complaint

Mrs M has complained about advice given by Peter Morris and Company in October 2008 to invest £25,000 of her Self Invested Person Pension (SIPP) into the Stirling Mortimer No 7 Cape Verde Fund (the Fund).

background

I issued a provisional decision on 28 February 2013 saying that I intended to uphold Mrs M's complaint. In my view the investment presented a higher risk than Mrs M was prepared to accept or should have been advised to take.

Mrs M and her representative had no further comments about the merits of the complaint.

Peter Morris and Company and its representative responded, setting out Mrs M's circumstances and saying, in summary -

- Having taken over the servicing rights of her pension, the adviser knew what Mrs M's pension holdings were when he made his recommendation, but the fact find was not completed for sometime. Mrs M had expected that her pension fund would provide an income of £18,000 per year but it was only once she actually completed the fact find that the adviser was able to project what her existing holdings would get her. This was considerably less than she wanted as she had hoped to retire in a year and led Mrs M to realise she had to continue to work.

- Other than the issue of liquidity the Cape Verde funds are worth the values that are put on them and by October 2008, Mrs M's initial £100,000 investment (in another Cape Verde fund) was worth over £116,000. Mrs M also had a substantial cash holding (between £77,000 and £80,000) which, combined with her other holdings, equated to circa £147,000 in total) with only £100,000 of her money exposed to investment risk. Mrs M knew that, without investing more of her money, she simply could not afford to retire.

- The adviser's notes show that he took care to ensure, when recommending a further Cape Verde investment, that Mrs M was going to hold off taking any pension benefits because he knew that the investments had, in effect, 'tie in' periods, thereby making them illiquid. The adviser made it clear that the investment was only suitable if Mrs M did not plan to take benefits within the next two years or so.

- Mrs M was not risk averse but she was averse to investing in equities. Investing in higher risk investments was the only way in which her fund would have the opportunity to grow enabling her to take her desired £18,000 per year. This was, as the adviser pointed out, subject to her increasing her pension contributions, taking risk with some of her money and leaving her invested funds to grow, ie not retiring for as long as possible.

- Mrs M had experience of a UCIS (Unregulated Collective Investment Scheme) investment which had grown in value (from £100,000 invested the previous year to over £116,000).

- I had said that despite being described as such the Fund was not a UCIS but subject to section 86(7) of FSMA whereby the offer can only be made to or directed at

"Qualified Investors". It would be unusual, if not extraordinary, if that is so when the literature for these funds all expressly refer to the funds as UCIS.

- The FSA (now FCA) handbook expressly permits advising firms to rely on third parties for promotions etc provided there is nothing to suggest that it would be inappropriate to do so. By the point of sale in 2008, Stirling Mortimer's Cape Verde No 4 fund had seen an increase in its NAV (net asset value). UCIS, as alternatives to traditional asset classes, were booming. The adviser did not 'blindly' rely on documentation provided, taking maximum commission at his clients' expense. Instead he asked an expert compliance provider to consider the literature before he made any recommendations. Given that the compliance provider did not find any information that would render it unreasonable to rely on the assertion that the funds were UCIS then or at any point thereafter, it cannot be said that it was inappropriate for the adviser to rely on the representations in the literature. Nor did the compliance provider identify any problems with the funds generally and such that would have led the adviser to conclude that the funds should not be recommended.

- The FCA has not highlighted any such procedural breaches during its lengthy thematic review of UCIS business. Furthermore, its final consultative paper on the issue, does not mention the 'qualified investor' status or section 86(7) of FSMA 2000 and/or Directive 2003/71/EC. The regulator would have identified any other legal provision which applied to the sale and/or promotion of UCIS funds. So if there is legal opinion that the provisions referred to do apply then it should be acknowledged that the basis on which the funds were promoted was false. In turn the basis on which the adviser sold the investment to Mrs M would have been subject to a misrepresentation. No blame can be attributed to Peter Morris and Company if it has now transpired that the funds were not, in fact, UCIS but protected cells of the company referred to. Another decision by this service on another complaint against Peter Morris and Company which was reported in the press referred to another Cape Verde fund as a UCIS. All in all it was fair and reasonable, at the time the recommendation was made, for the adviser to assume the Fund was a UCIS.

- COBS 4.12 applied at the time the recommendation was made. The adviser was entitled to, and did, rely on the COBS 4.12 category one exemption – by that time, Mrs M was 'a *person* who is already a *participant* in an *unregulated collective investment scheme*;' She had previous experience of another UCIS '*whose underlying property and risk profile [was] 'substantially similar' (see Note 1) to those of [the proposed] collective investment scheme;'*. Note 1 states:

  '*The property of a collective investment scheme is 'substantially similar' to that of another collective investment scheme if in both cases the objective is to invest in the same one of the following sectors:*

  (c) the property market (whether in security of property companies or in property itself);

- It is fundamentally important even taking into account any legislation imposed before such funds can be promoted, to be able to evidence that a client's attitude to risk, circumstances and the risk posed by the recommended investment were all considered. In this case, the NAV on the existing UCIS investment was up by some £16,000. Amidst the financial crisis, that investment had held its own and indeed grown in value as the literature had indicated was likely.

The literature clearly highlights that there was a risk posed by investing with just two property companies, rather than across a whole market. It is fair and reasonable to suggest that a woman of Mrs M's intellect would have understood the adviser's explanation that '*putting too many eggs in one basket*' increased the risk of loss in this context. Mrs M was given sufficient warning of this particular risk.

- By 2008, equities were falling in value and by October 2008 when this business was transacted, even banks holding deposits had been negatively affected. Mrs M had lost money on deposit with an overseas bank and the economic crisis was even affecting banks and deposits which are supposed to carry nil risk. Despite not having traditional suitability letters, the evidence shows that the adviser warned about the material risks posed by investing with in a second Cape Verde fund. All those risks are highlighted in the literature. It is not claimed that those risk warnings were unfair, unclear or misleading, nor has it been suggested that the adviser missed any of the applicable risk warnings.

- The advice was suitable. It was only after the adviser had assessed Mrs M's income requirements in retirement and the need to continue working to allow the investment strategy to work, that he recommended further investment and only after making it clear that the investment would not be suitable if Mrs M intended to take income within 2 years. Mrs M had by then said that she considered herself to be a balanced investor and also a professional investor. There was nothing in Mrs M's background to alert the adviser to a need to challenge her willingness to take a balanced risk going forward. Even though she had not invested in UCIS prior to the first Cape Verde investment, she had experienced volatility and fluctuations in capital value with her equity portfolio, which she was not comfortable with. By 2008 her faith in banks and leaving money in cash had been undermined which meant she was more willing to consider alternatives suggested by the adviser.

- The adviser having researched the market followed his own advice and later went on to invest himself and believed that the UCIS investment was suitable for his client.

- The economic climate at that time must be factored in because it impacted heavily on Mrs M's fears, her attitude to risk as regards her willingness to invest in alternatives, and, fundamentally, because it played such a role in any reasonably competent adviser's rationale when making investment recommendations. The recommendation was tailored to meet Mrs M's specific objectives of:

    - Increasing her holdings to the extent that it would give her £18,000 per year;
    - Leaving her money for 1 – 5 years;
    - Agreeing not to touch her money, for a 'few years';
    - Willingness to take a 'balanced' risk with her capital investment;
    - Avoiding equities.

- As a percentage of her pension holdings the total investment into two, separate, Cape Verde funds therefore only equated to 71% of her pension holdings and just over 51% of her total holdings. The key risk was thought to be illiquidity and non-diversification, and she was warned about these risks.

- The adviser selected investments that would be tied as it were for 2 years, and left cash in her pension from which she could take pension benefits if she elected to do so. Given the evidence of his due diligence, it was fair and reasonable for him to recommend further investment into another Cape Verde fund.

- The risk posed by the investment again fell within the parameters that Mrs M was willing to take. Property is, generically speaking, a relatively stable investment. The underlying properties do exist and currently have value, although the illiquidity risk about which Mrs M was warned, and for which the adviser made provision with her cash holdings, has materialised.

my findings

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

It remains my understanding that the Fund is not a UCIS. The Supplemental Memorandum which I have seen (dated 6 May 2008) does not describe the Fund as such. But it does set out:

'*This Offer is being made, and may only be made, to or directed at persons in the United Kingdom who are 'Qualified Investors' within the meaning of Section 86(7) of* [FSMA].'

My understanding is that Qualified Investor schemes are regulated and so are not UCIS. So I do not agree with any suggestion that I am seeking to impose other legal requirements which do not in fact apply to the promotion of UCIS. But the point is that other restrictions apply. Specifically that the investment can only be promoted to or subscribed for by 'Qualified Investors'. I said in my provisional decision that I did not see that Mrs M met the definition of a Qualified Investor. That remains my position.

Indeed it has not been argued that she did meet that definition. Instead arguments have been made that the COBS 4.12 category one exemption (which apply to the promotion of UCIS) was validly relied upon.

First, if the investment was not a UCIS, I do not see that the exemptions from the restrictions on promotion of UCIS are relevant. In saying that I note what has been said about why the adviser may have thought the Fund was a UCIS. Mrs M had previously invested in another Cape Verde fund and my understanding is that some versions of the literature for that Fund did indicate that it was a UCIS and subject to the restrictions on promotion set out in section 238 of FSMA. Later versions of the documentation did however correct the position. I have not looked into the other decision mentioned and which was reported in the financial press but it may have been issued before any discrepancy came to light.

But, as I have set out above, the Supplemental Prospectus for this particular fund, the No 7 Cape Verde Fund, did not describe it as a UCIS but set out that 'Qualified Investor' status was required for investment. So I do not see that any confusion caused by references elsewhere to another fund being a UCIS ought to have led to a conclusion that this fund was a UCIS when it was not referred to as such.

Even if I am wrong about that and the adviser reasonably understood the funds were UCIS, I do not see that this takes matters much further forward. First, I would not necessarily agree that the adviser was entitled to rely on the COBS 4.12 category one exemption when the previous participation in a UCIS may have resulted from an unsuitable recommendation.

Further the exemptions to the restrictions on promotion of UCIS in COBS 4.12 apply where the firm concerned has taken reasonable steps to establish that the recipient is in the category relied on. Such reasonable steps must be taken at the time – there is no provision for the requisite assessment to be carried out retrospectively. So ideally a firm should be able to produce contemporaneous evidence to show that it took the necessary steps at the time and why it considered that the investor fell within the category or categories of exemption relied on. I am not persuaded that the necessary steps were taken or that any conclusion that Mrs M was a person to whom a UCIS could lawfully be promoted was reasonable.

All that said, any conclusion that the promotion was not lawfully made would not necessarily mean that the complaint should be upheld – I would still go on to consider whether the recommendation was suitable. So, and regardless of any debate about whether the Fund is a UCIS or a Qualified Investor scheme, the overarching question remains whether the investment was suitable for Mrs M.

On that issue, there are no suitability reports to formally record why the investment was considered suitable for Mrs M.

The No 7 Cape Verde Fund was a specialist geared off shore property based fund. It was subject to a large number of risk factors, including illiquidity, development risk, emerging market and currency risks. Leaving aside the earlier investment into another Cape Verde fund, the investment was outside Mrs M's previous investment experience.

The second investment (albeit in a different fund) meant that a further significant portion of Mrs M's pension fund was held in a high risk, speculative and largely untested investment. I note what has been said about the apparent increase in value of the earlier investment but I am not persuaded that this justified exposing more of Mrs M's pension fund to the sort of risks that the funds presented.

The combination of the earlier and second investments meant that over 70% of her pension fund was held in what I consider to be a high risk environment. The funds were similar – both invested in a very specialised investment area in the same geographical location (right to purchase contracts relating to property developments within the Cape Verde islands). I consider that this lack of diversification added to the risks.

I note that the comments that this risk would have been apparent to Mrs M from the literature. But even if that is so, as I have explained below, I do not see that this absolved the adviser from making Mrs M aware of the risks and factoring that in when assessing whether the investment was suitable.

Nor am I persuaded that what has been said about property being a relatively stable investment applies to the Fund. This was not an investment in a property fund. It was an investment in right to purchase contracts. It was speculative and could involve borrowing in order for the development to proceed.

I can understand that Mrs M had been disappointed to learn that her pension fund would not generate her target retirement income. But I do not see that the investment strategy should have been predicated on the basis that Mrs M's pension fund was exposed to more risk than she was prepared or should have been advised to take. My view remains that the Fund was a high risk, speculative investment and I do not see that it was suitable for Mrs M.

The adviser maintains that the risks were fully discussed with Mrs M. But in the absence of any suitability letters explaining the risk factors and drawing Mrs M's attention to them, it is difficult to say precisely what was discussed and the extent to which the risk factors were properly explained and fully understood by Mrs M.

For example, I note that the adviser maintains that he ensured that Mrs M was made fully aware that there was a two year 'tie in' period (based on an indicative redemption date of 31 October 2010). Mrs M's apparent acceptance of that appears to have been based on a recognition that she needed to delay her retirement so that her fund could benefit from investment growth. But that does not necessarily mean that Mrs M understood that there was a risk that she might not be able to access her money for a very considerable period after that. The point I am making is that in the absence of written evidence to show that the risks were clearly explained by the adviser it is difficult to be confident that Mrs M understood the true extent of the risks, such as illiquidity, of the investment.

And, even if Mrs M had been given a copy of the prospectus, that does not mean that she was in a position to make her own decision as to whether to invest. It was for Peter Morris to assess the risks and advise accordingly. I do not consider that duty is discharged by providing copies of what is lengthy, technical and detailed information.

I do not ignore that Part IV of the Supplemental Memorandum set out a large number of risk factors, including gearing which, as explained, could amplify losses as well as gains. The section dealing with risks concluded (in bold type):

'*An investment in the Fund is suitable only for experienced investors who appreciate the risks involved, which may include the loss of their entire investment. Investment is not suitable for investors who may wish to realise their investment at short notice.*'

Nor do I dispute that Mrs M was capable of understanding the documentation, including the risks set out. But, as I have said, it is the adviser's role to assess the risks and provide suitable advice. Adequate risk warnings do not negate an unsuitable recommendation.

I do not consider, and regardless of how she may have considered herself, that Mrs M was an experienced investor or that she was in a position to take the risks associated with the investment. I have noted that, prior to Peter Morris and Company's involvement, Mrs M's pension fund included some medium and higher risk investments. But, as the adviser himself recognised, these carried more risk than appropriate for a balanced investor and his aim was to reduce that risk exposure. I am not persuaded that this limited experience meant that Mrs M would have understood and been prepared to accept the risks associated with a specialist, unregulated investment. Nor do I see that this type of investment met the adviser's objective of reducing risk.

Nor do I agree what having some funds in cash to draw on made the investment suitable. There is no indication that Mrs M wanted or was suitable for a phased and/or drawdown plan. Overall I am still of the view that Mrs M was not in a position to take such risks, nor should she have been advised to do so. In my view the recommendation was unsuitable for her.

My aim in awarding redress is to put Mrs M as far as possible in the position in which she would have been had Peter Morris and Company given her suitable advice. I still consider that the APCIMS Balanced Index is an appropriate comparator.

my decision

I uphold the complaint and issue a final decision requiring Peter Morris and Company to redress Mrs M using the following method -

1. Establish the value that the money invested Stirling Mortimer Cape Verde No 7 fund would have had based on returns in line with the APCIMS balanced index. An allowance can be made for amounts (if any) paid out from time to time from the fund by way of withdrawals, distributions of capital.
2. This should be compared with the actual value for the relevant investment. An up to date valuation should be sought for the Stirling Mortimer Cape Verde No 7 fund. Mrs M's loss is 1 less 2.
3. Peter Morris and Company should pay into Mrs M's SIPP such sum as is required to increase its transfer value by the amount of the loss (if Mrs M's SIPP provider accepts the payment as a relievable contribution then Peter Morris and Company will only need to pay the net amount).
4. If Mrs M's SIPP provider is unwilling or unable to accept the payment then a cash payment should paid direct to Mrs M net of a deduction of 20% representing notional tax.
5. Peter Morris and Company should also purchase Mrs M's holding in the Stirling Mortimer Cape Verde No 7 Fund by paying into her SIPP the value ascertained in 2 above. Peter Morris and Company should also meet any fees incurred. Mrs M should note that ownership of her holding in the Cape Verde No 7 Fund will be transferred to Peter Morris and Company who will then become the registered owner of the holdings and so entitled to any further distributions or value obtained when the holding can be redeemed.

Lesley Stead
ombudsman