

## **complaint**

Mr T's complaint is that:

1. A fund he was advised by Reid Scott & Ross Limited ("the firm") to invest in via his Self-Invested Personal Pension ("SIPP") has liquidity problems, affecting his ability to access the money.
2. He was not told at the time of advice that lack of liquidity could be a major risk.
3. He now understands that the fund is an unregulated collective investment scheme ("UCIS"), which is unsuitable and too risky.

## **background**

I outlined the background to this complaint in my provisional decision. A copy is attached here and forms part of this final decision. Neither party contests the chain of events, so I shall not repeat it here.

After reviewing my provisional decision, the firm said:

- The investment in the Quadris UCIS ("the investment") was recommended because Mr T wanted to achieve a higher rate of return than he was getting from a liquid assets fund. And it was recommended not in isolation, but as part of a range of investments. It was assumed Mr T would invest for the long term.
- The Suitability Letter at the time of sale included a number of risk warnings. The important documents outlined two major risks—illiquidity and the possibility of redemptions being suspended.
- Whilst the investment was unregulated, it was within its rights to sell it to Mr T because (a) it had taken reasonable steps to ensure it was suitable for him; and (b) he was an established customer of the firm.
- It did not agree that the investment was unsuitable for Mr T taking into account his circumstances at the time, which were not disputed.
- It regretted that liquidity problems meant it was not possible to sell the investment. It said, however, that it wished to make an offer to resolve the complaint.
- It therefore proposed to pay him £80,000 in cash, inclusive of all costs and interest, on condition that he retain the investment. The FOS's offer, on the other hand, required that the investment be assigned to the firm. As the investment was worth about £40,000 more than he paid for it—and substantial income from similar assets was expected until 2032—this would leave him in a better financial position.
- The offer was without prejudice or admission of liability and in full and final settlement of all claims against the firm. The terms of the offer must remain confidential.

Mr T made no comment about my provisional decision. However, he said he had told the firm he did not accept its settlement offer as he did not wish to keep the investment.

### **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 not changed the opinion I came to in my provisional decision.

Whilst it may be true that Mr T sought higher returns than he was receiving at the time, some risk warnings were given in the literature and the firm assessed Mr T's circumstances before making the recommendation, I still consider that the recommendation was unsuitable. My reasons for concluding this are as set out in my provisional decision.

The amount recommended, the nature of the investment and the investment strategy meant it was reasonably foreseeable that almost a third of Mr T's SIPP would be inaccessible for long periods of time and might even be lost entirely.

### **my final decision**

I uphold this complaint.

Reid Scott & Ross Limited must calculate Mr T's loss in line with the methodology I set out in my provisional decision.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr T to accept or reject my decision before 11 January 2016.

Terry Connor  
**ombudsman**

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### **Provisional Decision**

#### **complaint**

Mr T complains that:

1. A fund he was advised to invest in via his Self-Invested Personal Pension ("SIPP")

has liquidity problems, affecting his ability to access the money.

2. He was not told at the time of advice that lack of liquidity could be a major risk.
3. He now understands that the fund is an unregulated collective investment scheme ("UCIS"), which is unsuitable and too risky.

#### **background**

In 2009, Mr T approached Reid Scott & Ross Limited ("the firm") for advice about retirement planning.

He completed and signed a Fact Find. Among other things it said:

- He was 60 years old, married with two children (then 2 and 4 years old).
- He was self-employed as a sports commentator, earning £160,000 a year.
  - His assets included his main residence (worth circa £1 million with no mortgage); a second property (worth circa £150,000 with £130,000 mortgage); and joint savings of approximately £10,000.
  - His financial priority was pension planning.
  - His intended retirement date was not recorded.

Under "Risk Profiler", Mr T's attitude to risk was described as cautious, defined as:

*'A Cautious Investor is looking for an investment which, while giving some potential for real returns, produces returns that are at least as good as those from a high street deposit account. A high level of security of their capital is a priority. Whilst recognising that investment values will change, they would feel uncomfortable if their investments rose and fell in value very rapidly'.*

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Under "Knowledge and Experience", Mr T's past and current investments were listed, including building society and savings accounts, investment bonds, unit trusts and pension plans.

Finally, Mr T confirmed:

*'I have a reasonable knowledge of investments, having previously purchased Investment/Pension contracts. If the products purchased fluctuated in value, have you been comfortable with this (Yes)'.*

In May 2009, the firm sent Mr T its Suitability Letter. It said:

- Mr T's SIPP was not performing as well as expected. He wanted advice about how to improve his potential retirement fund.
- The firm said Mr T should invest in the Quadris Environmental Fund Plc and buy Fixed Rate Accumulation Shares. It recommended investing via an Offshore Bond within Mr T's SIPP.
- It explained: *'As discussed at our meeting, I must firstly point out that this fund is registered on the Isle of Man and therefore you are not covered by the UK Investors Compensation scheme in terms of consumer protection'*.
- It also said: *'...you need to be aware that, whilst the Isle of Man is a "Designated Territory" (i.e. its regulation and supervision is at least as strict as in the UK) investors are not covered by the UK Compensation Scheme. You therefore need to feel comfortable that the opportunity for additional return is*

*enough to compensate for the additional risk posed by the lack of investor protection'.*

- It said this would be a suitable investment because returns from commercial forestry are generally very attractive for investors. The returns were consistent with other asset classes but gave portfolio diversification.
- It recommended a total investment of £100,000 into this fund (out of total £334,000 in Mr T's SIPP). This was appropriate given his need for surplus income in the event of emergency and tax-free cash at retirement.
- It enclosed a Key Features document and illustration. These set out the investment's aims, charges and legal/tax status. They also outlined the risks of the investment.

An "Offering Document" was given to Mr T. Among other things, this said:

*Investment in qualifying funds may involve special risks that could lead to a loss of all or a substantial portion of such investment. Unless you fully understand and accept the nature of the Fund and the potential risks inherent in the Fund you should not invest in the Fund. (p.1)*

*Investment in the Fund is only appropriate for those whose business and investment experience is such that they are capable, in conjunction with their professional advisers, of evaluating the merits of their prospective investment, can afford the loss of the whole of their investment and have no need for their investment to be liquid. (p.5)*

*Because there is not a recognisable market for investments which the Fund may make it may be difficult for the Fund to deal in any such investments or to obtain reliable information about their value or the extent of the risks to which such investments are exposed. (ibid)*

*The objective of these Classes [The Investment – Fixed Rate Classes] is to achieve a fixed rate of return from investment in a variety of fixed rate bonds and zero coupon bonds issued by Floresteca. (p.14)*

*The Fixed Rate Accumulation Shares will accumulate all income arising from the investments in Floresteca and all interest payable on Shareholders' funds held in cash. After deduction of charges and expenses, as defined herein, Shareholders will receive a fixed rate of capital growth of 6.75% per annum on the value of the Shares. (ibid)*

*The liquidity of investments held by the Fund cannot be guaranteed. Any liquidity may prevent the Fund from concluding an investment transaction on satisfactory terms and, in certain circumstances, may prevent redemptions of (and subscriptions for) investments and Shares. (p.18)*

*An investment in Shares should be considered high risk; therefore a holding of Shares should not be considered a complete investment programme. (ibid)*

*In certain circumstances, including, but not limited to, the inability of the Fund reasonably to determine Net Asset Value by reason of the suspension of trading on any established market where interests of the Fund or the funds are traded, or*

*default of delay in payments due to the Fund from banks or other persons, the Fund may in turn suspend redemptions of Shares as of the applicable Dealing Day or delay payment to persons requesting redemption of shares. (p.27)*

*In such cases, the Fund shall as soon as practicable thereafter cause such Shares to be redeemed or such redemption payment to be made. The Shareholders will be notified immediately of any period of suspension and the Directors will take all reasonable steps to bring such a period of suspension to an end as quickly as possible. (ibid)*

Mr T accepted the recommendation to invest via his SIPP in the Quadris Environmental Forestry Fund ("the Quadris fund").

In April 2015, Mr T complained to the firm. He was dissatisfied because there were liquidity problems with the Quadris fund. Liquidity risk was not explained to him at the time. He now knows that the Quadris fund was a UCIS, which was unsuitable and too risky.

After investigating Mr T's complaint, the firm issued its final response. It said:

- Quadris had confirmed that the fund had liquidity issues. A shareholder update dated 24 October 2014 explained there were sufficient funds to sustain operations for five years. Its focus would remain on protecting the core investment to produce long-term returns. It was possible for Mr T to withdraw funds from other investments in his SIPP but, it would not be possible to withdraw funds from the UCIS fund until the '*current redemption request suspension*' had been lifted. No timescale was given for this.
- The firm said that fund literature about the Quadris fund had been given to Mr T at the time of advice. These explained the risks of this type of investment. Mr T confirmed that he had received these and that he was happy to invest on this basis. Also, its letter of 5 May 2009 outlined that the fund would hold 10% of its value in cash. This was to give some protection against the risk of illiquidity.
- The firm said that Mr T had been categorised by its fact find as a cautious investor. And, in 2008, it had deemed it appropriate to select for Mr T a '*deposit type fund*', due to recent volatility in the stockmarket. A £100,000 investment into the fund was appropriate in April 2009. The Suitability Report explained that the Quadris fund was an Isle of Man UCIS, which might not be covered by UK compensation schemes.
- It did not uphold Mr T's complaint. This was because a Fact Find had been completed at the time of advice, so the firm was aware of Mr T's circumstances. His attitude to risk was taken into account when the recommendation was made. The recommendation was discussed and confirmed in a Suitability Report. The supporting documents made clear the fees, charges and risks associated with the Quadris fund.

Mr T did not agree. He referred his complaint to this service for a decision.

### **my provisional findings**

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

This service has jurisdiction to consider complaints that relate to acts or omissions by Financial Conduct Authority regulated firms in carrying on regulated activities. Regulated activities are defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

These include giving investment advice and arranging deals in investments. Units in a collective investment scheme are designated investments (or 'specified investments' in the Regulated Activities Order 2001), regardless of whether the scheme is regulated. Therefore, I consider that the Financial Ombudsman Service has the necessary authority to consider this complaint.

The Financial Conduct Authority (previously the Financial Services Authority) Conduct of Business Sourcebook (COBS) 4.12, or the FSMA (Promotion of Collective Investment Schemes (Exemptions) Order 2001 ("the PCIS Order") restrict the promotion of unregulated collective investment schemes to certain classes of investor who are exempt from the prohibition of promotion of such schemes in section 238 of FSMA.

The Quadris fund is an unregulated collective investment scheme ("UCIS"). Section 238 of the Financial Services and Markets Act prohibits the promotion of unregulated collective investment schemes to the general public. However, it allows for promotion of such schemes

*'otherwise than to the general public'* under certain exemptions determined by the regulator and the Treasury. Those exemptions are set out in the Conduct of Business Sourcebook (COBS 4.12 in April 2008) and in the FSMA (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 ('the PCIS Order').

COBS 4.12 required that a firm should take reasonable steps to establish that its client fell into one of the defined categories prior to promotion of the investment. The PCIS Order required that the client should sign a statement with prescribed wording confirming that he was a sophisticated or high net worth investor. Therefore, exemption could not properly be established retrospectively.

It is my understanding that the firm has taken no position about whether Mr T was a sophisticated investor or a high net worth investor. Furthermore, although the suitability report, which Mr T signed, made reference to the fact that the investment was unregulated, I have not seen any evidence that the firm took any steps to establish his exemption from the prohibition in section 238 of FSMA prior to recommending the investment. It therefore appears that the promotion of the Quadris fund was not compliant with the regulations in place at the time.

On the other hand, Article 21 of the PCIS Order allows promotion of unregulated collective investment schemes to high net worth individuals, with one of the criteria being income of £100,000 or more. Mr T earned in excess of this amount. And, although this was joint income, he appears to have been the sole or primary income earner. Therefore, this exemption would have been available to the firm. So UCIS could *potentially* have been promoted to Mr T in a manner compliant with the regulations in place at the time.

However, based on the evidence I reviewed, this investment appears—in addition to being an unregulated investment scheme—to be an Isle of Man Qualifying Investor Scheme. A copy of the original application form Mr T signed is no longer available. But when he took out the investment, he would have signed a disclaimer similar to, or identical with, the following statement from Schedule 6 of the Isle of Man Collective Investment Schemes (Qualifying Fund) Regulations 2010:

*Part 1 Certification – This certification is to be completed by all*

*applicants... “I/we confirm that—*

*(b) I am/we are sufficiently experienced to understand the features and risks associated with an unauthorised and unapproved fund of this type;*

In my opinion, there is insufficient evidence that Mr T had the level of experience required. He appears to have been a normal retail investor. Therefore, I am not persuaded that this investment should have been promoted to Mr T at all, regardless of the fact that he met the definition of a high net worth investor in the PCIS Order.

In summary, I do not believe that the scheme should have been promoted to Mr T, and therefore I believe he should be placed in the position he would be in if it had not been promoted to him, I also consider that the investment was unsuitable. This is for the following reasons.

The Quadris fund came with a high level of risk. The Offering Document clearly outlines—in several places and in several different ways—the various risks associated with it. But in the Fact Find, Mr T's attitude to risk was described in the following terms:

*We established that your attitude to risk could realistically be described as Cautious. A Cautious investor is looking for an investment which, while giving some potential for real returns, produce returns that are at least as good as those from a high street deposit account. A high level of security of their capital is a priority*

On the face of it, I do not consider that the riskiness of the Quadris fund on the one hand, and Mr T's cautious attitude to risk on the other, can be reconciled. Mr T has said that he does not take risks when it comes to financial matters. This is supported by the documentary evidence in the Fact Find. Based on this, I consider that there is insufficient evidence showing that Mr T had experience of, or any particular interest in, riskier investments such as this one.

However, in forming my opinion, I have taken into consideration his entire SIPP investment selection. Out of a total SIPP value of approximately £334,000, the firm recommended Mr T invest around a third into Quadris. The investments underlying his particular share class were debt instruments issued by a single Brazilian forestry company. This clearly contrasts with a typical fixed interest fund, which would be invested in securities issued by a wide and diverse range of issuers. The prospectus stated that the fund should not be considered a complete investment programme.

Even for a qualifying investor, I do not believe investment of a significant proportion of a portfolio could reasonably be considered suitable. In general, I consider that investment in such high risk, unregulated schemes can only be considered suitable as a small

proportion of a diverse portfolio. This is supported by the regulator's statement of December 2010:

*UCIS are generally regarded as being characterised by a high degree of volatility, illiquidity or both – and therefore are usually regarded as speculative investments. This means that in practice they are rarely regarded as suitable for more than a small share of an investor's portfolio.*

Similarly, in July 2010 ("Unregulated Collective Investment Schemes: Good and poor practice report") the regulator cited as an example of good practice:

*The firm set up a maximum portfolio proportion for UCIS investments within their customers' portfolio and monitored it on an on-going basis. This level was between 3% and 5% and was backed-up by the Firms' robust and on-going due diligence and monitoring.*

Although this guidance was published after the firm made its recommendation, I nonetheless consider that it reflects the regulator's expectations of firms subject to the restrictions on the promotion of UCIS funds at the time of advice. Whilst a small proportion of UCIS might have been suitable—as part of a qualifying investor's diversified SIPP investment portfolio—I do not consider the proportion recommended in this case (which was nearly a third of the SIPP) would have been suitable for Mr T's circumstances and attitude to risk, even if he had been a qualifying investor.

In summary—

- I do not consider Mr T was a qualifying investor, or therefore that the Quadris fund should have been promoted to him at all.
- I also believe the recommendation to invest a substantial proportion of Mr T's SIPP into the fund was unsuitable for his circumstances at the time of advice;
  - Our approach to complaints is to try to put consumers as closely as possible back into the position they would have been if suitable advice had been given;
- The firm should pay Mr T redress (as described in the following sections); and
  - It should also pay him compensation for the trouble and upset the recommendation has caused him.

The offshore bond was recommended specifically to hold the Quadris investment, and this added an extra level of charging. I have taken this into account in my redress recommendations.

### **fair compensation**

In assessing what would be fair compensation, I consider that my aim should be to put Mr T as close as possible to the position he would probably now be in if he had not been given unsuitable advice. I think Mr T would have invested differently. It is not possible to say *precisely* what he would have done, but I am satisfied that what I have set out below is fair and reasonable given Mr T's circumstances and objectives when he invested.

### **what should Reid Scott & Ross Limited do?**

To compensate Mr T fairly Reid Scott & Ross Limited should:

- Compare the performance of Mr T's investment in the offshore bond with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investment. If the *actual value* is greater than the *fair value*, no compensation is payable. It should also pay any interest, as set out below.

If there is a loss, it should pay such amount as may be required into Mr T's pension plan, allowing for any available tax relief and/or costs, to increase the pension plan value by the total amount of the compensation and any interest.

If unable to pay the total amount into Mr T's pension plan, it should pay that amount direct to Mr T. 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 use Mr T's marginal rate of tax at retirement.

For example, if Mr T 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 T would have been able to take a tax free lump sum, the *notional* allowance should be applied to 75% of the total amount.

- In addition, it should pay Mr T £200 for the trouble and upset caused by his discovery that the investment was a UCIS (and therefore unsuitable), as well as his inability to withdraw his money when he anticipated he would be able to.
- Give the details of the calculation to Mr T in a clear, simple format.

Income tax may be payable on any interest awarded.

investment name	status	Benchmark	from ("start date")	to ("end date")	additional interest
Offshore bond	still exists	for half the investment: FTSE WMA Stock Market Income Total Return Index; for the other half: average rate from fixed rate bonds	2 April 2009	date of calculation	8% simple a year from date of calculation to date of payment

### ***actual value***

This means the actual amount payable from the offshore bond at the end date, i.e. its surrender value.

My aim is to return Mr T to the position he would have been in but for the unsuitable advice. This is complicated where an investment is illiquid (meaning it could not be readily sold on the open market) as in this case. It would be difficult to know the *actual value* of the investment. In such a case the *actual value* should be assumed to be nil to arrive at fair compensation. It should take ownership of either the illiquid investment or

the bond by paying a commercial value acceptable to the bond provider. This amount should be deducted from the total payable to Mr T and the balance be paid as I set out above.

If unwilling or unable to purchase the investment the *actual value* should be assumed to be nil for the purpose of calculation. The firm may require that Mr T gives an undertaking to pay it any amount he may receive from the investment in the future.

#### ***fair value***

This is what the sum invested in the offshore bond would have been worth at the end date had it achieved a return in line with the benchmark.

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, it 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. Apply those rates to the investment on an annually compounded basis.

Any additional sum paid into the offshore bond should be added to the *fair value* calculation from the point in time when it was actually paid in.

Any withdrawal, income or other payment out of the offshore bond 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.

#### **why is this remedy suitable?**

I have chosen this method of compensation because:

- Mr T wanted capital growth with a small risk to his capital.
  - The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to his capital.
  - The WMA index is a mix of diversified indices representing different asset classes, mainly UK equities and government bonds. It would be a fair measure for someone who was prepared to take some risk to get a higher return.
  - I consider that Mr T's risk profile was in between, in the sense that he was prepared to take a small level of risk to attain his investment objectives. So, the 50/50 combination would reasonably put Mr T into that position. I do not mean that Mr T would have invested 50% of his money in a fixed rate bond and 50% in some kind of index tracker investment. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mr T could have obtained from investments suited to his objective and risk attitude.
- Mr T has not yet used his pension plan to purchase an annuity (or take other benefits).

#### **further information**

The information about the average rate can be found in the 'Statistics' section of the Bank of England website under 'Interest and Exchange Rates Data' / 'Quoted household interest rates' / 'Deposit rates' / 'Fixed rate bonds' / '1 Year'.

Information about the WMA index can be found on the Wealth Management Association or the FTSE Group websites.

Some examples of how the calculation should be carried out are available on our website under 'Publications' / 'Online Technical Resource' / 'Investment' / 'Calculating compensation in investment complaints'.

#### **my provisional decision**

My provisional decision is that I uphold this complaint.

**Terry Connor  
ombudsman**