complaint

Mr P's complaint is about redress offered to him by AFH Independent Financial Services Limited (AFH) for gaps in its discretionary management of his Investment Bond and Individual Savings Account (ISA) portfolio.

background

Prior to 2010 AFH managed Mr P's bond and ISA portfolio on an advisory basis, under its Portfolio Management Service (PMS). In September 2010 they were both moved into AFH's Discretionary Management Service (DMS).

The bond was surrendered in July 2016. In September 2016 AFH conducted a rebalancing of the ISA portfolio. In doing so it says it discovered that there was no evidence that the portfolio and the bond had been rebalanced since June 2012. It wrote to Mr P in December 2016 to notify him of this and to offer compensation of £1,825.12 – a refund of the total DMS charges for the period between June 2012 and September 2016. The idea being that a refund was due because Mr P had not received the DMS service during this period.

Mr P considered the offer insufficient and, in December 2016, complained to AFH. He said the offer did not reflect returns that his portfolio and bond had lost due to the absence of management and that he expected an improved performance with the DMS. AFH said a refund of the DMS charges was a fair basis for compensation – it distinguished this from commission from the bond provider which it said was unrelated to the DMS charges. In terms of performance loss, it said there was no loss because the portfolio and bond had outperformed what it considered to be an appropriate benchmark, for comparison purposes, provided by Asset Risk Consultants (ARC).

Mr P disagreed. In the main, he said:

- It is inherent within the DMS arrangement that he should have received an incremental benefit from it – this element being absent from the compensation offer.
- The ARC benchmark is inappropriate because it was not the performance benchmark for the DMS arrangement at the outset – so it was inappropriately being applied retroactively. Furthermore, the ARC based calculation had failed to capture additional investment(s) he had made during the period.
- Calculation of the charges refund cannot be verified as the charges were not transparent.
- There was no evidence of rebalancing in June 2012 as AFH claimed and he considers that the gap in DMS management began at the outset in 2010 – and ran up to AFH's discovery in 2016.

Mr P considered that AFH's responses to these points were inadequate so he referred the matter to this service. One of our adjudicators considered it and, in the main, concluded as follows:

- Mr P is correct in terms of additional investments missing from AFH's calculation. Two top up payments of £5,000 each were made into the portfolio in March 2012 and April 2013 respectively and the calculation missed them.
- The ARC benchmark does not adequately reflect the composition of the portfolio and bond, so it is an inappropriate benchmark and should be substituted with the FTSE Private Investors Total Return (PITR) Index. Use of this particular index is consistent

with the approach for redress benchmarks in this service for an investor willing to take some risks but not high risks. This is comparable to the "realistic" risk profile that he had for the DMS arrangement.

- Redress, in terms of performance, should be calculated from 19 June 2012 (when AFH said the last rebalancing was done) for both investment and up to 27 July 2016 (when the bond was surrendered) for the bond and 29 September 2016 (when the ISA portfolio was rebalanced) for the portfolio. It should be based on the starting values of both investments (within the DMS arrangement) and should include the portfolio top up payments. Interest should be added. There could be a correlation between performance redress and compensation for fees/charges if the redress amount is the same or less than any total charges refund due to Mr P. If so, no performance redress would be due because the FTSE PITR index produces a fair value that excludes charges/fees, so deduction of the equal or higher value of any total charges refund would cancel it out.
- More information is required to determine when the DMS gap began and to determine the calculation of the charges refund that Mr P is entitled to.
- Mr P was not *guaranteed* an incremental benefit from the DMS arrangement so this specific point should not succeed.
- Mr P should be given £200 for the trouble and upset caused to him.

AFH agreed to this partial outcome and additional information was provided to the adjudicator. Mr P disagreed on the following points:

- He retained his argument in terms of compensation for loss of an incremental benefit and said his losses were more than the effect of AFH's failure to rebalance his investments.
- He said his risk profile at the outset was "realistic to aggressive" so the benchmark should reflect this.
- He was not persuaded by some of the adjudicator's comments about AFH's rebalancing obligations or by the notion that contract notes and investment reports indicate management activity.

The adjudicator then provided a revised and more complete view, having considered additional evidence. He made some changes and additional conclusions. In the main, he said:

- Diary sheets between 5 November 2010 and 5 November 2012 show that there was management activity in the investments during this period. The same applies for diary sheets between 30 September 2016 and 17 January 2017. Contract notes from 2010 and up to 2012 were reasonably aligned with the diary sheets but contract notes in 2013 were not. In conclusion, the gap in management for both investments began from 5 November 2012 (not 19 June 2012 as previously stated) and the portfolio top up payment in March 2012 should be excluded from the redress and charges refund calculations. The contract notes also show that even though the ISA portfolio was reviewed in September 2016 corrective action did not take place until 19 October 2016, so this date (19 October 2016) should be the new end date for its performance redress calculation.
- Considered in the context of discretionary portfolio management, there was enough evidence to conclude that the DMS arrangement had been in effect up to November 2012. Mr P's points relate less to rebalancing and reviewing of the investments, at AFH's discretion, and more to conducting review meetings with him – which is less

common in discretionary arrangements. Overall, evidence did not suggest that AFH had been negligent up to November 2012.
- Evidence suggests that Mr P's "realistic to aggressive" profile was set in July 2010 before the DMS arrangement. In the documents related to the arrangement in September 2010 the profile had become "realistic". The latter applies.
- Calculation of the refund of DMS charges, for the portfolio, should begin from 2 November 2012 (to align with the 5 November 2012 diary sheet evidence) and end on 19 October 2016, excluding the fee related to the April 2013 top up payment, so the total amount due would increase to £2,054.89.
- A refund of commission received by AFH for the bond is also due to Mr P. The adjudicator noted its argument that the commission was not taken from the fund but from the provider, however the adjudicator concluded that it should be refunded because during the relevant gap period it was commission that AFH received for a service it did not provide to Mr P. He said the refund should be calculated for the gap period relevant to the bond.

AFH accepted this outcome but Mr P did not. He retained the view that no active management took place between 2010 and 2016 – or that insufficient activity took place between 2010 and 2012. He also retained *his incremental benefit* point, he argued that the "1% of capital" DMS charge meant he was entitled to at least that percentage in returns and his proposal was redress in the value of £12,750, representing 1.25% of the portfolio's final value for six years. He was not persuaded that the diary evidence correlated to management activity.

Mr P appeared to suggest that an indication of the total value of redress proposed by the adjudicator might help him consider his position further. The adjudicator assisted in this respect and provided that indication, but Mr P concluded that the matter should be referred to an ombudsman as his disagreements remained.

my findings

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

I consider that the adjudicator's view letters in this matter have been comprehensive and competently presented. I also consider that the core issues have already been addressed, in those letters, in detail. Overall, I have reached the same conclusions as the adjudicator's for broadly the same reasons.

Discretionary Portfolio Management and the DMS arrangement

The adjudicator sought to explain the distinctions between a discretionary portfolio manager's roles in rebalancing of investments, reviewing of investments, switching of investments upon reviews and reviewing of a portfolio with the investor. Mr P appears to have considered the explanation surplus to requirements. This suggests he understands the relevant distinctions, so I will proceed to address evidence related to these roles.

I note a comment from Mr P about AFH's records being more detailed, seemingly to his liking, after 2016. If so, this does not mean they should have been as detailed as he appears to have expected previously. It is common within a discretionary management arrangement that all work on a portfolio will not be documented or documented in detail. This is the

context in which I have considered the diary and contract notes evidence. Firms can and will differ in the level of detail within their records of portfolio management.

According to the diary evidence, after the DMS arrangement began in September 2010 there appear to have been two reviews of the investments before the end of that year, in 2011 there were four reviews of the investments roughly spaced out quarterly, in 2012 there were three such reviews with about five months between them and then there were three reviews between September and October 2016. There are also contract notes that are broadly aligned with the reviews in November and December 2010 and November 2012. This suggests that AFH was discharging its rebalancing and reviewing roles at the time, with some switching activities.

A discretionary portfolio manager is not expected to invest or switch investments just for the sake of doing so or just for the sake of giving the semblance of activity. It is reasonable to expect that AFH's activity would have been guided by the mandate(s) for the portfolio and bond and wider market considerations. In order to establish negligence or the conclusion that no service was given between 2010 and 2012 evidence of AFH breaching its mandate(s) or evidence of action that a reasonably minded manager in its position would have taken – which AFH did not take – would be needed. I have not seen such evidence.

I note Mr P's perception of inactivity but the discretionary arrangement meant he did not have as much ongoing insight into AFH's work as I consider he would need in order to nullify the diary evidence. In this respect I mean that unless he can show (on balance) that the reviews I (and the adjudicator) have mentioned, based on the diary evidence, were devoid of any meaningful activity, I am persuaded (on balance) that they were meaningful and that their volume and frequency between 2010 and 2012 were not unreasonable.

I do not consider that Mr P has presented enough to alter this conclusion. He has argued that the previous PMS arrangement offered more reviews than the DMS did and that such a situation cannot be right. He referred to the service documentation to support this point. I do not consider that the document offers such support. In terms of the PMS arrangement, the document promises "*Recommendations made to client supported by half yearly adviser review.*" No such provision is stated for the DMS arrangement more likely (than not) because it is a discretionary service where little or no *recommendations* take place.

Overall and on balance, I am persuaded that Mr P's ISA portfolio and bond received the benefits of the DMS arrangement as they were entitled to, up to November 2012. I agree with the adjudicator's view that the start date for performance related redress should be 5 November 2012 (2 November 2012 for the DMS charges refund matter). In light of evidence of activity resuming in the ISA portfolio from 19 October 2016 I also agree with the adjudicator's conclusion (and reasons) that this should be the end date for redress related to the ISA portfolio. I consider that the end date for redress related to the bond will be when it was surrendered on 27 July 2016.

Benefit of DMS arrangement

Mr P's argument is that he is entitled to an incremental benefit of at least 1% or more, given the promises from and cost of the DMS service. I disagree. I note the manner in which the service was sold to Mr P and the positive way in which potential benefits from the service were sold to him. However, as the adjudicator noted, performance was never guaranteed. I do not consider that Mr P has a credible basis to say AFH had a contractual obligation to

deliver a certain level of performance. In the absence of that, reference to and usage of an appropriate benchmark will be the way forward in terms of redressing Mr P's position.

Benchmark

The FTSE PITR index is the benchmark this service would usually use in calculating redress for an investor willing to take some risks but not high risks – especially in the absence of an alternative that more accurately reflects how an investment would have performed, but for mismanagement or unsuitability. I have not seen evidence of such an alternative in Mr P's case and I share the adjudicator's view on the unsuitability of the ARC benchmark proposed by AFH.

The risk profile, for Mr P, which relates directly to the documentation for, and the onset of, the DMS arrangement in September 2010 says he was "realistic". This profile sits in the middle of the profile options relevant to the arrangement, so I am satisfied that it is comparable to an investor willing to take some risks but not high risks – in which case the FTSE PITR index is appropriate. Mr P says the change in risk profile from "realistic to aggressive", as his profile was in July 2010, to "realistic" in September that year was not brought to his attention. However, he also said that his interest in the DMS service was because it was offered as "… *an enhanced process to improve management of the portfolio and minimise exposure to losses …*" and that he was "… *keen to accept this as* [he] *had made significant losses in 2008 …*" [my emphasis] It seems plausible that his risk profile was reduced in this context.

Refund of Bond commission

In straightforward terms, I agree with the adjudicator's view that redress for AFH's inactivity in managing the bond, during the relevant period and up to its surrender, should extend to a refund of this commission for the same period. It could be argued that Mr P paid indirectly, in some way, for the commission at the outset and that it is not as remote to him or his DMS arrangement as AFH has suggested.

fair compensation

In assessing what would be fair compensation my aim is to put Mr P as close to the position he would probably now be in if his ISA portfolio and investment bond had not been subjected to a gap in AFH's DMS service. I consider that *fair compensation* should address the performance of both investments during the period in which they were unmanaged, the DMS charges for the portfolio (subject to offsetting as explained above and by the adjudicator) and the bond commission payments (without offsetting, to avoid duplication). I also agree that Mr P should be given £200 for the trouble and upset caused to him.

what should AFH do?

Redress for the ISA portfolio and the investment bond

AFH must:

- Compare the performance of Mr P's investments with that of the benchmark shown below and pay the difference between the fair value and the actual value of the investments (Redress A). If the actual value is greater than the fair value no

compensation is payable. Redress A is also subject to the "Redress for the DMS charges" section below – as explained below.

- Pay interest as set out below. Income tax may be payable on any interest awarded.
- Provide the details of the calculation to Mr P in a clear, simple format.

Investment	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Standard Life Bond and ISA Portfolio	Bond – surrendered ISA Portfolio - uncertain	FTSE UK Private Investors Income Total Return Index	5 November 2012	Bond – 27 July 2016 ISA Portfolio – 19 October 2016	8% simple per year from the end dates to the date of settlement

actual value

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

fair value

This is what the investment(s) would have been worth at the end date had it produced a return using the benchmark. Any additional sum paid into the investment(s) during the period stated above should be added to the *fair value* calculation from the point in time of payment.

why is this remedy suitable?

- Mr P was willing to accept some investment risks. The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return 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 P's profile can fairly be matched with this benchmark. It does not mean that I consider he would have invested in some kind of tracker fund. Rather, I consider that the benchmark is a reasonable compromise that broadly reflects the sort of return he would have obtained, but for the gap in management.
- The additional interest is for Mr P being deprived the use of any compensation money since the end dates.

Redress for the DMS charges

AFH must:

- Provide Mr P with an account (and calculation) of each of the DMS charges/fees applied to his ISA portfolio between 2 November 2012 and 19 October 2016.

- Calculate the total value of all DMS charges/fees applied to the portfolio during this period, minus the charge of £150 on 3 April 2013 (Redress B).

- If Redress B is greater than Redress A, then only Redress B is payable to Mr P. If Redress A is greater than Redress B, then only Redress A is payable to Mr P. If Redress B is due, interest (on which income tax may be payable) applies to it at the rate of 8% simple per year from the date of this decision to the date of settlement (if it is not paid within 28 days of AFH being notified of Mr P's acceptance of the decision).

Redress for the Investment Bond's commission

AFH must:

- Provide Mr P with an account (and calculation) of each commission payment it received in relation to Mr P's investment bond between 1 November 2012 (because evidence suggests commission payments were made on the first of the month) and 27 July 2016 (when the bond was surrendered).

- Calculate the total value of all of the commission payments it received in this respect and pay that total in compensation to Mr P. Interest (on which income tax may be payable) applies at the rate of 8% simple per year from the date of this decision to the date of settlement (if this compensation is not paid within 28 days of AFH being notified of Mr P's acceptance of the decision).

Trouble and upset

AFH must pay Mr P £200 for the trouble and upset caused to him in this matter.

my final decision

For the reasons given above, I uphold Mr P's complaint and I order AFH Independent Financial Services Limited to compensate him as set out above. Under the rules of the Financial Ombudsman Service, I'm required to ask Mr P to accept or reject my decision before 19 August 2018.

Roy Kuku
ombudsman