Financial Ombudsman Service

complaint

Mr H complains that advice from Furness Financial Management ('FFM') to open a Self Invested Personal Pension ('SIPP') to then invest in an unregulated collective investment scheme ('UCIS') was unsuitable for his circumstances and attitude to risk.

background

The background to the complaint was set out in detail in the adjudicator's assessment. The parties have not made further substantive submissions. So I have not repeated everything the adjudicator said in full here.

In April 2014 FFM noted that:

- Mr H had little previous investment experience;
- Mr H was aged 45 and married;
- Mr H's salary was £18,000 a year;
- it was not known if Mr H had any funds in deposit accounts, or if he had non-pension investments or owned any property;
- Mr H's retirement funds were valued at £52,471.31;
- Mr H had a Personal Pension Plan ('PPP') and had asked FFM to review this plan with a view to improving his retirement income;
- Mr H was interested in transferring into a SIPP with a view to more esoteric investment strategies;
- Mr H was not intending to make any further contributions into this pension fund although this would be reviewed on a regular basis;
- Mr H had an attitude to investment risk of seven on a scale of one to ten. This was classified as medium to high;
- Mr H could tolerate small to medium losses without significantly impacting his future standard of living;
- Mr H's PPP was invested in a Managed Fund and a With Profits Fund;
- it was recommending Mr H open a SIPP because he wanted to invest in alternative investments not available through his PPP;
- he also wanted to control and understand the investments within his pension fund;
- the critical yield for the SIPP to provide equivalent benefits to those which the PPP was projected to provide in retirement was around 5%;
- as Mr H had a risk rating of seven and given that his term to retirement was sixteen to twenty years then the yield was acceptable;
- a Stakeholder Plan was not suitable as Mr H wanted to invest in alternative investment strategies not available via a SHP;
- the recommendation was for 60% to be invested in *"Best Car Parks"*, a UCIS and the balance invested with Verbatim Asset Management;
- Best Car Parks was a commercial property investment;
- it would be possible to invest £27,000 at around 23% discount below market value;
- it would be possible to earn a guaranteed 8.28% average yield annually for five years with certain operators;
- property purchase could be realised at any time with structured exit routes in place;
- Verbatim Funds were actively managed by some of the most respected names from investment houses in the UK;
- based on Mr H's attitude to investment risk it recommended the Verbatim Portfolio 7;
- Mr H knew the risks of investing the majority of his pension fund into a single holding;

- investing 60% of Mr H's pension into Best Car Parks was consistent with his attitude to risk.

One of our adjudicators investigated the complaint. He said it should be upheld. He considered FFM's unsuitable advice was the reason for Mr H's transfer into a SIPP and to then invest in a UCIS.

Individuals recorded by the regulator as partners of FFM have made submissions that they should not be held liable for the advice. But they have not made substantive submissions on the merits of the complaint in response to the adjudicator's assessment.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

FFM was at the relevant time a partnership. The status of the surviving partners is disputed. That issue may have to be resolved elsewhere. But my decision here relates to FFM.

Those recorded by the regulator as partners of FFM have been asked for submissions on the merits of this complaint. No such submissions have been provided. The submissions I have received from FFM have only addressed liability, which is denied.

But based on information from the Financial Conduct Authority, I am persuaded it is appropriate for me to issue a final decision in respect of this complaint. Although FFM is no longer trading or regulated any former FFM partner(s) may be liable for its obligations.

Having reviewed the evidence, I have reached the same conclusions as the adjudicator and for the same reasons.

The Best Car Parks holding was a UCIS. So it was subject to the scheme promotion restriction rules as set out in s.238 Financial Services Markets Act.

Adviser firms have a choice between two different sets of exemptions from the s.238 restriction s.238 (6) and the Promotion of Collective Investment Schemes (Exemptions) Order 2001 SI 1060 (as amended) and under regulatory rules exempting the promotion of UCIS under certain circumstances. COB 3 Annex 5 of COB 3.11 also set out seven categories of investor to whom a UCIS may be promoted without breaching section 238 of FSMA. The only category that might have applied to Mr H is Category 2.

I am not convinced FFM would be able to rely on an exemption (whether under PCIS or COBS) such that the promotion of the UCIS was not in breach of section 238. But, all that said, I have gone on to consider whether if FFM sought to rely on Category 2 (or indeed any other exemption category), the investments selected would be considered to have been suitable for Mr H.

In July 2010 the then regulator, the FSA, issued a report about the quality of advice given when promoting and recommending investments in UCIS. The project arose from issues identified in 2009 and focussed on UCIS business written during 2008 and 2009. In my view FFM ought to have been aware of the project findings prior to advising Mr H on the pension transfer and subsequent investment.

In those project findings good practice was defined as including a maximum portfolio proportion for UCIS investment of between 3% and 5%, monitored on an on-going basis to ensure that those levels were maintained. I consider that this gave a clear indication of the risk the FSA believed these products represent – where the consumer's capital is at risk and where there may be limited recourse to the Financial Services Compensation Scheme.

Best Car Park was an unusual fund, operating in a very specific way. It could suffer significant losses, the extent of which would be difficult to predict or estimate at outset. I understand its investment objective was to provide a return in excess of 8% a year.

At the date the recommendation was made to invest I am satisfied that a reasonably competent body of advisers would have been aware of the prevailing low interest rate environment. In my view, an investment with a declared target yield in excess of 8%, ought to have raised immediate concern that a higher than average level of risk would have to be taken to meet such a high return.

The fact that the investment was not correlated to the stock market and might have been a low volatility proposition does not mean that the investment was not potentially high risk.

The actual effectiveness of using volatility as a measurement of risk is questionable. I note that the FSA made a similar point in guidance on assessing suitability published in March 2011 and there is no suggestion that point is a new one. Volatility is a measurement over time that relies on historical data and past events do not guarantee future results. Using historical volatility as a predictive measure of future risk is limited by the uncertainty of future returns. In the financial markets, somewhat unpredictable future returns and radical events are especially prevalent.

The Best Car Parks holding was an unusual fund, operating in a very specific way and without a substantial track record. It had what might reasonably be described as sophisticated and/or complex underlying structure, the nature of which was somewhat opaque. The Fund could suffer significant losses, the scale of which would be difficult to predict or estimate at the outset.

The fund was, in my opinion, non-standard and specialist. It was not suitable for investors uncomfortable with its particular, unusual risks. I consider FFM ought to have been aware that such a specialist holding was unlikely to be a suitable investment for the bulk of Mr H's pension provision. Indeed, I have real doubts whether such an investment would have been suitable for all but the most experienced of retail investors. It was certainly not suitable for investors such as Mr H.

It ought to have been apparent that the associated risks with the Best Car Parks fund were significant, especially given the lack of any consumer protection; the investors being unable apply to the FSCS in the eventuality that the Fund failed. Notwithstanding the comments that were made in the suitability letter it also ought to have been apparent that liquidity issues could arise.

It is important for advisers to take these matters into account when assessing the suitability of the products for an individual investor, and for potential investors to understand that such investments presented a significant risk to the monies being invested and I am not persuaded that the degree of risk to which the investment exposed Mr H's monies was adequately explained to him.

With investments such as those this complaint concerns it is not, in my view, sufficient to reference a few brief details from the product literature. Nor is it sufficient for the adviser to assert that they relied on the headline description of an investment; rather, they should be exercising professional judgment about the inherent nature of the investment and its suitability for their client's particular investment needs.

The recommended investment exposed a significant proportion of Mr H's total pension provisions to considerable investment risk. This was well in excess of the degree to risk to which I would have considered it appropriate to expose such a proportion of the pension provisions of a retail client in Mr H's circumstances and with his attitude to investment risk.

I am satisfied from the evidence that Mr H was a retail client, I am also satisfied that Mr H was not an experienced investor. Mr H sought advice from FFM about his pension and did so because he wanted professional advice. I am satisfied that Mr H felt sufficiently confident in his own ability to determine what he wished to do with his pension then there would have been no need for him to have sought advice from FFM.

I am not persuaded that Mr H would have independently transferred his pension from the PPP into the SIPP and then invested in a UCIS if FFM had not advised that course of action.

The obligation on FFM was to review Mr H's circumstances and then to make recommendations which were more likely than not to leave him better off in retirement within a degree of risk which was appropriate for him. I am not persuaded that FFM met this test by recommending Mr H transfer into a more highly charged contract and then recommending he invest the bulk of his pension funds into an unregulated holding. I consider that to have been unsuitable advice.

In my view, a competent adviser would have explained to Mr H that his existing PPP and fund selection was appropriate for his circumstances. I consider it more likely that had FFM given that advice then Mr H would have retained his pension funds in the PPP and would not have transferred into a SIPP. I am also satisfied that had suitable advice been given then Mr H would not have invested in unregulated holdings.

my decision

I uphold this complaint.

Furness Financial Management ('FFM') must redress Mr H as set out below.

My aim is to return Mr H to the position he would now be in but for FFM's unsuitable advice. In my view, Mr H would not have transferred his funds into the SIPP and then invested in a UCIS. The asset allocation of Mr H's PPP at the date of advice was appropriate. So FFM must calculate redress by comparing the value of that PPP, if Mr H had not transferred, with the current value of his SIPP.

FFM must redress Mr H as follows:

1. Obtain the notional transfer value of Mr H's previous pension plan if it had not been transferred to the SIPP. That must be the value at the date of this decision.

If difficult to get a notional valuation then the FTSE WMA Stock Market Income Total Return Index must be used. It is a reasonable proxy for the type of return that could have been achieved over the period in question.

FFM must assume that any contributions or withdrawals that have been made would still have occurred and on the same date.

2. Obtain the current transfer value of Mr H's SIPP, including any outstanding charges. That must be the value at the date of this decision.

3. Pay a commercial value to buy any illiquid holdings Mr H has in his SIPP.

If there are any illiquid holdings in the SIPP then it would be best if they could be removed from the SIPP. Mr H would then be able to close the SIPP and stop paying its fees. In calculating compensation, FFM should agree with the SIPP provider a commercial value for any illiquid holdings. It should then pay the sum agreed plus any costs and take ownership of any illiquid holdings.

If there are illiquid holdings and FFM is unable to buy them then it must give them a nil value in calculating compensation. FFM may then ask Mr H to give an undertaking to account to it for the net amount of any payment the SIPP may receive from the illiquid holdings. That undertaking should allow for the effect of any tax and charges on the amount Mr H may receive from such investments and any eventual sums he would be able to access from the SIPP. FFM will need to meet any costs in drawing up the undertaking.

FFM must also:

4. Pay an amount into Mr H's SIPP so that the transfer value is increased to equal the value calculated in step one. This payment should take account of any available tax relief and the effect of charges.

If it is not possible to pay the compensation into the SIPP, FFM must pay it as a cash sum to Mr H. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore the total amount should be reduced to notionally allow for any income tax that would otherwise have been paid.

The notional allowance should be calculated using Mr H's marginal rate of tax in retirement. For example, if Mr H is likely to then be a basic rate taxpayer, the notional allowance would equate to a reduction in the total amount equivalent to the current basic rate of tax. But if Mr H would have been able to take a tax free lump sum, the notional allowance should apply to 75% of the total amount.

5. Only if there are illiquid holdings in the SIPP which cannot be bought, then FFM must pay five years of future fees owed by Mr H to the SIPP.

Had FFM done what I have concluded it ought to have done then there would not be a SIPP. It would not be fair if Mr H had to pay annual SIPP fees if there are illiquid holdings which cannot be sold so preventing the SIPP from being closed.

Ideally FFM would take over any illiquid holdings, thereby allowing the SIPP to be closed. This is the fairest way of putting Mr H back in the position he would have been in. But third parties are involved and we do not have the power to tell them what to do. To give certainty to all parties, if there are illiquid holdings and if FFM is unable to buy them from the SIPP, then FFM must pay Mr H an upfront lump sum equivalent to five years' worth of

SIPP fees (calculated using the previous year's fees). This gives a reasonable period to arrange for the SIPP to be closed.

6. Pay Mr H £250 for the distress and inconvenience caused.

Simple interest should be added to the losses at 8% a year from the date of this decision until the date of payment. Tax may be due on this interest.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr H to accept or reject my decision before 9 March 2017. .

Terry Connor
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