Financial Ombudsman Service

complaint

Mr B has complained to BlackStar Wealth Management Ltd (BlackStar) about the pension investment advice he received. He said the recommended investments were too high risk.

background

In August 2015, BlackStar recommended that Mr B transfer the benefits he held in an occupational pension scheme and two personal pensions to a self-invested personal pension (SIPP). They advised Mr B to invest into Dolphin Capital, in Best International – Lateral Eco Parks and in Beaufort Securities.

In February 2017, Mr B raised a complaint with Beaufort Securities. Their discretionary fund management service had been suspended and Mr B was worried about whether he would get his funds back. During the review of that complaint, BlackStar confirmed they advised Beaufort Securities to invest Mr B's portfolio at a risk level of nine out of ten (one being the lowest risk and ten being the highest risk).

Mr B complained about BlackStar's advice, he said the Beaufort Securities portfolio was supposed to reduce the overall risk of his investment. He was prepared to accept a medium-high level of risk, not high risk.

BlackStar said their advice was suitable for Mr B's circumstances but Beaufort Securities hadn't invested their portfolio appropriately.

An adjudicator assessed Mr B's complaint and recommended it should be upheld. He said the advice to transfer Mr B's pensions wasn't appropriate and the subsequent investments were, overall, too high risk.

BlackStar said the advice to transfer was suitable for Mr B's circumstances; his primary issue was to do with the Beaufort Securities portfolio. They had agreed to assess Mr B's loss comparing his portfolio to a recommended index. BlackStar said this should be done when the two unregulated investments had matured.

Mr B didn't accept the alternative offer made by BlackStar and asked for an ombudsman's to review his complaint.

my findings

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

The trigger for Mr B's complaint seems to have been the Beaufort Securities portfolio. BlackStar initially raised a complaint on his behalf, and when he became aware that BlackStar had instructed Beaufort Securities to invest at high risk, nine of ten; Mr B complained about the advice he received from BlackStar.

Mr B's complaint is essentially about risk. He said he'd agreed a medium-high level of risk and that he was told the Beaufort Securities portfolio was included to reduce the overall risk of his portfolio but it hadn't.

In May 2015, Mr B met with an unregulated introducer who completed a BlackStar fact find and risk questionnaire. Mr B was recorded as having five personal pension plans along with benefits in an occupational pension scheme.

Mr B’s retirement objectives were detailed as;

- consolidating the pensions for ease of administration;
- doesn’t like the current pensions being reliant on the stock market;
- concerned about paying multiple fees for multiple pensions;
- would like the pensions to ‘work harder’; and
- he was aware his funds could go up or down but was hopeful for long term growth.

A ‘SIPP checklist’ was completed. The last section of the form listed a number of investments which appeared to be, or have, underlying unregulated bonds. The form stated: *‘please ask the client to indicate which investments they may be interested in, and in what proportions’*

It was noted Mr B had interest in Dolphin Capital GmbH Loan Notes and Lateral Eco Village. It’s not clear how the investments were described to Mr B and whether they were put in context with more mainstream, regulated collective investments. There was no evidence that Mr B had experience or knowledge of those types of investments and they appear to have been brought to his attention by the introducer, on behalf of BlackStar.

In June 2015, BlackStar sent an introductory letter to Mr B. They said he had been assessed as having a *high* attitude to investment risk. They would look into whether he should leave his pensions where they were, the suitability of transferring them and any proposed investments. Alternative investments were described as offering the highest level of returns with the greatest amount of investment risk.

Notes of a telephone interview held with Mr B in August 2015 stated that he agreed with having a *medium-high* attitude to risk and considered himself to be a moderately experienced investor. Mr B’s perception was his existing pensions weren’t making a lot of money and he wanted them to work harder.

BlackStar recommended Mr B to transfer his occupational pension benefits and personal pensions to a SIPP. This would provide him with better access and control of his pension benefits. In addition it would reduce the volatility of his investments whilst being able to invest in more aggressive investments. His existing plans wouldn’t meet his objectives.

The investment recommendation was to invest:

£23,000 into Dolphin Capital GmbH
£22,000 into Best International - Lateral Eco Parks
~£92,500 with the Discretionary Fund Manager - Beaufort Securities

Following a telephone conversation with Mr B the above recommendations were adjusted to:

£35,000 into Dolphin Capital GmbH
£35,000 into Lateral Eco Parks
~£67,500 - Beaufort Securities.

The adviser said: *'the first two investments named above are non-regulated and higher risk than the Discretionary Fund Management Service. If you are at all unsure about proceeding with these investments you should not do so. It is possible to invest your whole pension through the Discretionary Fund Manager - Beaufort Securities.'*

BlackStar described an example of a medium high portfolio as:

UK Equity	41%
US Equity	27%
Far East Equity	11%
Property	11%
European Equity	7%
Fixed Interest	3%

BlackStar instructed Beaufort Securities to invest Mr B's portfolio with them in line with the *'BlackStar Wealth Total Return Model Porfolio – risk scale 9'*.

The factsheet for the fund detailed investments would be spread across the following asset classes and geographic areas:

Fixed Interest	20%
UK Equites	25%
Developing Market Equites	12%
Emerging Market Equities	23%
Alternatives	15%
Cash	5%

UK	30%
Europe excluding UK	10%
US	35%
Emerging Markets	23%
Other	2%

The risk range of the fund was described as: 'On a scale of 1-10, with 1 being lowest risk and 10 being highest risk, Beaufort Wealth would anticipate the collection of funds within the portfolio to expose an investor to a level of risk at 9 — high risk profile.'

The anticipated returns for the portfolio were 7.3% per year.

Of the funds transferred to Beaufort Securities, over £26,000 was invested in Carduus Housing Plc 6.25% bond and just over £36,000 in Silex plc 8% secured bonds 31/12/2020.

It's clear that the BlackStar adviser knew the alternatives investments were higher risk than the proposed Beaufort Securities portfolio. And I would agree with this. The high risk portfolio with Beaufort Security aimed to provide a return of 7.3% per year. This compares to the yearly yields of the alternative investments of 10% for the Dolphin Capital loan notes and 10.31% for the Eco Lateral Park bonds.

In general, the yields offered by bonds are an indicator of risk. The higher the interest rate the higher the risk. So with the alternative investments being higher risk than the proposed high risk Beaufort Securities portfolio, the recommendation was more risky than Mr B's agreed attitude to risk of medium-high.

Given the unsuitability of the investment recommendation, and that the selling of the existing pension benefits was primarily to facilitate the subsequent investments, I have considered the pension transfer advice.

Firstly, BlackStar have explained that Mr B wanted greater flexibility to access his pension benefits. However, that wasn't an appropriate reason to consider a transfer. Mr B was just over 40 years old at the time of advice and wasn't in a position to draw benefits from his pension until at least age 55. This could have been a decision made much nearer the time.

It was also stated that Mr B had concerns about the volatility of the stock market. Of the expected transfer values totalling over £140,000; around £48,500 was from Mr B's occupational pension scheme and £36,530 from With-Profits funds. Given Mr B didn't have investment risk through his occupational pension scheme and With-Profits funds smooth investment returns; I think the advice actually increased the potentially volatility of Mr B's pensions rather than reducing it.

In relation to the occupational pension advice, for the industry wide pension review, the regulator published a list showing the growth rate that might have been considered achievable. In addition the regulator had for many years up to 2005 been publishing growth rates. This practice was continued beyond 2005 by the Financial Ombudsman Service for use in similar loss assessment calculations and published on our website.

Whilst the rates published by this service are not upper limits on what investment returns could be achieved, they do provide a reasonable benchmark for likely investment returns. If the critical yield for a pension transfer was lower than the published growth rates, it is reasonable to consider the scheme benefits were likely to be matched or possibly improved upon. However if the critical yield was higher, it was considered less likely that the scheme benefits could be matched and so there could be a lower income in retirement.

The comparison of the critical yields calculated by BlackStar and this service's published growth rates were:

Taking benefits at age 60 – 7.3% critical yield compared to 4.6% growth rate
Taking benefits at age 67 – 5.67% critical yield compared to 4.9% growth rate

So if the returns were similar to the published growth rates, Mr B is likely to have lower retirement benefits following the transfer of his pension.

Even if the view from BlackStar's recommendation report, that a return of 6% per year was achievable, Mr B would be taking a greater risk to broadly mirror his existing benefits by age 67. There doesn't appear to be a good reason to take the additional risks unless there is a reasonable probability of improving his retirement benefits. Therefore, I'm not persuaded the transfer of Mr B's occupational pension benefits was in his best interests.

I note Mr B's attitude to investment risk was higher than his existing with-profit funds, however, before going to the cost of switching a pension and incurring ongoing SIPP costs, fund switching within the existing pensions could've been considered.

Switching Mr B's personal pensions to the high risk investments within the SIPP wasn't suitable. Whilst Mr B did have a medium high attitude to investment risk, I'm not persuaded his circumstances and capacity for loss mirrored his outlook.

Apart from his pensions, Mr B had £4,000 in a savings account and £2,000 in a current account. I'm not satisfied that he had the capacity to recoup any substantial losses that could have arisen from investing at high risk. So I don't think it was suitable advice to recommend a high risk portfolio or alternative investments.

With suitable advice BlackStar ought to have recommended retaining Mr B's occupational benefits and consider the options for some possible fund switches.

BlackStar haven't agreed that their advice was unsuitable. They said the pension transfer advice was suitable, but would be willing to consider whether Mr B has suffered a loss due to the composition of the investment portfolio.

However, BlackStar said resolving the matter now wouldn't be in Mr B's best interests because they can't purchase the alternative investments and Mr B wouldn't be in a position to repay an undertaking when they mature.

In my view to avoid this problem BlackStar should pay sufficient redress directly to Mr B so that he can repay any returns achieved from the alternative investments.

It is also clear to me that part of the issues encountered by Mr B were as a result of Beaufort Securities investing their portfolio differently from the approach detailed in their factsheet. The actual investments lacked the diversification which was described. BlackStar shouldn't have to cover the costs of Beaufort Securities error and this should be taken into account in redressing Mr B.

fair compensation

My aim is that Mr B should be put as closely as possible into the position he would probably now be in if he had been given suitable advice.

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

what should BlackStar do?

To compensate Mr B fairly, BlackStar must:

- Compare the performance of Mr B's investment with that of the benchmark shown below. If the *fair value* is greater than the combined *actual and notional value* there is a loss and compensation is payable. If the combined *actual and notional value* is greater than the *fair value*, no compensation is payable.

  BlackStar should add interest as set out below.

  If there is a loss, BlackStar should pay into Mr B's pension plan to increase its value by the total amount of the compensation and any interest. The amount paid should allow for the effect of charges and any available tax relief.

  Compensation should not be paid into the pension plan if it would conflict with any existing protection or allowance.

If BlackStar is unable to pay the total amount into Mr B'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 B's actual or expected marginal rate of tax at his selected retirement age.

For example, if Mr B is likely to be a basic rate taxpayer at the selected retirement age, the reduction would equal the current basic rate of tax. However, if Mr B would have been able to take a tax free lump sum, the reduction should be applied to 75% of the compensation.

- Pay to Mr B £200 for the trouble caused by unnecessarily transferring his pensions.

Income tax may be payable on any interest paid. If BlackStar deducts income tax from the interest it should tell Mr B how much has been taken off. BlackStar should give Mr B a tax deduction certificate if he asks for one, so he can reclaim the tax from HM Revenue & Customs if appropriate.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
SIPP	mixed	FTSE UK Private Investors Income Total Return Index	date of investment	date of my decision	8% simple per year from date of decision to date of settlement (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.

It may be difficult to find the *actual value* of the investment. So, the *actual value* should be assumed to be nil to arrive at fair compensation. BlackStar should take ownership of the illiquid investment by paying a commercial value acceptable to the pension provider. This amount should be deducted from the compensation and the balance paid as I set out above.

If BlackStar is unable to purchase the investment, the *actual value* should be assumed to be nil for the purpose of calculation. BlackStar may require that Mr B provides an undertaking to pay BlackStar any amount he may receive from the investment in the future. That undertaking must allow for any tax and charges that would be incurred on drawing the receipt from the pension plan. BlackStar will need to meet any costs in drawing up the undertaking.

In this instance BlackStar should pay sufficient redress directly to Mr B so that he can set aside the funds to repay BlackStar when the Dolphin Capital and Eco Lateral park investments mature.

notional value (Beaufort Securities investments)

This is a notional calculation of what the investment would have been worth at the end date had it produced a return using the FTSE UK Private Investors Stock Market Balanced Index.

I have chosen the above index as it broadly reflects the composition of the BlackStar Wealth Total Return Model Porfolio – risk scale 9. This would represent the value of this element of Mr B’s pension investments had Beaufort Securities invested in line with BlackStar’s instruction.

fair value

For the transfer of occupational pension scheme benefits:

BlackStar should undertake a redress calculation in line with the pension review methodology, as amended by the Financial Conduct Authority in October 2017

For the switched personal pensions:

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

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

Any withdrawal, income or other distribution 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’ll accept if BlackStar totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I’ve decided on this method of compensation because:

- Mr B wanted capital growth and was willing to accept some investment risk.
- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with 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 B's circumstances and risk attitude.

my final decision

I uphold the complaint. My decision is that BlackStar Wealth Management Ltd should pay the amount calculated as set out above.

BlackStar Wealth Management Ltd should provide details of its calculation to Mr B in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr B either to accept or reject my decision before 12 July 2019.

Keith Taylor
ombudsman