

complaint

Mr S has complained about the advice over a period of time from S4 Financial Ltd (S4) to invest in a number of property schemes which he considers were inappropriate for his circumstances. This complaint concerns the advice to invest in the Merchant Place Property Partnership 47 ('MP47'), which he considers to have been unsuitable.

background

On advice from S4, Mr S made pension transfers totalling around £270,000 to a Self-Invested Personal Pension (SIPP) plan, commencing in 2005. He also started making large quarterly contributions.

In August 2005, Mr S invested £50,000 in MP47. He also invested his SIPP in other unregulated investment schemes.

MP47 was an unregulated collective investment scheme (UCIS). It planned to invest in six German supermarkets. These investments would be funded by a bank loan of up to 75% of their value. The returns on the investments would be highly geared.

The value of the investment in MP47 later fell. By 2013, its value was estimated to be around £11,000.

Mr S complained in mid-2013. S4 responded, saying that it had been able to promote the scheme to him, and that it had been suitable. It said that he had been an aggressive investor, and that he had understood the nature of the scheme. It also said that he had a reasonable to high capacity for loss.

An adjudicator assessed the complaint and considered that it should be upheld. He made the following main points:

- The Financial Services and Markets Act 2000 (FSMA) prohibited promotion of UCIS to the general public. S4 hadn't checked that Mr S was exempt. But Mr S had earned enough income to be classed as a high net worth individual. He would probably have signed a high net worth statement. A compliant promotion *could* have been made to Mr S.
- The documents said that Mr S's attitude to risk had been balanced. They also said he wanted to retire and draw an income in just over five years at age 60 in 2010. Mr S did not have enough capacity for loss. A lot of his savings were held in his pension. He would have expected to rely on his pension for income in retirement. There was a clear risk that a big loss would have an impact on his future income.
- The investment was high risk and highly geared. The documents had stated that it exposed investors to significant risk of total loss. It could also be difficult to sell the fund if Mr S needed to do so.
- The investment should be considered as part of Mr S's pension fund monies not as part of all of Mr S's assets. The purpose of the pension was to provide income in retirement, which was expected to be soon. It was distinct from his other assets. The adviser had also followed a target asset allocation in respect of the SIPP. That allocation was intended to be consistent with Mr S's attitude to risk. The adjudicator had not seen any evidence that the adviser was following a particular asset allocation across all Mr S's assets.

- Around 17% of the pension had been invested in the scheme. S4 recommended that around 8% should also be invested in another UCIS.
- By asset class around 35% had been invested in property and around 26% in equities via various collective investment schemes. The adjudicator felt that the asset allocation was not suitable for a balanced investor. He also said that it was not suitable for Mr S, as he planned to retire in around five years.

S4 did not agree. It made the following main points:

- Mr S was a balanced aggressive investor. He was willing to take more risk for greater returns as he wished to retire as soon as possible. It had been S4 who said that he should take a balanced approach.
- Mr S's intention to retire at 60 had been dependent on sale of share options. The future value of the share options was unknown, but it was expected to be significant.
- It had been expected that Mr S would draw an income rather than buy an annuity. It had also been expected that he would spend his non-pension savings first. This would keep the pension death benefits tax-free. The investment period was expected to be longer than five years.
- Mr S intended to make large pension contributions. He was also intending to make large investments outside his pension.
- Asset allocation had originally been based on the pension alone. But this was because Mr S's divorce had left him with most of his assets held in pension arrangements. The pension should be seen as a proportion of total assets.
- There had been little or no risk that rents would not be paid to the scheme. It was therefore unlikely at that time that loans would be put into default. The effects of the financial crisis were not reasonably foreseeable.
- The other UCIS fund Mr S had invested in was very different. It could not be compared to the property scheme.
- A sum had been earmarked for a further property investment. That sum was later used to invest in another unregulated property scheme. But at the time the actual investment had not been chosen.
- Including non-pension savings and expected employer contributions, the allocation to the UCIS had been less than 10%.

The adjudicator considered these points but his view didn't change. He made the following main points:

- The suitability report stated that Mr S's attitude to risk was balanced. The adjudicator stated that his view wouldn't have changed if he agreed Mr S's attitude was balanced aggressive.
- Mr S had said that he intended to rely on his pension in retirement. The financial report had stated that he intended to draw an income from age 60. He had not seen any mention of Mr S planning to leave the plan untouched until 75. He did not believe that the non-pension savings could reasonably have been expected to support Mr S for that long. The report had also stated that exercising share options would allow for an injection into the plan.
- Most of Mr S's savings were in his pension plan, and he intended to make significant contributions from his income. The adjudicator could not see how Mr S could have expected not to rely on his pension until 75. He still felt that Mr S had expected to draw an income from age 60. Therefore, he felt investing large sums in risky, unregulated, potentially illiquid schemes had been unsuitable.

- Mr S intended to make large contributions in the future. However, these could not be taken into account when considering whether the proposed asset allocation was suitable at the point an investment was made.
- Mr S's personal and financial circumstances had changed significantly since 2005. But the change in his financial circumstances could not have been foreseen.
- He still felt that the investments should be considered proportionally to the pension. That approach was consistent with the approach taken by this service in other similar cases. He also still felt that the scheme was high risk.
- The adjudicator noted that as a proportion of contributions made and transfers expected, the two UCIS investments represented around 24% of the pension. He argued this would be too high in any circumstances and particularly in Mr S's.
- He accepted that the £30,000 earmarked for a property opportunity had been held in cash. But he pointed out that the documents indicated that a similar investment to the Merchant Place scheme was anticipated. He argued that the initial investment would be unsuitable regardless.

As agreement has not been reached the complaint has been referred to me for a decision.

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 come to the same conclusions as the adjudicator, for the same reasons.

S4 does not appear to have promoted the scheme lawfully. But I agree with the adjudicator that it probably could have done. Mr S's loss cannot be attributed to its failure to promote the scheme properly.

In 2005, Mr S (then aged 55) wished to retire as soon as possible. His pension fund was at that time worth about £270,000. He intended to make quarterly contributions of £16,750, and potentially further one-off contributions. Although he held share options, their future value was uncertain. Mr S has stated that he expected to rely on his pension in retirement and in my opinion the documents support this.

A high earner would normally require a high level of retirement income in order to maintain his or her lifestyle. Mr S appears originally to have intended to draw £60,000 p.a. The future performance of the plan was of course uncertain. But it seems to me that this could reasonably have been expected to be a fairly high rate of income withdrawal.

The proposed UCIS was going to use significant levels of bank borrowing in the hope of improving the returns to investors if the underlying assets rose in value. However it also increased the loss to the investors if the value of the underlying assets fell in value. There is an increased risk that the investment might be difficult to sell. It had no set term. In my opinion the investment was inconsistent with Mr S's retirement plans.

The UCIS documents stated that investors were exposed to the significant risk of losing their capital. The documents indicate that Mr S's attitude to risk was balanced. S4 said that Mr S was willing to take more risk in order to be able to retire as soon as possible. I do not think that the potential for significant gains could reasonably justify the significant risks. Substantial losses would have an impact on his income throughout his retirement.

I agree with the adjudicator that the pension was not invested in line with Mr S's attitude to risk. And that the advice did not take proper account of his coming retirement. Following S4's advice, Mr S invested around 25% of his pension in UCIS funds. I do not consider he had sufficient capacity for loss to commit a substantial proportion of his pension to investments of this type.

I note that in 2010 the regulator said in a speech that:

'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.'

Whilst this was after the investments had been made on Mr S's behalf in my opinion the message that was being highlighted clearly applies to Mr S. The investments were speculative. Investing a high proportion of Mr S's pension in such investments was unsuitable.

In my opinion Mr S should not have been advised to invest in the Merchant Place Property Partnership 47.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr S as close to the position he would probably now be in if he had not been given unsuitable advice.

I take the view that Mr S would have invested differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr S's circumstances and objectives when he invested.

what should S4 do?

To compensate Mr S fairly, S4 must:

- Compare the performance of Mr S's investment 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.

S4 should also pay interest as set out below.

If there is a loss, S4 should pay such amount as may be required into Mr S'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 S4 is unable to pay the total amount into Mr S's pension plan, it should pay that amount direct to him. 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 S's marginal rate of tax at

retirement.

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

- Pay to Mr S £100 for distress and inconvenience caused by the unsuitable recommendation.

Income tax may be payable on any interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
Merchant Place Property Partnership 47	still exists	FTSE WMA Stock Market Income Total Return Index	date of investment	date of my decision	8% simple per year from date of decision (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value

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

My aim is to return Mr S 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. S4 should take ownership of the illiquid investment by paying a commercial value acceptable to the pension provider. This amount should be deducted from the total payable to Mr S and the balance be paid as I set out above.

If S4 is unwilling or unable to purchase the investment the *actual value* should be assumed to be nil for the purpose of calculation. S4 may wish to require that Mr S provides an undertaking to pay S4 any amount he may receive from the investment in the future.

fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark.

Any withdrawal, income or other payment out of the investment 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. If there are a large number of regular payments, to keep calculations simpler, I will accept if S4 totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because:

- Mr S wanted capital growth and was willing to accept some investment risk.
- The WMA index is made up 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.
- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr S's circumstances and risk attitude.
- Mr S has not yet used his pension plan to purchase an annuity.

my final decision

I uphold the complaint. My decision is that S4 Financial Ltd should pay the amount calculated as set out above.

S4 Financial Ltd should provide details of its calculation to Mr S in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr S either to accept or reject my decision before 15 February 2016.

Adrian Hudson
ombudsman