DRN-3674151

The complaint

Mrs S complains Mercer Limited ("Mercer") traded her pension investments excessively.

Mrs S is assisted in her complaint by a representative. For simplicity I refer below to Mrs S when referring to things said or done by Mrs S or by her representative on her behalf.

What happened

Mrs S says the turnover of her portfolio holdings totalled 370% in the four years to July 2021. She has said Mercer was taking advantage of her as a trusting customer who was almost 70 when the portfolio started. Also Mercer's complaint response focused on the suitability of the funds selected but her concern was the volume of trading and that investments were often held for months rather than years. She seeks a return of the costs and fees.

Mrs S said that during the period she had examined, the portfolio had marginally exceeded its benchmark almost as often as it had failed to do so – which she says shows that excessive trading gave no improvement in performance. She said investment costs were £17000 and fees £17000 on a portfolio with investment income of £18000, which was more evidence she had been treated very badly and the portfolio overtraded.

She points out her portfolio wasn't made up of individual stocks but of collective investment funds, which shouldn't need the level of trading that took place here (such funds already hold a variety of investments, adjusted by fund managers from time to time). She said the level of trading, where about 77 transactions took place in four years at a cost of £15000, couldn't be justified. She also noted that funds were sometimes sold after only a short period, at a loss. She said the commentary in the quarterly reports was general in nature and didn't comment on withdrawals or additions of funds to the portfolio (so didn't explain or justify the trading).

In reply, Mercer said changes will be made because it continually reviews the portfolio in light of changing market conditions. In addition, market conditions have been *"subject to various challenges over the period"* and it has worked to deliver its mandate and so will trade when it considers it needs to, whether that be due to market conditions, portfolio rebalancing or its views on a particular holding. Mercer says funds may be sold after short periods due to fund issues, like management changes, or when drastic changes in market conditions alter Mercer's view of the holding. There were more detailed exchanges about the rationale behind the buying and selling of various particular holdings. I won't outline all those here.

Mercer also noted that the use of the discretionary management service by Mrs S was the result of advice she had received from her own adviser. It said if the arrangement didn't suit her any longer, this was a matter for her to take up with her adviser.

Mercer said Mrs S was at the lower end of its moderate risk spectrum at 5/10 on its risk scale and it said its management was in line with that. It said since the portfolio had started it had returned 111% net of all charges compared to 84% for its benchmark.

Our investigator considered the complaint and didn't think it should be upheld. He thought the reasons Mercer's final response had given for particular transactions or trading patterns was reasonable. As regards the complaint of excessive trading, he noted the Financial Conduct Authority (FCA) handbook definition of *"churning"* (excessive trading) relates to *"decisions to trade… with a frequency that is not in the best interests of a client."* He didn't think Mercer's trading was, on the available evidence, undertaken with an objective that wasn't Mrs S's best interests. Rather he thought her disagreement with Mercer's trades and strategies showed a preference for a less active, buy and hold type approach compared to a more active approach that attempted to time the market. He wasn't persuaded that the former would necessarily have produced better results for Mrs S than the latter or that it could've been known that it would do so without the benefit of hindsight.

Our investigator said he was not trying to decide whether Mercer's approach, in general or as regards any particular transaction, was the best approach available but rather whether it had acted reasonably. He accepted that the trades Mercer had done had resulted in charges – and so the higher level of trading had led to higher charges – but he didn't think this meant trades were placed with the objective of generating charges – and he didn't think there was evidence to support such a conclusion. He noted that some of the specific decisions made by Mercer may not have worked out for Mrs S, but Mercer didn't have to be successful in all its investment decisions.

Our investigator considered that the fees Mrs S had been charged had arisen due to trades conducted by Mercer as a result of investment decisions it had made with the aim of achieving Mrs S's growth objective. He said it would take a higher level of trading than he had seen on the quarterly statements before he would conclude that the objective of the trading had been to generate fees.

Our investigator also thought the absence of any manifestly inappropriate individual holdings was generally supportive of the idea that the trading had been conducted with the objective of achieving Mrs S's objectives rather than for some other reason. Likewise he thought the absence of a marked reduction in the overall value of the portfolio – aside from that which corresponded with the onset of the pandemic in 2020 - was another indication that Mercer's approach couldn't fairly be characterised as gratuitous trading conducted with the aim of generating fees. He noted the portfolio had also recovered from the 2020 falls.

Our investigator did agree that a degree of portfolio rebalancing was apparent. But he noted that the discretionary management offering had at the start been referred to as one where the portfolio is managed on a day to day basis and where the discretion given allowed the investment manager to take advantage of investment opportunities as they arise.

Our investigator said the total charges weren't excessive overall for a discretionary managed service and although an alternative approach could have been more productive, he hadn't seen evidence Mercer's investment decisions weren't in keeping with Mrs S's objectives.

Mrs S doesn't question the suitability of the portfolio or asset allocation overall, and our investigator agreed this was suitable given Mrs S's risk attitude and concluded that Mercer had managed the portfolio in line with the mandate it had been given.

Finally our investigator noted the portfolio return of 111% since the start was better than the 84% return of its benchmark. He concluded that the evidence overall didn't suggest that Mercer wasn't acting in Mrs S's best interests or had taken an unreasonable approach.

In reply, Mrs S said the 26% outperformance of the benchmark was not the point. She questioned whether Mercer's pursuit of returns that met its benchmarks, or the resulting returns it had produced, required the number of trades that had taken place, which she said had been consistently excessive in recent years.

She said that in the period in question, the portfolio had marginally exceeded its benchmark performance almost exactly as often as it has failed to do so. In 2016 it rose by 5.68% and the benchmark rose 8.64%. In 2017 it rose 7.14% and the benchmark rose 6.69%. In 2018 it fell 6.38% and the benchmark fell 5.14%. In 2019 it rose 10.24% and the benchmark rose 11.38%. In 2020 it rose 5.19% and the benchmark rose 4.84%. In 2021 the portfolio returned 10.25% compared to 11.51% for the benchmark. She said this might appear satisfactory on the surface, but the results were achieved by a 370% turnover of the portfolio investments.

Mrs S said Mercer would say the ends justify the means but she didn't agree. She pointed out there were only two quarters when trades were less than 10% of the portfolio and for both of those the performance exceeded the benchmark – by 1.63% against 0.4% and 5.16% against 4.51%. She said this perhaps shows that a portfolio holding 'suitable' investments (which she has never disputed) doesn't necessarily need those suitable investments to be changed so frequently.

Mrs S said Mercer's view that it might need to trade for reasons specific to the fund, the portfolio balance or market conditions, in effect gave it carte blanche to trade as frequently as it had done and in so doing it had taken advantage of a trusting client in her 70s. She said the portfolio performance could be defended but the way the performance was achieved was very debatable and the turnover was without doubt 'churn' and more to Mercer's advantage than hers. She said this type of fund management would give the City a bad name.

As the complaint couldn't be resolved informally, it has been passed to me to decide.

What I've decided – and why

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

Having done so, I've arrived at the same conclusion as our investigator and for the same reasons. I won't repeat here all that our investigator said, but I'll explain briefly.

It isn't disputed that in the period on which Mrs S's complaint focusses, the investments her portfolio held from time to time was a suitable mix given her objectives and risk attitude. So on that basis it was, on the face of it, managed by Mercer in accordance with the mandate it had been given. The performance, if measured from the start, wasn't in line with what might have been expected had the portfolio been managed entirely in line with its benchmark – but the portfolio exceeded rather than fell short of its benchmark return.

Neither of these points exclude the possibility that Mercer's trading was excessive – and that the returns it achieved, while better than its benchmark, would have been even higher had it achieved these or similar returns while making fewer adjustments to the portfolio than it did. Also I don't overlook that performance against the benchmark in the recent years that Mrs S has highlighted, wasn't as favourable as the overall performance since the start.

Also I do note Mrs S's portfolio was an investment using broad based collective investment funds and I have sympathy with the view that the turnover of the portfolio was high with that in mind. But this doesn't mean that it was excessive or that the management of the account overall, or particular patterns of transactions within that, are best explained as trading whose main or sole objective was generating trading costs rather than improving Mrs S's returns.

Mercer as investment manager had discretion as to how to exercise its mandate and seek to achieve Mrs S's investment objectives. This extended to how actively it traded or adjusted the holdings in Mrs S's portfolio. What I'm deciding is not whether the level of trading was optimal or whether Mercer's approach in general was the best approach. What I'm deciding is whether Mercer's approach or its level of trading meant its management of the portfolio fell outside the range of reasonable approaches that could legitimately be taken by a competent manager given Mercer's remit.

So there is latitude there. Mercer's approach needs to fall within what is necessarily a fairly broad range of reasonable and legitimate approaches. I understand that while some favour more active and frequent trading, the frequency of trades on Mrs S's portfolio will not be to everybody's taste, given the context I've outlined above such as the use of collective funds. But this doesn't mean the trading amounted to churning or was otherwise excessive.

I note Mercer has appealed to investment conditions in recent years being more challenging. Also one of the reasons it gives to explain changes of a very short-term nature, is drastic changes in market conditions. It seems to me that challenging investment conditions are only so where existing market positioning means those conditions do not favour the portfolio as it stands. Similarly short-term changes made to existing holdings in response to a change in market conditions, whether drastic or not, would seem to imply that the existing positioning of the portfolio was not set up to benefit from that change.

From that point of view, more frequent trading may simply amount to or correspond to a period of less successful trading, where more adjustments and corrections were required as a result. I note also here the performance of Mrs S's portfolio in the more recent years that she has focussed on does appear to be worse than its performance in earlier periods, judged by the overall performance figures Mercer has cited. That performance though, as Mrs S notes, wasn't in itself poor enough as to not be defensible. There will necessarily be better and worse periods of performance over time, and I don't overlook the outperformance of the portfolio overall since it started. This isn't in itself proof Mercer managed the portfolio competently or treated Mrs S fairly, but it is still a relevant factor I take into account when judging Mercer's management of Mrs S's portfolio and its conduct overall.

So with all I've said above in mind, and having examined the patterns and frequency of trading – both as discussed in the figures Mrs S has provided and as disclosed in the periodic reports produced by Mercer for the period in question – on balance I'm not persuaded that Mercer's level of trading while high was such that its management of the portfolio fell outside the range of reasonable approaches that could be legitimately taken by a competent manager given its remit. Mercer's approach won't always have been successful, and the frequency of trades may at times have been linked to this, but I'm not persuaded Mercer was taking advantage of Mrs S or otherwise treating her unfairly.

So, for the reasons I've given, I've decided not to uphold Mrs S's complaint.

My final decision

For the reasons I've given and in light of all I've said above, I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs S to accept or reject my decision before 26 February 2024.

Richard Sheridan
Ombudsman