complaint

Mr C has complained about advice given by W H Ireland Limited (WHIL) to invest monies into a Livestock Technology Solutions (LTS) Fund and a Data Technology Resource Group Limited (DTRG) holding.

background

WHIL completed a fact find with Mr C in November 2007 which recorded that Mr C:

- Was the managing director of a family business with a 50% ownership of the company.
- Had a basic salary of just over £41,000.
- Was born in 1961.
- Was not married and did not have any financial dependents.

There was also a form headed "D*escription of investment risk" which set out f*ive categories of attitude to investment risk, from *"Defensive – Lower Risk"* to *"Aggressive – Higher Risk"* with a description for each. The fourth category was '*Growth – Higher Risk*, described as:

- *Investor priority is long-term real capital growth.*
- *Total return expectations are for capital growth comfortably ahead of inflation over the investment term. Capital values will fluctuate over short and medium term.*
- *Appropriate for long term investors (up to 10 years).*
- *The portfolio will hold mainly equities, property and, where suitable, alternative assets with a minority of fixed interest securities.*

''*Aggressive – Higher Risk'* was the fifth category, described as:

- *Investor priority is maximum capital growth.*
- *Total return expectations are commensurate with higher risk assets, i.e. significant increases in capital values in inflation-adjusted terms. Capital values will fluctuate to a high degree over medium term.*
- *Appropriate for very long term investors (greater than 10 years).*
- *Equity based investments and alternative assets will be used almost exclusively.'*

Under *"investment objective"* it was recorded that Mr C was looking to invest over a term of 5 – 15 years and that his attitude to investment risk was *"Growth for majority. Small exposure to aggressive.'*

Mr C made an investment of £30,000 into the LTS fund in January 2008 and an investment of £1,000 into the DTRG fund in August 2009.

The investment in LTS was an unquoted share purchase in a private company. The information memorandum said:

LTS is seeking to position itself as providing both Defra and the UK farming community with a total solution for the electronic recording of livestock movement and registration. Moreover, this service will be enhanced by providing a full genealogy service to pedigree breeders that provides full 'cradle to grave' livestock history data in addition to taking advantage of other cross-selling opportunities …. such as the selling of animal feeds, fuel oil and other farming products and services.'

The DTRG investment was also an unquoted share purchase in a private company, of which Mr C's adviser was a director. According to the adviser DTRG was incorporated with a view to buying the assets of LTS. Shares were issued at no cost to investors in LTS and an offer to existing shareholders to purchase more shares was then made by DTRG. Mr C took up the offer and purchased 1000 cumulative redeemable preference shares of £1 each.

Mr C subsequently had concerns about the investments and complained to WHIL. In response WHIL stated no advice had been given but that the adviser had told Mr C that he was having "a punt" on the LTS investment and that Mr C had independently decided to do likewise. Mr C did not agree with that version of events and referred his complaint to us.

One of our adjudicators investigated Mr C's complaint and concluded that advice was given to Mr C by WHIL to invest in the LTS and DTRG holdings, that Mr C acted with reliance on that advice and that Mr C would not have effected investments but for that advice. The adjudicator further considered that the investments were inappropriate for a retail client in Mr C's circumstances.

In its response to the assessment WHIL said that Mr C:

- Had previously purchased shares in 'private equity, equities and collectives'.
- Was presently a director and had previously been a director of a number of firms.
- Had specifically instructed the purchase of 'Index Linked Government Stocks 2024 and 2025' on an execution only basis.
- Had 14 years until his selected retirement age and his objective was for growth.

WHIL did not agree with the adjudicator's recommendation that redress should be paid in line with the APCIMS Growth (Total Return) Index (as it was then known). WHIL said that the underlying assets of that index were inconsistent with a cautious attitude to risk. If the index fairly represented Mr C's attitude to risk then this indicated that the funds were suitable.

WHIL also said that new evidence had come to light. It had contacted the adviser who had said that Mr C regarded himself as 'sophisticated' in the context of investing. It provided a copy of what it described as a *'sophisticated' investor certificate as per Section 238 FSMA 2000.'* That was a document headed '*Pro-forma Certificate re: Sophisticated Investor'* signed by the adviser and dated December 2007 certifying that Mr C was '*sufficiently knowledgeable to understand the risks associated with investments of the following kind*' and listing equities, private equity and collectives.

WHIL produced some other documents, all also dated December 2007, including:

- An LTS adviser document titled "*Letter of Engagement for Services"* confirming that Mr C's adviser was promoting the LTS investment '*only to those individuals who we believe are 'High Net Worth Individuals' or 'Sophisticated Investors' for the purposes of the Financial Services and Markets Act (Financial Promotion) Order 2001*.'
- An *Investor Declaration* indicating (on the second page) that the approximate net worth or value of Mr C's portfolio was between £500,000 and £1,000,000. It included a 'Notice of Acceptance' signed by Mr C confirming that he had 'sufficient understanding of investments and markets and of the risks involved as an Intermediate Customer.' It went on to say that he understood he would not benefit from the protection offered to private customers by the FSA (the Financial Services Authority as it then was) and that he would lose the right to access this service or FSCS (the Financial Services Compensation Scheme).

- A '*Pro-forma Certificate re: Sophisticated Investor*' in which the adviser confirmed that he was an authorised person within the meaning of FSMA and that he certified that Mr C was 'sufficiently knowledgeable to understand the risk associated with investments of the following kind:' and listed equities, private equities and collectives.

This further information was shared with Mr C. He commented:

- He had been complimented by the adviser as to his basic understanding of investments and told that he was 'obviously not a novice'. But, had he been an experienced investor, he would not have needed to pay for advice. He had, in common with others his age, previously bought some privatisation shares.
- Other than the family business of which he has been a director for 30 year, he was a director of a friend's company but has since resigned and a director of a company he set up to promote internet sales at the family business but this company was closed after 18 months.
- He had twice specifically instructed the purchase of Government Stocks because he had lost all faith in WHIL but wanted his pension fund to be invested without risk until he could get independent advice.
- His objective was indeed for growth but he has managed decent growth with index linked securities and they are not high risk. He said he did not understand how wanting growth could be interpreted as only high risk growth.
- He was pleased that '*after months of denying that advice was given'* WHIL had produced paperwork to confirm that advice was given.

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 reached similar conclusions to those of the adjudicator in that I agree that advice was given by WHIL, that the advice was unsuitable and that WHIL should redress Mr C for losses sustained by him in relying on WHIL's advice.

WHIL initially contended that no recommendation to invest in the LTS fund was given and that what was said by the adviser was in an informal or social context only. But the further documentation more recently produced by WHIL confirms that the adviser did promote the LTS investment to Mr C.

I say that because, if the adviser was only acting as a friend of Mr C's and not in any formal capacity, then I do not see that the adviser would have asked Mr C to complete the various forms that he did. As discussed below, those forms were aimed at demonstrating that Mr C was a person to whom the LTS investment could be promoted. The adviser has also confirmed that he passed a copy of the information memorandum about the LTS investment to Mr C. It therefore seems clear that the adviser did promote the investment to Mr C.

But, that aside, the Letter of Engagement for Services appears to put the matter beyond doubt. It refers to the LTS investment having been brought to its (ie the adviser's) attention by the sponsors of LTS. And that the adviser has '*made this opportunity known only to those individuals who we believe are 'High Net Worth Individuals' or 'Sophisticated Investors' for the purposes of the Financial Services and Markets Act (Financial Promotion) Order 2001*.' It goes on to say the adviser's role is to *'source and introduce these investments to individual investor client(s)*.' So I think it clear that the adviser was engaged to and did promote the LTS investment.

By way of background, generally financial promotions can only be made by authorised persons unless the promotion has been approved by an authorised person (section 21 of FSMA) or the promotion falls within an exemption under the financial promotion regime – the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the 2001 Order) was revoked and re-enacted, with certain amendments, by the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 2005 Order) which came into effect on 1 July 2005 (and so was in force at the time the advice to invest in LTS was given).

The adviser was an authorised person and so was able to promote the LTS investment. But in doing so he needed to ensure that he complied with the relevant COBS provisions, in particular, COBS 4.2.4G(1), 4.5.2R(2), 4.5.2R(4) and 4.5.7. Amongst other things the adviser needed to satisfy himself that the risks were sufficiently prominent, that the key drawbacks were adequately explained and that the promotion was clearly targeting a suitable audience. It is clear from the letter of engagement that the adviser knew that the investment was not for the general public and was only to be promoted to certain clients, specifically high net worth individuals and/or sophisticated investors.

The second page of the Investor Declaration indicates that the approximate value or net worth of Mr C's portfolio was between £500,000 and £1,000,000. Article 48 of the 2005 Order denotes a high net worth individual as someone whose annual income in the financial year immediately preceding the date of the certificate is £100,000 or who has held assets to the value of £250,000 or more (not including the person's primary residence, rights under certain insurance contracts and pension benefits). I do not know if the estimate given for Mr C included the value of his home and pension rights but on the assumption that it did not he may have qualified as a high net worth individual.

But article 48 requires the individual to have signed a statement in prescribed form as set out in Part I of Schedule 5 of the 2005 Order. The 2001 Order also required a prescribed form of wording to be used. WHIL has not produced anything to show that Mr C signed a correctly worded statement. Article 48(3) (of the 2005 Order) provides that the validity of a statement is not affected by a defect in the form or wording of the statement. But it goes on to say that the defect must not alter the statement's meaning and certain wording must be included – an acknowledgement that the individual can lose his property and other assets from making investment decisions based on financial promotions. I have not seen anything to indicate that Mr C signed the requisite statement.

WHIL's main argument seems to be that Mr C was a sophisticated investor. Articles 50 and 50A of the 2005 Order refer to certified sophisticated investors and self certified sophisticated investors respectively.

Article 50(1)(a) requires a certificate signed by an authorised person to the effect that the investor is sufficiently knowledgeable in relation to the investments set out to understand the risks associated with that description of investment. But, under article 50(1)(b),the investor is also required to sign a statement in prescribed form. Again there is provision (in the 2005 Order) for the statement not to be invalidated by any defect, provided its meaning is preserved.

The Pro Forma Certificate re Sophisticated Investor which the adviser signed in December 2007 could amount to the requisite certificate. But it is not accompanied by the necessary statement in the prescribed wording or equivalent signed by Mr C. So I do not think that WHIL can rely on the statement as showing that Mr C came within the certified sophisticated investor exemption and such that the LTS investment could be promoted to him.

Article 50A of the 2005 Order refers to self certified sophisticated investors defined as meaning an individual who has signed within the previous 12 months a statement complying with Part II of Schedule 5 of the Order. I have seen nothing to suggest that Mr C signed a self certification statement whether in the requisite form or otherwise.

In saying that I have considered the terms of the 'Notice of Acceptance' which Mr C did sign. It refers to a loss of protections – access to this service and to FSCS. But it refers to an entirely different category of client – intermediate customer. Looking at the glossary definition of intermediate customer I cannot see that Mr C met any of the categories set out unless he was an expert private customer classified as an intermediate customer under COB 4.1.9R. Under that rule a firm could classify a client who would otherwise have been a private customer as an intermediate customer. The firm was required to take reasonable care to determine that the client had sufficient experience and understanding to be classified as an intermediate customer and warn him that he would lose various protections under the regulatory system.

The reference is to an 'expert' client. Even if Mr C did have some understanding of investments I do not see how he could reasonable have been classified as an expert and such that he met the definition of an intermediate client.

That said, the regulatory regime changed with effect from 1 November 2007 and new client categories were introduced. Clients that might previously have been referred to as intermediate customers are now professional clients. Given that the 'Notice of Acceptance' was signed at the end of December 2007 the correct client classification ought to have been professional client, rather than intermediate customer. But I do not think that WHIL would have been justified in classifying Mr C as a professional client.

WHIL has also referred to the sophisticated investor statement '*as per section 238 of FSMA 2000*'. Section 238 relates to the promotion of collective investment schemes and precludes promotion by an authorised person unless a relevant exemption is available. Some of the exemptions are equivalent to those contained in the 2005 Order (high net worth individuals and certified sophisticated investors). So it is part of the promotions regime but with specific reference to collective investment schemes.

The upshot is that I do not think that the adviser should have promoted the LTS investment to Mr C – he was not properly classified as a sophisticated investor. Firstly, the adviser did not ensure that the necessary documentation was properly completed. Secondly, and in any event, I do not see that Mr C's investment experience and understanding was such that he ought properly to have been regarded as a sophisticated investor.

I have spent some time exploring the question of promotion and I have found that the adviser did promote the LTS investment to Mr C when he should not have done. But that still leaves the question of whether the adviser gave advice – did he recommend that Mr C invest in LTS? In deciding whether advice was given I have considered all the circumstances before reaching a finding on the balance of probabilities, ie what I consider is more likely to have occurred.

There is no recommendation letter which might suggest that no advice was given. Nor are there any formal meeting notes which might record exactly what was discussed in relation to the investment and the context in which what the adviser expressed any view on the investment.

Again the absence of such a note might support a finding that no formal advice was given. But the absence of a recommendation letter and/or record is not of itself determinative of no advice having been given. Nor is the fact that no commission appears to have been paid to WHIL conclusive.

Mr C's position is that the adviser recommended the investment. It is not denied that there was an advisory relationship between Mr C and the adviser – the latter had advised Mr C about his pension arrangements in November 2007 – only a matter of weeks before the LTS investment was made.

Further, like the adjudicator, I note that the adviser himself says that '*as a friend, and an IFA, I merely gave* [Mr C] *my opinion of the opportunity*.' Given what I have said about Mr C's pre-existing advisory relationship with the adviser, I think Mr C would reasonably have understood that what the adviser said about the investment was in his capacity as Mr C's financial adviser. I note that there is no suggestion that the adviser sought to qualify what he said or make it clear that he was merely giving a personal opinion, which did not amount to a recommendation and upon which Mr C ought not to rely.

It is now clear that the adviser had more involvement in the LTS investment than initially appeared – I am satisfied that he promoted it. And it seems that the adviser accepts that there was some discussion about the investment. I think it more likely than not that what he said about the opportunity amounted to a recommendation or advice to invest – I do not see that Mr C would have gone ahead had he not understood that the adviser was recommending the investment.

And although no commission appears to have been received by WHIL, the investment was placed through them. Mr C sent a cheque made payable to LTS which was forwarded by WHIL. That suggests that WHIL knew about and was instrumental in bringing about the investment which is consistent with WHIL having recommended it.

So all in all I agree with the adjudicator that it is more likely than not that advice was given.

I have therefore gone on to consider whether a recommendation that Mr C invest £30,000 in the LTS investment was suitable for him.

I am satisfied that Mr C was aware of the fact that the investment was of a higher than moderate risk. However, I am not satisfied that WHIL made Mr C aware of all of the risks associated with the investment it promoted and recommended – in particular, that he could suffer a total loss of capital.

It was not, in my opinion, sufficient to provide a copy of the information memorandum to a retail client such as Mr C. This was a complex financial investment and WHIL ought to have highlighted all the various advantages and disadvantages. I note that page 22 of the information memorandum contained a 'SWOT Analysis' setting out the perceived strengths and weaknesses of the proposed venture. But as I have said, I do not regard it as sufficient merely for Mr C to have been provided with a copy of the information memorandum and left to make up his own mind as to the risks involved. The information memorandum is somewhat akin to a sales brochure and is couched in positive terms. The weaknesses and threats are somewhat less in number than the strengths and opportunities listed. To some extent the risks involved in a new venture, with no operating history and aimed at a specialist market are underplayed.

I think it ought to have been clear that the unusual and specialist nature of the investment meant that it could suffer significant losses. That should have been recognised and discussed with and explained to Mr C before deciding to go ahead with the investment. Given that there is no recommendation letter and no note of the meetings with Mr C it is difficult to gauge the extent to which, if at all, the risks of the investment were explained and made clear to Mr C.

That said, even if I was satisfied that a proper explanation as to the risks had been given, I would not regard the investment as suitable for Mr C.

I acknowledge that he was recorded as wanting to invest the majority of his fund for growth. But I do not think that the assessment is entirely credible. I think that growth would be an objective for many investors and I do not think that a desire for growth necessarily indicates that an investor is seeking maximum growth opportunities, such as are generally commensurate with high risk investments. I do not regard the description of the 'Growth – Higher Risk' category as particularly illuminating. I am not satisfied that in selecting that category Mr C was agreeing and understood that his capital would be exposed to the degree of risk that this investment represented.

I do not think that the adviser should have proceeded on the basis that his and Mr C's understanding as to what that attitude to risk meant were the same. WHIL should have explored with Mr C whether he fully understood the degree of risk entailed and whether, given his circumstances, he was in a position to take that level of risk.

Advice should not be given on the basis of what a client appears to want but, using the adviser's professional expertise, experience and judgment, what the adviser considers the client, given his particular circumstances, should do. If a retail client expresses a wish to effect certain investments then an adviser is still expected to assess suitability and advise accordingly unless acting on an insistent client basis. I am not satisfied that Mr C would have invested in the LTS fund, but for WHIL recommending that he did so.

Overall, I take the view that the recommendation to invest in LTS exposed Mr C's capital to significant risks and that this was not commensurate with the degree of risk that was appropriate for a retail client in Mr C's circumstances.

I turn now to the investment in DTRG. There is very little information available but I note that the offer to purchase the preference shares was made direct to Mr C by DTRG. The letter is signed by the adviser whose position is that his dealings with Mr C in connection with the LTRG investment were not as WHIL's representative but as a director of DTRG and that no advice was given.

But Mr C says differently and that he was persuaded to invest on the premise that he would receive a 5% annual return and that a percentage of his original investment (in LTS) would be returned.

I see no real reason to doubt what Mr C says and I am prepared to accept that advice was given by the adviser in his capacity as Mr C's financial adviser. I think it is somewhat artificial to expect Mr C to be aware of any distinction between the adviser acting as such and in some other capacity – I think that Mr C would have been justified in understanding that what the adviser said about the DTRG investment amounted to advice, as Mr C's financial adviser.

I think the letter dated 3 December 2009 sent by WHIL on the adviser's behalf (during his absence from the office) supports that. It enclosed fund sheets for all funds held in Mr C's SIPP and then went on to deal with the DTRG investment. A business update was apparently attached although I have not seen a copy. But the letter gives considerable detail about DTRG and how the company intended to move forwards. I do not think that the letter is consistent with Mr C having only dealt direct with DTRG. Rather the letter reads as an update on an investment which the adviser had recommended. If, as suggested, Mr C's dealings with DTRG had been with that company direct then I would have thought that the letter would have referred him to DTRG if he wanted an update.

But in any event I see the DTRG investment as a consequence of the LTS investment. In my views the DTRG investment was an attempt by Mr C to recoup some of his losses. Mr C was trying to mitigate his losses, albeit that he was unsuccessful, and the investment in DTRG only came about because of the original investment in LTS. In the circumstances WHIL is also responsible for Mr C's loss in connection with the DTRG investment.

Where, as here, I consider unsuitable advice has been given, my aim in awarding redress is to put Mr C, as far as possible, in the position in which he would have been, had suitable recommendations been made.

I am unable to say exactly how Mr C's monies would have been invested had suitable advice been given. But I am satisfied that he would still have invested for a return and that the monies this complaint concerns would have been exposed to a higher than moderate degree of investment risk in the hope of generating preferential returns.

I agree with the redress methodology suggested by the adjudicator. Accordingly redress should be based on what the sums invested in LTS and DTRG would now be worth, had a return in line with the FTSE WMA Growth (Total Return) index been achieved.

I have noted WHIL's comments as to why the use of that index is not appropriate. Although I am not sure that Mr C fully understood the level of risk to which his money would be exposed if invested in line with the '*Growth – Higher Ris*k' and '*Aggressive – Higher Risk*' categories selected, I am satisfied that he was willing to take an above moderate degree of investment risk with the monies in question. Indeed he appears to have acknowledged as much. But the LTS investment was a very unusual investment with significant risks, including the risk of total capital loss. I am not convinced, had Mr C been given a proper explanation of the risks involved, that he would have invested the amount he did in LTS. I think the index suggested represents a diversified spread of higher risk holdings and so is appropriate.

As set out below WHIL is entitled to take into account and reliefs that Mr C has enjoyed. Mr C's accountant has told us that EIS relief was claimed on the LTS investment and tax relief of £6,000 given. In calculating the redress below WHIL may need to revert to Mr C or his accountant for further details such as the date upon which the relief was given.

my final decision

I uphold this complaint and I direct W H Ireland Limited to do the following:

1) Ascertain what £30,000 invested on 7 January 2008, with an additional investment of £1,000 on 14 August 2009, would be worth as at today's date, had it enjoyed a return equivalent to the FTSE WMA Growth (Total Return) index.

In calculating this sum W H Ireland Limited should make a deduction for any tax relief Mr C has enjoyed by his having invested in the LTS and DTRG arrangements. The deductions for such reliefs are to be considered to have occurred on the date on which they were actually enjoyed. The value of such investments less any reliefs is to be termed (A).

2) W H Ireland Limited should also pay interest at 8% simple on (A) (or any part thereof) which remains unpaid after 35 days after W H Ireland Limited has been notified by this service of Mr C's acceptance of this decision.

3) W H Ireland Limited may make the payment of (A) plus interest contingent on Mr C agreeing to the ownership of any residual holdings he might have in either LTS or DTRG being transferred to it. If any problems occur with effecting this change of ownership then a suitable alternative would be to make the payment of (A) plus interest to be made contingent on Mr C first providing W H Ireland Limited with a written undertaking. That written undertaking is to be to the effect that Mr C will pay W H Ireland Limited a sum equivalent to any monies realised, from today's date onwards, from his LTS and DTRG holdings.

Mr C will be expected to co-operate fully with W H Ireland Limited in assisting it to obtain any information it might need so as to calculate and then pay the appropriate level of redress to him. For example, if it needs his written authority to obtain information from a third party (such as Mr C's accountant or tax office) then this service would expect him to provide such authority promptly.

Lesley Stead
ombudsman