced Growth investors will be inclined to look for a combination of investments with differing levels of risk and they understand that they may need to take some risk to meet their investment goals.'

On the face of it a balanced growth portfolio doesn't look unsuitable for Mr C taking account of his responses to the attitude to risk questionnaire, his investment experience, personal and financial circumstances and his investment objectives. I think its clear Mr C was looking for the potential reward of capital growth and was aware of the risk in doing so but that was a risk he was prepared to take.

So, I don't agree that Mr C's portfolio was to be managed with a low to medium risk profile as he has suggested, but – as agreed – with a 'balanced growth' as identified above by Fairstone with a Risk Profile 6.

The Report also detailed Mr C's capacity for loss;

> 'We agreed a risk level for your objectives which also incorporates your capacity to bear losses which may impact on your ability to achieve your objectives.
>
> In the context of your "capacity for loss" i.e., your financial resilience, or ability to withstand periods of poor or negative investment performance, we discussed the amount of your investments that you can afford to lose, and we agreed losses up to 20% which represents £121,334 of your initial overall investment value of £606,670.
>
> Whilst this is covered in the Risk Profile factsheet, it is important to bring to your attention any potential losses, a key measure of the level of investment risk you are prepared to take.'

Mr C says he doesn't recall a capacity for loss being discussed. But I can see its noted on all the fact find/meeting notes as well as the Report and reviews as detailed above. Mr C saw those documents so if he wasn't convinced they were a reasonable reflection of what had been discussed and agreed at the meetings, then I think he had the opportunity to raise this and I can't see that he did.

Because of the records kept and correspondence about Mr C's capacity for loss and the fact that Mr C saw those records and correspondence but didn't challenge their accuracy, I think it more likely than not that Mr C's capacity for loss was discussed and established. I don't find this outside of what I would expect to see for an investment objective for a balanced growth portfolio.

Taking all of the above into account and after considering of Mr C’s circumstances and investment objectives, I don’t find the conclusions reached about Mr C’s attitude to risk or capacity for loss to be unfair or unreasonable.

<u>The advice</u>

Mr C wanted to invest for the longer term for growth. Mr C was advised to sell his ISA investments with his existing provider, and it was recommended the resulting proceeds plus the £200,000 cash be split between seven funds;

- Vanguard LifeStrategy 60% Equity
- Royal London Sustainable Diversified Trust
- Liontrust Sustainable Future Managed
- HSBC Global Strategy Balanced Portfolio
- Premier Miton Diversified Growth
- Janus Henderson Global Responsible Managed
- Baillie Gifford Managed

The Investment Planning Recommendation Report then went on to say;

> ‘A key principle of investment is that there is diversification amongst a range of investments. This can reduce the risk of loss through exposure to one individual fund or asset, type of asset or sector.

| **Asset class** | **Asset allocation for risk profile six** | **Actual asset allocation** |
|---|---|---|
| North America Equity | 22% | 26% |
| UK Corporate Bonds | 11% | 9% |
| Emerging Markets Equity | 11% | 2% |
| Europe (ex-UK) Equity | 7% | 11% |
| UK Equity | 13% | 16% |
| Japan Equity | 5% | 3% |
| UK Government Bonds | Nil | 1% |
| Other | Nil | 16% |
| Global (ex-UK) Fixed Income | 6% | 8% |
| Global Property | 5% | Nil |
| Developed Pacific (ex-Japan) Equity | 11% | 2% |
| Commodities | Nil | Nil |
| Cash - Short Term Money Market | 9% | 6% |
| Private Equity | Nil | Nil |

> The actual asset allocation of your proposed … portfolio does differ from the typical asset allocation prescribed by [Fairstone’s third party risk profiler] for a Risk Profile 6 fund. however, I am not concerned about the difference in these asset classes at present as the sustainable funds will invest in a range of different sectors which are not mainstream, and these may come under the ‘other’ heading so I am happy that the funds will still provide diversification.’

So, considering Fairstone's above statement, that it was aware when giving the advice to Mr C he would be investing in a range of assets, but those assets were outside of the asset allocation that was recommended for an investor with a risk profile of six. The above commentary suggests that it was the two sustainable funds – Royal London Sustainable Diversified Trust and Liontrust Sustainable Future Managed – that may have been the cause of that, as they would likely be classified under 'other'.

Mr C's capital was invested equally between seven funds, so 14% was to be invested in each plus 2% in cash. This meant the two sustainable funds accounted for 28% of the total investment made. So, I've looked further into those two funds and what they were invested into at the time, particularly as they 'may' have accounted for the portfolio's 16% exposure to 'other'.

In response to the investigator, Fairstone said that while the table showed there was a higher weighting in equities, there was a much lower weighting in Asian equities. It believed;

> '…it is therefore incorrect to suggest that total amounts held in equities came to 69%. In reality they were a lot lower, and we believe more befitting a client with a risk profile of 6.'

But Fairstone hasn't been able to evidence this or show what was included in 'others' wasn't solely equity content which wouldn't fit under any other category. If Fairstone included the assets generally considered to be more likely as having a lower risk than equities – fixed income/corporate bonds, cash and property – then I would have expected them to be recorded under the appropriate asset class, irrelevant of whether they were held within the sustainable funds or not. And if Fairstone isn't able to identify what the asset allocation was then it would be difficult for Mr C to understand what was held in his portfolio, so I can see why Mr C concluded that he was exposed to more risk than he agreed to, hence him making his complaint in the first instance.

However, when the investigator considered the complaint, he used updated fund fact sheets for Liontrust and Royal London. But I asked Fairstone for the factsheets for both funds from when the recommendation was given in November 2021 – which it has been able to do – and which I consider is more relevant to the complaint about the advice to invest. Below is a breakdown of their asset allocation at the time;

| **Asset class** | **Asset allocation – Liontrust** | **Asset allocation – Royal London** |
|---|---|---|
| North America Equities | 34.64% | 27.63% |
| UK Equities | 20.13% | 19.58% |
| European Equities | 14.10% | 10.62% |
| UK Fixed Interest | 11.48% | |
| Money Market | 7.03% | 1.08% |
| Others | 4.81% | |
| Global Fixed Interest | 3.69% | 39.75% |
| Japanese Equities | 3.02% | |

| | | |
|---|---|---|
| Asia Pacific Equities | 1.10% | |
| Global Emerging Markets | | 1.12% |
| UK Gilts | | 0.24% |

It can be seen that Liontrust had a 22.2% exposure to what I consider to be lower risk investments when compared to the suggested 31% asset allocation, 72.89% to equity investment and 4.81% in ‘other’. Royal London had a 41.07% exposure to lower risk investments and 58.95% in equity investment.

With the exception of Liontrust’s 4.81% exposure to ‘others’, all of the other assets fall within a recognised asset class so it’s still difficult for me to assess what the 16% ‘other’ asset allocation for Mr C’s portfolio was invested into. However, it is clear that both funds had a higher exposure to North American Equity than for that risk profile – Liontrust particularly. But UK Equity exposure was also higher than the asset allocation which potentially could have counterbalanced that higher US risk with more UK exposure. European exposure was higher but Japanese/Asia exposure was lower. Also notable is the much higher exposure to global fixed interest which, while it would have exposure to currency risk, would be lower risk than equity exposure.

The investigator concluded after looking at the updated factsheets for both Liontrust and Royal London there was additional exposure to US equities – 31.32% compared to the suggested asset allocation of 22%. He considered US equities as an asset class to be high risk. He also concluded that as the Liontrust fund was able to invest into derivatives, this increased the risk exposure within Mr C’s portfolio. Overall, he wasn’t persuaded the recommended portfolio matched Mr C’s attitude to risk, so the advice was unsuitable and not in line with the level of risk Mr C was prepared to take. However, I’m currently minded to disagree with the investigator’s assessment. I’ll explain why.

With regard to derivatives, I should say that I don’t find it unusual for funds such as the ones invested into for Mr C to use derivatives to hedge their positions. In isolation derivatives are recognised as being high risk but used appropriately within a fund they can hedge against the risk of other assets and currencies etc held within the fund. So, I’m not persuaded that the use of derivatives and similar instruments – in themselves – would lead me to conclude that a fund posed a higher than its stated risk because of its use of derivatives.

I’ve also considered the investigator’s conclusions about Mr C’s portfolio’s exposure to US equities. He concluded US equities as an asset class were high risk. It’s not the role of this service to risk rate investments but clearly there is a very wide range of US equities that Mr C’s portfolio could have been invested into which would attract different levels of risk. But, as an example, the largest direct equity holding (2.75%) in Liontrust was Alphabet Inc which is one of the world’s largest tech companies with a capitalisation of more than US$2.05 trillion. In comparison, currently the largest UK company by market capitalisation is £183 billion.

So, while I accept there is an inherent risk in investing overseas mostly, but not limited to, currency movements, those investments can be both positive as well as negative for the portfolio. I don't think it would be an unreasonable assessment that US equities posed a higher risk than UK equities by dint of the currency risk etc, but I wouldn't as a generalisation say that US stocks are inherently high risk in comparison to a UK equivalent business – just higher risk than investments that didn't have currency risk exposure or similar.

Fairstone disagreed with the investigator's assumption that 16% 'other' was made up of equities which would make the portfolio unsuitable. It has provided a table which it says reproduces as close as it is able to what it believed the 'other' 16% of assets were invested into. While it hasn't provided a basis of how it has gone about that, Fairstone has reduced the 'other' allocation to 2.8%. But looking at the factsheets for both funds at the time of the investment, the asset allocations are clearer and don't cause me to conclude the overall asset allocation exposed Mr C to a higher level of risk than was agreed.

I've also reviewed the 'Risk Profile 6 – Balanced Growth' document provided by Fairstone, and which describes the investor profile and typical asset allocation. I can see that for the typical asset allocation it says, 'This is an indication of the likely portfolio asset allocation for this risk profile.' So, the asset allocation wasn't rigid, and I don't think there is enough for me to say that because the asset allocation didn't square with what was identified as the right asset allocation for a Risk Profile 6 means the recommendation was unsuitable. In my opinion there has to be some flexibility in the asset allocation and I would expect for changes to be made depending upon market and global outlook etc.

Taking all of the above into account, I don't think that Fairstone was wrong in providing Mr C with investment recommendations because of his age. I'm satisfied that Mr C had sufficient investment experience and knowledge to understand the investment risks he was being exposed to. And the recorded information suggests that Mr C had sufficient assets outside of his portfolio so there's nothing to suggest that the investments were unaffordable for him.

I haven't seen enough to persuade me that Mr C's portfolio was invested outside the agreed investment risk profile for a balanced growth investor with a Risk Profile 6. While the markets were volatile during the period of investment, I note that Mr C was invested for less than 16 months before he raised his complaint. He agreed that his investment term was for the long term with no fixed timeframe, so the short-term volatility has no doubt impacted on the performance of his investments and performance in itself isn't something that I can consider.

Provided a portfolio is invested in line with its overall objectives and disclosed risk – in this case for balanced growth over the long term by investing in a combination of assets – within the agreed risk profile, then it wouldn't be fair or reasonable for me to uphold the complaint on this point. I haven't seen anything to suggest that the portfolio was invested outside of its stated investment objectives or risk profile.

And the fact that the risk of underperformance of the portfolio materialised in the short term, this does not automatically mean that the Fairstone did anything wrong. In the absence of any evidence that Fairstone didn't provide suitable advice for the investment of the portfolios – and the performance of the portfolios alone doesn't evidence this – I am unable to say that Fairstone has done anything wrong in the overall management of Mr C's investments.'

I concluded by saying that overall, in the individual circumstances of Mr C's complaint, my provisional decision was that I don't uphold it.

Neither Fairstone nor Mr C replied to my decision.

**What I've decided – and why**

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

As neither party to the complaint has given me anything further to consider, I see no reason to depart from my provisional decision. So, I confirm those findings.

**My final decision**

For the reasons given, I don't' uphold Mr C's complaint about Fairstone Financial Management Limited.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr C to accept or reject my decision before 3 January 2025.

Catherine Langley
**Ombudsman**