Financial Ombudsman Service

complaint

G complains about the advice it received from Pi Financial Ltd ("Pi Financial") to invest in the Connaught Guaranteed Income Fund Series 1. This fund was an unregulated collective investment scheme ("UCIS"). G considers that the advice to invest was unsuitable.

background

The complaint was investigated by one of our adjudicators who concluded that it should be upheld. In summary, the adjudicator said:

- G was only willing to accept a small risk to its capital and the recommendation posed greater risk than it was willing to accept.
- They had not seen any evidence to suggest that the rules governing UCIS promotion had been followed.
- Pi Financial should have been aware that the risks associated with the fund made it an unsuitable recommendation.

Pi Financial did not agree with the adjudicator's conclusions. It said:

- It agreed that G's attitude to risk was cautious or low.
- The UCIS was promoted under the COBS 4.12 category 2 exemption.
- The fund could reasonably be considered as low risk at the time that the investment was made and this is supported by the fund literature.
- Changes in the management of the fund resulted in its failing and this is not something for which Pi Financial should be expected to accept liability.

G also provided additional evidence in support of its attitude to risk.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. Having done so, I have come to the same conclusion as the adjudicator and for broadly the same reasons.

Like the adjudicator I am satisfied that the rules governing UCIS promotion were not properly followed. However, this was an advised sale and the outcome will ultimately depend on the suitability of the advice.

G was seeking an investment that provided better returns than the funds were receiving in a deposit account. The fact find confirms that G's attitude to risk was "low risk" and low risk was defined as *"seeking better returns through growth/income with some protection against inflation. Minimal capital fluctuations".*

G has provided evidence to show that before making the investment into the UCIS, the funds were held in deposit accounts at high street banks. For a number of years the corporate funds were in exceptionally low risk accounts. G approached Pi Financial for a recommendation to invest the funds cautiously.

However, I am not satisfied that the recommended fund could reasonably be described as a low risk fund.   I am also satisfied that it would have been apparent to a reasonably competent adviser at the time that this was not a low risk investment.

Risk and return are inextricably linked and a fund offering a high return must be assumed to involve a commensurate level of risk. The Connaught fund was designed to generate a guaranteed return for investors of 8.5%. This is a very high level of return, particularly given base rate and bond yields at the time. I consider that the significant disparity between the returns being offered by the Connaught fund and other low risk investments should have alerted the adviser to the fact that the risk of the fund was not low.

I also consider that an investment in bridging finance for property development (even on a secured basis) would not obviously be considered to be a low risk activity.

I also note that in the fund documentation it makes clear that the term 'low risk' does not have a generic meaning but specifically refers to a risk categorisation of the loans (based on loan to value ratios) within the fund.

Reliance is also placed on the guarantee provided by a participant in the fund. The degree of confidence that it is reasonable to place on a guarantee will depend on the financial standing of the entity making the guarantee. The fund information highlights the guarantee but without any information on the guarantor I consider that it should not have provided a great deal of comfort to investors.

The fund also clearly has significant liquidity risk. The money invested is all invested with typical terms of up to 9 months. Whilst there is a liquidity buffer held within the fund, the prospect of a delay in receiving funds is a potential issue, based on the available information. Borrowing money from investors who need to give 1 months' notice and lend this to borrowers for periods up to 9 months clearly has the potential for liquidity problems.

There is also the fact that the fund is unregulated and this in itself means that the fund has additional risks, apart from the underlying investment risk, such as fewer investor protections. The risk of an investment is not confined to investment risk.

I also consider that the issue of a lack of diversification was not properly considered by Pi Financial. The advice that G received was on the management of its liquid funds. After the advice around a third of this was placed in a single unregulated fund with a very narrow focus. I consider this lack of diversification is a further reason to consider the advice unsuitable.

Allegations of fraud have been made in relation to the funds, and there has been much press and other comment about the conduct of the parties associated with them. As charges have not been brought, it would not be appropriate for me to give a view on that issue. I consider that G would not have been in this particular investment had it not been for the unsuitable advice given by Pi Financial. It follows that, notwithstanding any failings on the part of the parties involved with the fund, I consider it fair and reasonable that Pi Financial should be responsible for putting G back in the financial position it would have been in but for that poor advice.

I am aware that The Financial Conduct Authority (FCA) has recently announced that it is focused on securing fair redress for those who invested in the Connaught Income Funds. The possible impact of this is covered in the fair compensation section below.

I am also satisfied that this matter will have caused G some inconvenience and that it is reasonable that it be compensated for this. I consider the sum of £300 to be a suitable sum.

fair compensation

The adjudicator originally concluded that redress should be calculated based on an alternative benchmark made up of 50% fixed rate bonds and 50% based on the WMA Income index. I did not consider this to be the most appropriate benchmark. Instead it was my view that a benchmark based solely on fixed rate bonds was the most appropriate. Whilst G was described as a cautious investor, at the time of the advice investment in gilts/bonds (and equities) had been turned down as being too risky due to the potential for capital loss. For this type of investor a substantial investment in the WMA index would represent too high a level of risk.

Pi said it considered redress should be somewhere in the middle and suggested a split of 75% fixed rate bonds and 25% WMA index. However, it remains my view that for an investor who considered that the risk of an investment in a bond fund was too high risk even a 25% exposure to the WMA index is too high.

In assessing what would be fair compensation, I consider that my aim should be to put G as close to the position he would probably now be in if he had not been given unsuitable advice.

I take the view that G would have invested differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I have set out below is fair and reasonable given G's circumstances and objectives when it invested.

what should Pi Financial do?

To compensate G fairly, Pi Financial must compare the performance of G's investment with that of the benchmark shown below.

The compensation payable to G is the difference between the *fair value* and the *actual value* of G's investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

Pi Financial should also pay G any interest, as set out below. Income tax may be payable on the interest awarded.

In addition, Pi Financial should pay G £300 for the inconvenience experienced as a result of the unsuitable advice.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
Connaught Income fund series 1	still exists but illiquid	average rate from fixed rate bonds	date of investment	date of my decision	8% simple p.a. from date of decision (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value

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

The FCA has recently announced that it is focused on securing fair redress for those who invested in Connaught Income Funds. The process it is undertaking is confidential and at this stage no further information is available. But I think it is reasonable to say that some compensation might be payable in relation to G's investment, and to make allowance for this possibility. So, in exchange for the compensation payable by the business, G should agree to give an undertaking to the business to repay to it any amount of compensation it may receive in relation to the investment in the future, subject to the further requirements set out below .

If at the end date the investment is illiquid (that is could not be readily sold on the open market), it may be difficult to work out what the *actual value* is. In such a case the *actual value* should be assumed to be zero. This is provided G agrees to Pi taking ownership of the investment, if it wishes to. If it is not possible for Pi to take ownership, then it may request an undertaking from G that it repays to Pi any amount it may receive from the investment in future. However, the circumstances under which this ownership transfer should take place are set out below.

fair value

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

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Pi Financial should use the monthly average rate for the fixed rate bonds with 12 to 17 months maturity as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other payment out of the investment should be deducted from the *fair value* at the point it was actually paid so it ceases to accrue any return in the calculation from that point on.

If there are a large number of regular payments, to keep calculations simpler, I will accept if Pi totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because G wanted to achieve a reasonable return without risking any of its capital.

The average rate for the fixed rate bonds would be a fair measure given G's circumstances and objectives. It does not mean that G would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with little risk to their capital.

my final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, plus any interest and/or costs that I consider appropriate. If

I consider that fair compensation exceeds £150,000, I may recommend the business to pay the balance.

determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Pi Financial Ltd should pay G the amount produced by that calculation – up to a maximum of £150,000 (including distress and/or inconvenience but excluding costs) plus any interest set out above.

If Pi Financial Ltd does not pay the full fair compensation, then any investment currently illiquid should be retained by G. This is until any future benefit that he may receive from the investment together with the compensation paid by Pi Financial Ltd (excluding any interest) equates to the full fair compensation as set out above.

Pi Financial Ltd may request an undertaking from G that either he repays to it any amount he may receive from the investment thereafter or if possible, he transfers the investment at that point.

In addition, Pi Financial Ltd should pay G £300 for the inconvenience caused by this matter.

Pi Financial Ltd should provide details of its calculation to G in a clear, simple format.

recommendation: If the amount produced by the calculation of fair compensation exceeds £150,000, I recommend that Pi Financial Ltd pays G the balance plus any interest on the balance as set out above.
This recommendation is not part of my determination or award. It does not bind Pi Financial Ltd. It is unlikely that G can accept my decision and go to court to ask for the balance. G may want to consider getting independent legal advice before deciding whether to accept this decision.

Michael Stubbs
ombudsman