

complaint

Mr J has complained about advice he received from Kingswood Financial Advisors to transfer his pension into a self-invested personal pension (SIPP). This was to buy a Harlequin Property.

background

The advice was provided to Mr J in 2010. Prior to the advice Mr J had met with a third party adviser who'd promoted Harlequin Property. This was an unregulated overseas property development. Kingswood recommended the SIPP to Mr J. It did not give any advice on the property to be bought in the SIPP.

At the time of the advice Kingswood recorded Mr J's circumstances as being:

- he was aged 40 and married;
- he was employed with a gross income of about £14,000 a year;
- he had no other investments or assets other than his home;
- he had an attitude to risk of 4 on a scale of 1 to 10;

Mr J had an existing personal pension plan with a value of around £35,000. The illustrations provided to Mr J indicated that the SIPP would be more expensive than his existing plan.

Shortly after the SIPP was recommended and arranged by Kingswood, Mr J made an investment of £31,000 into Harlequin Property. The investment failed and cannot currently be sold. I think it's likely that Mr J has lost most of his pension.

One of our adjudicators investigated the complaint. He concluded that the complaint should be upheld for the following reasons:

- Kingswood was giving advice. This was a regulated activity and the firm was required to follow the rules set by the regulator. COBS 9 required the firm to obtain information about Mr J's circumstances. It then had to provide suitable advice. Without knowing what that investment was Kingswood couldn't have provided suitable advice on the SIPP.
- The SIPP was more expensive. It was standalone advice. Therefore it was unsuitable and likely to leave Mr J worse off in retirement.
- Kingswood should have thought about the investment that Mr J intended to make within the SIPP. Had it done so, Kingswood's advice would have been that the investment was unsuitable. Mr J should have been advised to keep his existing plan.
- The adjudicator considered the role of the third party firm. But concluded that it had been unregulated. Therefore as the only regulated adviser involved, Kingswood was fully responsible for Mr J's losses.

Kingswood did not agree with the adjudicator. It asked for more time to reply, but provided no further submissions.

my findings

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

When considering what is fair and reasonable, I am required to take into account relevant law and regulations; regulator's rules, guidance and codes of practice; and what I consider to have been good industry practice at the time.

What was Kingswood required to do?

Kingswood was required to comply with the regulations. That includes knowing its client and giving suitable advice. It was also required to act in its client's best interest. I don't think Kingswood can avoid these obligations by limiting its role to only advising on the SIPP.

What did Kingswood do?

Kingswood argues that it only provided advice on the SIPP and did not give advice on the investment made in Harlequin Property. It explains that Mr J had already received advice from another adviser about Harlequin. Mr J committed himself to buying the property by signing the relevant contracts. Kingswood therefore cannot be held responsible for the suitability of that investment. But, Kingswood was required to give suitable advice.

What should Kingswood have done?

The investment in Harlequin Property exposed Mr J's pension funds to significant risk. It was an overseas property development. The way the investment was intended to work was not entirely clear. The rental income from a hotel room was to be paid to Mr J. But, the income depended on the success of the venture. I think this should have been clear to Kingswood when its adviser wrote to Mr and Mrs J in January 2010.

The SIPP was being used to buy a hotel room in a property that hadn't been built. Part of the cost was being met by Mrs J's pension. In total 30% of the hotel rooms would be owned by Mr and Mrs J's SIPPs. The balance of 70% would have to be paid for using other assets or by borrowing.

I am satisfied that the advice to transfer to the SIPP was unsuitable. The investment was too risky for Mr J. I think that Kingswood should have advised Mr J against transferring to the SIPP; and also advised him not to invest in Harlequin. That advice should have been given before the application for the SIPP was made.

What would Mr J have done?

Mr J had paid a reservation fee of £1,000 to Harlequin. That didn't commit him to completing the contract. And the contract hadn't been signed by the Trustee of the SIPP. So, if Kingswood had given suitable advice I need to consider what Mr J would have done.

Kingswood should have advised Mr J that investing in Harlequin was high risk. He could lose all of his pension. If he hadn't signed the contract I think he would have lost the £1,000 reservation fee. It would have been a difficult choice to make. But I think, on balance, that Mr J would have taken notice of the advice. Kingswood was a firm regulated to give financial advice and I think Mr J would have given that some weight. I think Mr J would not have transferred his pension.

The role of other parties in the transactions

The role of the other adviser is important. Clearly, anything he said could have influenced Mr J to invest in Harlequin Property. But, Mr J isn't able to refer a complaint about that to this service. I understand that the other adviser had two businesses with similar names. One was an appointed representative of a network of regulated advisers. But I know that the network would not allow its representatives to advise on unregulated investments. The other business was an agent for Harlequin Properties. I think it's likely that the adviser was dealing with Mr J as an agent of Harlequin; even though Mr J may also have been a customer of the regulated firm. One of the aims of regulation is to protect consumers. Kingswood was providing advice on investments. This is a regulated activity.

I have concluded that the advice to start the SIPP was unsuitable. It follows that those losses are the responsibility of Kingswood. My view is that all of the losses flowed from the unsuitable advice. I don't think suitable advice could be given without considering the transaction as a whole. And if suitable advice had been given then the investment in Harlequin Property would not have gone ahead.

I know that it would be difficult for Kingswood to reclaim any of the losses from the third party. But I think Mr J should be compensated for his losses in full. Those losses could not have been made unless a regulated firm was involved. If Kingswood wants to take an assignment of any rights of action against any third parties from Mr J then I think that would be reasonable. Mr J should co-operate with Kingswood if they try to recover those losses.

There is no market for the investment in Harlequin. Mr J should be returned to the position that he would now be in, if he had been given suitable advice. I consider that Kingswood should compensate Mr J in full and take ownership of the investment in Harlequin.

fair compensation

My aim is to put Mr J in the position he would now be in if he had received suitable advice. I think that: a.) he would have kept his existing pension; b.) he wouldn't have invested in Harlequin; and c.) as a result he wouldn't have opened the SIPP (and now be subject to ongoing SIPP fees). In setting out how to calculate fair compensation my objective is to address these three issues. That is what I'm trying to achieve.

There are a number of possibilities and unknown factors in making an award. While I understand Harlequin will allow Kingswood to take over the investment from Mr J, the involvement of third parties – the SIPP provider and Harlequin – mean much of this is beyond this service or Kingswood's control.

All the variables are unknown and each may have an impact on the extent of any award I may make. The facts suggest it's unlikely that the property will be completed and unlikely that the contract and any future payments would be enforceable. While it's complicated to put Mr J back in the position he would have been in if suitable advice had been given, I think it's fair that Mr J is compensated now. I don't think I should wait and determine each and every possibility before making an award. What is set out below is a fair way of achieving this.

Kingswood should calculate fair compensation by comparing the value of Mr J's pension, if he had not transferred, with the current value of his SIPP. In summary:

1. Obtain the notional transfer value of Mr J's previous pension plan on the date of this decision, if it had not been transferred to the SIPP.
2. Obtain the actual transfer value of Mr J's SIPP on the date of this decision, including any outstanding charges.
3. Pay a commercial value to buy Mr J's share in the Harlequin Property investment.
4. Pay an amount into Mr J's SIPP so that the transfer value is increased to equal the value calculated in (1). This payment should take account of any available tax relief and the effect of charges. It should also take account of interest as set out below.

In addition, Kingswood should:

5. Pay five years' worth of future fees owed by Mr J to the SIPP; if the Harlequin property cannot be purchased.
6. Pay Mr J £300 for the distress and inconvenience caused.

I have explained how Kingswood should carry this out in further detail below.

1. *Obtain the notional transfer value of Mr J's previous pension plans on the date of this decision if they had not been transferred to the SIPP.*

If there are any difficulties in obtaining a notional valuation then the FTSE WMA Stock Market Income Total Return Index should be used. That is a reasonable proxy for the type of return that could have been achieved if suitable funds had been chosen.

2. *Obtain the actual transfer value of Mr J's SIPP on the date of this decision, including any outstanding charges.*

This should be confirmed by the SIPP provider. The difference between 1 and 2 is the loss to the pension.

3. *Pay a commercial value to buy Mr J's Harlequin Property investment.*

The SIPP only exists because of the investment in Harlequin. In order for the SIPP to be closed and further SIPP fees to be prevented, the Harlequin investment needs to be removed from the SIPP. I understand this can be done.

The valuation of the Harlequin investment may prove difficult, as there is no market for it. To calculate the compensation, Kingswood should agree an amount with the SIPP provider as a commercial value, and then pay the sum agreed plus any costs and take ownership of the investment.

If Kingswood is unable to buy the investment, it should give it a nil value for the purposes of calculating compensation.

Kingswood may ask Mr J to provide an undertaking to account to it for the net amount of any payment the SIPP may receive from the Harlequin investment. That undertaking should allow for the effect of any tax and charges on the amount Mr J may receive from the investment and any eventual sums he would be able to access from the SIPP. Kingswood will need to meet any costs in drawing up the undertaking.

I have been provided with the contract between Harlequin and Mr J. He signed a different contract for the deposit and the remainder. Separate contracts were signed. It means that the SIPP has paid a deposit under a contract with Harlequin. That is the loss I am trying to redress. Mr J agreed to pay the remainder of the purchase price under a separate contract. Those sums have not yet been paid, so no further loss has been suffered. However, if the property is completed, Harlequin could require those payments to be made. I think it's unlikely that the property will be completed, so I think it's unlikely there will be further loss. But there might be. Mr J needs to understand this, and that he won't be able to bring a further complaint to us if this contract is called upon. Mr J may want to seek independent advice on how to cancel this ongoing contract for the remaining amount.

If Kingswood takes over the contract from the SIPP trustees then it may be liable for the remaining amount of the purchase price. As a result any total award that Kingswood may have to pay could exceed £150,000. This won't be known until the redress in steps 1 and 2 above has been calculated. If it will exceed £150,000 then I can't tell Kingswood to take over the contract from Mr J's SIPP. But I can address the ongoing SIPP fees that may continue if the SIPP can't be closed. I have dealt with this in step 5 below.

- 4. Pay an amount into Mr J's SIPP so that the transfer value is increased to equal the value calculated in (1). This payment should take account of any available tax relief and the effect of charges. It should also take account of interest as set out below.*

If it's not possible to pay the compensation into the SIPP, Kingswood should pay it as a cash sum to Mr J.

I am also not certain whether, currently, Mr J can pay the redress into a pension plan. If he can, it means that the compensation is able to be paid into a pension in the time until Mr J retires and he should be able to contribute to pension arrangements and obtain tax relief. If this is the case, the compensation should be reduced to notionally allow for the income tax relief Mr J could claim. The notional allowance should be calculated using Mr J's marginal rate of tax. For example, if Mr J is a basic rate taxpayer, the total amount should be reduced by 20%.

On the other hand, Mr J may not currently be able to pay the redress into a pension plan. But had it been possible to pay the compensation into the plan, it would have provided a taxable income. Therefore the total amount to be paid to Mr J should be reduced to notionally allow for any income tax that would otherwise have been paid. The notional allowance should be calculated using Mr J's marginal rate of tax in retirement. For example, if Mr J is likely to be a basic rate taxpayer in retirement, the notional allowance would equate to a reduction in the total amount equivalent to the current basic rate of tax. However, if Mr J would have been able to take a tax free lump sum, the notional allowance should be applied to 75% of the total amount.

Simple interest should be added at the rate of 8% a year from the date of the redress calculation until the date of payment. Income tax may be payable on this interest.

5. *Pay five years' worth of future fees owed by Mr J to the SIPP; if the Harlequin property cannot be purchased.*

Had Kingswood given suitable advice I don't think there would be a SIPP. It's not fair that Mr J continues to pay the annual SIPP fees if it can't be closed.

I think Kingswood should be able to take over the investment to allow the SIPP to be closed. This is the fairest way of putting Mr J back in the position he would have been in. But I don't know how long that will take. Third parties are involved and I don't have the power to tell them what to do. To provide certainty to all parties, I think it's fair that Kingswood pays Mr J an upfront lump sum equivalent to five years' worth of SIPP fees (calculated using the previous year's fees). This should provide a reasonable period for the parties to arrange for the SIPP to be closed. There are a number of ways they may want to seek to achieve that. It will also provide Mr J with some confidence that he will not be subject to further fees.

In my view, awarding a lump sum for an amount equivalent to five years fees strikes a fair balance. It's possible that the Harlequin investment could be removed from the SIPP in less than five years. But given the time it has taken to date I think it is possible that it could take a number of years more to resolve all of the issues. So using a figure of five years' worth of fees is an approximate and fair award to resolve the issue now.

6. *Pay Mr J £300 for the distress and inconvenience caused.*

Mr J has been caused some distress by the loss of his pension benefits. I think that a payment of £300 is appropriate to compensate for that distress.

my final decision

I uphold this complaint. Kingswood Financial Advisors should now calculate and pay compensation as set out above.

Under our rules, I'm required to ask Mrs J to accept or reject my decision before 13 January 2017.

Roy Milne
ombudsman