DRN-4459847

Financial Ombudsman Service

The complaint

Mr J complains that Investment Funds Direct Ltd ("IFDL"), trading as Ascentric, didn't carry out proper due diligence in respect of a security (CFB issue 10) before allowing the security on its SIPP platform and his application to invest in it.

What happened

As I shall explain, Mr J invested in CFB bonds as part of a model portfolio made available on IFDL's platform by a discretionary fund manager or "DFM". Before I set out what happened I think it would be helpful if I set out the role of the various parties I will be referring to.

IFDL – a regulated SIPP operator and administrator with permissions from the FCA which included establishing, operating, and winding up a personal pension scheme, and which provided services to advised retail clients. It operated a platform through which its SIPP clients could invest through an independent financial adviser and/or one of the Discretionary Fund Managers it permitted to use its platform.

Clear Capital Management LLP ("CCM") (previously called Kalis Capital LLP) – a DFM offering model portfolios through IFDL's platform at the time of Mr J's investment. It belonged to the same group of companies as Corporate Finance Bonds Limited.

Huntsman Hawkes Limited – an Independent Financial Adviser (IFA) which at the time of Mr J's investment was authorised by the FCA and who advised Mr J to invest his pension in a CCM model portfolio on IFDL's platform

Corporate Finance Bonds Limited ("CFBL") (previously called SA Secured Growth Ltd) - issuer of the CFB bonds. A company incorporated in June 2015 and part of the same group of companies as CCM. Its intended business was to use the proceeds of the bonds, which were issued in a number of series, to advance loans to third party businesses.

Heritage Corporate Finance Limited ("Heritage") – became the issuer of the bonds in May 2020 in place of CFBL and replaced all series of CFB bonds with one 'recovery bond' with a maturity date of 18 May 2027.

Specialist Advisors Limited ("SAL") – The promoter of the CFB bonds to IFDL. Its director also being a director of CFBL

CCM's relationship with CFBL

As I have said, CCM and CFBL belonged to the same group of companiesd. Specificically theyr were both part of the 'SA Group' of companies. CCM is also shown as having approved the Investment Committee submission from CFBL and is identified in that document as the investment advisers for CFB series 8 and described as having detailed insight into the bond programme from its 'privileged position' as a member of CFBL's 'Investment Advisory Committee'. CFBL developed CFB series 8 and CFB series 10 for inclusion in CCM's model portfolios. The two companies therefore weren't just part of the same group but also had a close business relationship.

CCM's dealings with IFDL

I shall explain something of the history of dealings between CCM and IFDL prior to Mr J's investment, focussing on how the CFB bonds came to be offered on IFDL's platform within CCM's model portfolios.

In 2015 CCM completed IFDL's due diligence questionnaire for DFMs. A one-page approval form was thereafter completed by IFDL which refers to CCM being a new DFM start-up with zero assets currently under management and with no existing relationships with other wraps or platforms.

CCM appears to have been accepted onto the platform for the purposes of being permitted to introduce clients to it after a meeting of IFDL's Finance and Investment Committee in September 2015, the minutes from which refer to CCM's application being 'readmitted' because financial accounts had been released and reviewed. The accounts for the year to March 2015 show that the business was operating at a loss.

The outcome from the Finance and Investment Committee meeting was that CCM was allowed to introduce clients onto the platform subject to CCM being restricted to accepting business from two named financial advice firms that were already using IFDL's platform.

IFDL was at some point in the process provided with details of the compositions of two of CCMs 'balanced' model portfolios as of August 2015. According to IFDL, this was simply to check if the assets within the portfolios could be held on its platform. The portfolios at this stage were made up of standard assets and didn't include the CFB bonds, as these weren't in existence at the time. This later changed when CCM added CFB bonds to all its portfolios.

IFDL entered into an agreement with CCM on 3 November 2015 for it to provide its DFM services on IFDL's platform. The agreement included a provision that IFDL would consider a request to add to the platform any particular investment requested by CCM.

In July 2016 IFDL was approached by CCM in relation to IFDL accepting the CFB bond onto its platform so clients could invest in this through CCM's model portfolios. After vetting it, IFDL accepted onto the platform CFB series 3. However, this security couldn't be used in CCM's model portfolios because there was an issue with IFDL ensuring the coupon received was paid to individual clients.

This led to the creation of CFB series 8 as a zero coupon note specifically so that it could be used within CCM model portfolios on IFDL's platform. Following vetting by IFDL this was accepted onto the platform in January 2017. CFB series 10 was subsequently developed as another zero coupon note that again could be accepted within CCM's model portfolios and on IFDL's platform. It was accepted onto the platform following vetting, in June 2017.

There were four tranches of CCM's model portfolios (bespoke, absolute return fixed weight, classic active, and classic passive) within which different categories of portfolio (such as cautious, balanced, and adventurous) were available. IFDL's systems recorded the make-up of assets in the portfolios and intended proportions. This occurred when the tranches of model portfolios were set up on its platform: 31 January 2017 for tranche 1, 8 September 2017 for tranche 2, 8 January 2018 for tranche 3 and 20 August 2018 for tranche 4.

Mr J's investment in CFB bonds

Mr J decided to retire early and opted to withdraw his pension from his final salary scheme and put his money into a flexible drawdown SIPP - opting out of his final salary scheme on 31 March 2018.

He appointed Huntsman Hawks as his IFA and was advised to invest his pension moneys in one of CCM's model portfolios on IFDL's platform within a SIPP. He transferred the funds from his final salary scheme pension to his flexible drawdown SIPP operated by IFDL on 26 June 2018.

CCM invested Mr J's pension moneys in one of its 'cautious' model portfolios, which included CFB series 10. It invested £408,281 in the bonds on 3 July 2018 and a further £6,662 on 16 November 2018 – around 30% of his total portfolio.

In 2019 Mr J became aware that his IFA had stopped trading which resulted in him transferring his pension investments to Fisher Investments. It informed him it couldn't transfer the amount invested in CFB series 10, as this was non-tradeable.

He complained to IFDL about its failure to carry out proper due diligence in respect of CFB series 10 and CCM, but it didn't uphold the complaint. It said that it had carried out a range of checks before adding the CFB bonds to its platform. It said these included ensuring the investment was listed on an exchange permitted by its internal policies, was tradeable with a market maker and was allowable within its pension under HMRC rules.

It said that at the time the CFB bonds were added to the platform the information available to it confirmed that the bonds had been designed for retail investors and were to be purchased through a platform. IFDL said that it is a provider of platform services and that it has no involvement in the selection of investments or DFMs and this is the responsibility of the client's financial adviser.

Mr J referred his complaint to us and it was considered by one of our Investigators who thought it should be upheld. He provided a comprehensive opinion, the key findings from which I have summarised below.

- The consideration in this case is whether IFDL treated Mr J fairly by accepting an application to invest in the CFB bonds within the CCM model portfolio.

- It is acknowledged that the IFA and DFM had their own regulatory responsibilities and IFDL could place some reliance on this but that doesn't mean it didn't have to take steps to comply with its own regulatory responsibilities.

- IFDL was not obliged and not able to give advice to Mr J on the suitability of the SIPP or the investment, but its obligations included deciding whether to accept investments onto its platform and whether to accept introductions of business.

- To meet the appropriate standards of good industry practice and the obligations in the regulator's rules, IFDL should have carried out due diligence on CFB bonds and CCM consistent with good industry practice and its regulatory obligations.

- IFDL should not, at the time of Mr J's application, have allowed the CFB bonds as used in the CCM model portfolio on its platform.

- It should have concluded by the time of Mr J's application that CCM's model portfolios, and in particular the use of CFB bonds within those portfolios, carried with them a significant risk of consumer detriment.

- The due diligence actually carried out by IFDL amounted to assessing technical issues and the business risk to itself and there is not enough evidence to show adequate consideration was given to the risk of consumer detriment associated with accepting the CFB bonds through CCM model portfolios.

- IFDL should reasonably have concluded that CFB bonds were a high-risk investment; there was not enough evidence to show the bonds were liquid because although listed on a recognised exchange they were in effect mini-bonds; the bonds were issued exclusively for CCM model portfolios which appear to have been the only market for them – CCM was the only buyer of the bonds; and the nature of the loans CFBL intended to make using the proceeds of the bonds meant CFBL was unlikely it could easily raise cash once the money was lent.

- IFDL assessed the bond as being available to retail clients but the pricing supplement for series 10 suggests it was considered by CFBL as being a non-readily realisable security. This didn't prevent a DFM from investing on behalf of a client but indicates the bonds were more akin to minibonds than a vanilla corporate bond.

- A return on the bonds of 6.25% after all costs suggests the issuer would have to engage in high risk lending, as does the possibility it would lend to as few as five businesses.

- Whether any security is offered in relation to CFBL's lending, and if offered its nature, is unclear.

- IFDL should have realised that such investments are highly unlikely to be suitable for inclusion in portfolios for many retail investors, especially pension investors such as Mr J.

- IFDL should have identified a clear and obvious risk of consumer detriment if the bonds were to be included, as they were, in portfolios for all retail investors in CCM model portfolio.

- At the time of Mr J's investment IFDL knew of widespread significant exposure to these bonds, with CFB bonds making up about a third of all portfolios - from cautious to adventurous.

- There was a basis to question the competency and motivation of CCM given the intention to include CFB bonds in all model portfolios.

- The model portfolios featuring the CFB bonds were a significant departure from the portfolios originally presented to IFDL by CCM in 2015 and the shift in approach should have raised concerns.

- CCM and CFBL were clearly linked as they were part of the same group of businesses. There was a clear conflict of interest which IFDL cannot reasonably have concluded was being managed adequately, given a third of every portfolio was invested by CCM in CFB bonds.

- The credit rating for the bonds initially indicated by the ARC ratings agency was provisional and CFBL pulled out of the ratings process which should have raised concerns.

- In the circumstances, it is fair and reasonable to say that IFDL shouldn't have allowed its SIPP, and by extension its platform, to be used to facilitate Mr J's investment in a CCM model portfolio.

IFDL didn't agree with the Investigator and provided a detailed response to his opinion. I have summarised the key points it has made as follows:

- The Investigator provided a lengthy section under the heading 'Relevant Considerations' which appears to have been copied almost verbatim from previous ombudsman decisions and to be standard text in decisions over the past year or so in decisions involving due diligence by SIPP operators. It is therefore concerned that the Investigator hasn't properly considered the matters stated in the findings and given proper consideration to the individual facts of this case.

- An example of this is the heavy reliance the Investigator has placed on the SIPP Operator Guidance which addresses what the FCA considers good industry practice for SIPP operators. The Investigator hasn't explained how this operates specifically in the context of the advised-only platform market and IFDL's business structure. The guidance doesn't extend to how SIPP operators ought to behave in relation to DFMs.

- The Investigator unfairly and unreasonably applied 2020 standards to facts and matters occurring in 2016, as the CFB bonds weren't obviously unsuitable in late 2016 as he has stated - and the cases relied on were decided between 2018 and 2021. There was little if any awareness of minibonds – speculative illiquid securities (SISs) – in 2016, or the risks that they entailed. There was no guidance on SISs from the FCA - in contrast to unregulated collective investment schemes (UCISs). It was not until late 2019 that the industry and the FCA understood the risks presented by mini bonds and it rejects the suggestion that it should have been obvious that the CFB bonds were unsuitable.

- Although the FSA's 2009 Thematic Review notes that good practice includes being able to identify anomalous investments the only example given is unquoted shares, showing unquoted investments was the area of concern.

- So, in 2016, it was far from clear that applying the SIPP Operator Guidance would have resulted in the CFB bonds being viewed as esoteric or anomalous.

- It isn't clear if we consider that it ought not to have permitted the CFB bonds and/or CCM on to the investment platform at all or that it ought not to have accepted Mr J's application for a SIPP.

- We have overlooked the important role played by the IFA. Once the CFB bonds were admitted to the platform it was open to CCM to include them in model portfolios as it saw fit, but a retail investor could only be invested in a model portfolio with CCM through being advised of the suitability of both by their FA.

- Thirteen different FAs recommended to their clients that CCM act as DFM and manage their investments in line with the model portfolios. They were required to assess suitability of the CFB bonds, and all appear to have considered the bonds were suitable. This is impossible to reconcile with the finding made that it should have been obvious to IFDL that the bonds were unsuitable.

- It is IFDL's belief that it wasn't the only SIPP operator platform to hold the CCM model portfolio as it was also held by 'Intelligent Money' and these facts run contrary to the assertion by the investigator that the series 8 and series 10 CFB bonds were exclusively to facilitate investments on its platform.

- The Investigator suggests IFDL turned a blind eye to every client with a CCM model portfolio having around a third invested in an illiquid investment - the CFB bonds – which suggests it had knowledge of this which it ignored. This conclusion isn't supported by any evidence and is rejected by IFDL.

- We have taken a stock position on this case and taken large parts of the findings in another SIPP case and applied them to this case but there are clear differences between the cases. In the other case all the affected customers were introduced to the SIPP operator by one FA with the introductions relating almost exclusively to non-mainstream unregulated investments. In this case there are 13 FA's who didn't just recommend CCM but also other DFMs.

- The due diligence IFDL performed was in accordance with good industry practice at the time for a SIPP/platform operator that used an advised-only execution-only model.

- There is nothing to suggest that if the bonds had not been accepted onto its platform Mr J wouldn't still have invested in the CFB bonds or something similar on another platform based on the advice from his IFA.

- It involves a huge leap in logic to say that if IFDL had refused to open a SIPP in which the CCM portfolio would be invested he would have remained with his original pension adviser or that IFDL should never have opened a SIPP for him at all. Awarding redress based on a comparison between the current value of his SIPP and the notional value of his previous pension isn't a fair and reasonable basis for calculating redress.

- The redress suggested by the Investigator hasn't taken account of the fact that CCM was primarily responsible for deciding if the CFB bonds were suitable for inclusion in its model portfolio and Mr J's FA was primarily responsible for advising on the suitability of the model portfolios for its clients.

- We have a wide discretion in making a fair and reasonable decision which allows us to determine if any other firm was responsible for Mr J's loss.

- Mr J has already been compensated by the Financila Services Comepnsation Scheme (FSCS) in respect of the advice from his IFA and the FSCS is considering claims in relation to CCM, which implies strongly that they are the true cause of Mr J's losses.

- The only asset in the CCM portfolio with which issue has been taken is the CFB bonds so it is unfair to base redress on the performance of the whole portfolio when the other assets were standard investments.

- Mr J transferred his SIPP to another firm on 17 December 2019 and thereafter the performance of his SIPP assets depended entirely on subsequent investment choices and IFDL isn't responsible if performance was impacted by poor investment choices.

IFDL subsequently provided a further generic response, covering more than just this complaint in which it made various points, which I have also considered.

As IFDL didn't agree with the Investigator, the complaint was referred to me to decide. I issued a provisional decision upholding the complaint, the findings from which are set out below.

"I must determine a complaint by reference to what, in my opinion, is fair, and reasonable in all the circumstances of the case. In making that determination I must take into account: relevant law and regulations; regulators' rules, guidance, and standards; codes of practice; and (where appropriate) what I consider to have been good industry practise at the relevant

time.

Having considered everything, I am of the view that this complaint should be upheld. In short, I think IFDL was at fault in accepting CFB series 10 on the platform and allowing CCM to provide its services on the platform knowing this would result in its ordinary retail SIPP clients who used CCM's services investing a significant proportion of their pension monies in the bonds. In my view, in so acting IFDL failed to: (a) act with due care, skill, and diligence (b) reasonably manage or control its affairs (c) pay regard to the interests of Mr J and treat him fairly.

I have noted the criticisms IFDL has made as to the investigator's findings, including what it refers to as 'cut and paste' paragraphs from other decisions by our service and the suggestion this might mean the complaint hasn't been considered on its own facts.

Given what it has said, before I set out my findings I want to make clear that, whilst we consider each case on its own facts, it is inevitable that extracts from relevant case law and publications by the FCA and other bodies, as well as what we say about these, will sometimes be the same or similar to what has been said in other decisions when we are dealing with complaints that raise similar issues. This doesn't mean that we do not consider each case on its own facts, as I have done with this complaint. The fact I have, to a large extent, made the same points as the investigator and referred to the same material evidence as he relied on does not mean I haven't considered all the information or decided this case independently.

In explaining why I have decided IFDL was at fault it is first necessary to understand its responsibilities as a SIPP operator.

What were IFDL's responsibilities in relation to Mr J?

IFDL is a platform provider and SIPP operator who provides its services to clients on an execution-only basis. Clients can only access its platform and SIPP through a financial adviser. It doesn't provide any advice on the suitability of any investment or model portfolio available on its platform, the composition of a client's portfolio or the instruction of a DFM. However, it did have other responsibilities in relation to its clients, as I set out below.

The regulatory framework

I think the starting point for IFDL's regulatory responsibilities are the FCA's Principles, which apply to all regulated firms.

PRIN 1.1.2G in the FCA's Handbook explains:

"The Principles are a general statement of the fundamental obligations of firms and the other persons to whom they apply under the regulatory system."

And PRIN 1.1.9G states:

"Some of the other rules and guidance in the Handbook deal with the bearing of the Principles upon particular circumstances. However, since the Principles are also designed as a general statement of regulatory requirements applicable in new and unforeseen situations, and in situations where there is no need for guidance, the FCA's other rules and guidance or onshored regulations should not be viewed as exhausting the implications of the Principles themselves."

Put simply, the above guidance makes clear that whilst there can be an overlap between the

Principles and rules and guidance in the Handbook, the Principles can potentially be wider in scope.

The Principles are set out under PRIN 2.1.1R and I think the following are relevant to this complaint:

Principle 2 - Skill, care, and diligence: A firm must conduct its business with due skill, care, and diligence.

Principle 3 – Management and control: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 6 - Customers' interests: A firm must pay due regard to the interest of its customers and treat them fairly.

IFDL has not argued specifically that the Principles aren't relevant or that we should not take them into account when determining a complaint. However, it has referred to the investigator cutting and pasting paragraphs from other decisions we have issued, as I have already mentioned. It has also pointed out that cases relied on by the investigator, which concern the application of the Principles, were decided between 2018 and 2020, after it accepted the CFB bond onto its platform and it became available within CCM model portfolios.

So, it does appear to be questioning whether these cases and their findings as to the relevance of the Principles can be taken into account. In the circumstances I think it is necessary for me to explain why the Principles are something I should consider in making a fair and reasonable decision. In doing so, I will be referring to some of the same extracts from the cases as the investigator but I have not cut and pasted these from his opinion or any other decision and, as I have already made clear, setting out the extracts that are referred to in other decisions doesn't mean I have not considered this complaint on its own facts.

The relevant cases are R (British Bankers Association) v Financial Services Authority (2011) EWHC 999 (Admin) ("BBA"), R (Berkley Burke SIPP Administration Ltd) v Financial Ombudsman Service (2018) EWHC 2878 ("BBSAL"), Adams v Options SIPP (2020) EWHC 1229 (Ch) and Adams v Options UK Personal Pensions LLP (2021) EWCA Civ 474.

The BBA case was decided in 2011, so long before the issues in this complaint arose. It involved a challenge, by way of judicial review, to a policy statement issued by the FSA in relation to the handling of PPI complaints by firms, which included amendments to the Handbook.

The main argument put forward by the BBA was that the policy statement was unlawful because it treated the Principles as giving rise to obligations owed to customers which led to compensation being payable for breach even though the Principles weren't actionable in law.

There was a secondary argument that because the regulator had made specific rules governing the manner in which PPI policies are sold - which were designed to incorporate in their ambit the implications of the Principles - it was unlawful for the FSA to provide in the policy statement that a customer might be entitled to redress by reference to Principles which conflicted with or augmented those specific rules.

It was also argued that if either of these arguments were correct then our service was acting unlawfully in setting out guidance on our website stating that the Principles would be taken into account when determining if compensation would be fair and reasonable redress.

In rejecting the arguments put forward on behalf of the BBA the court made various statements that related to the Principles and our consideration of them when we determine what is fair and reasonable. I think the extracts I have set out below make clear that we can and should take into account the Principles when deciding a complaint.

In referring to our obligation to take into account, amongst other things, relevant rules, guidance and standards, Ouseley J. said at paragraph 75 of his judgment that:

"I would have thought it obvious that the Principles were relevant rules, subject to the argument about their relationship to specific rules,…"

And at paragraph 77

"Indeed, it is my view that it would be a breach of statutory duty for the Ombudsman to reach a view on a case without taking the Principles into account in deciding what would be fair and reasonable and what redress to award. Even if no Principles had been produced by the FSA, the FOS would find it hard to fulfil its particular statutory duty without having regard to the sort of high-level principles which find expression in the Principles, whoever formulated them. They are of the essence of what is fair and reasonable, subject to their argument about their relationship to specific rules."

In dealing with the application of the Principles where there were specific rules in place he said the following at paragraph 161:

"The Principles are the overarching framework for regulation, for good reason. The FSA has clearly not promulgated, and has chosen not to promulgate, a detailed all-embracing comprehensive code of regulations to be interpreted as covering all possible circumstances…….The overarching framework would always be in place to be the fundamental provision which would always govern the actions of firms, as well as to cover all those circumstances not provided for or adequately provided for by specific rules."

And at paragraph 162:

"The Principles are best understood as the ever present substrata to which the specific rules are added. The Principles always have to be complied with. The specific rules do not supplant them and cannot be used to contradict them. They are but specific applications of them to the particular requirements they cover. The general notion that the specific rules can exhaust the application of the Principles is inappropriate. It cannot be an error of law for the Principles to augment specific rules."

In relation to our reliance on the Principles when deciding what is fair and reasonable Ouseley J. said at paragraph 184:

"The width of the Ombudsman's duty to decide what is fair and reasonable, and the width of the materials he is entitled to call to mind for that purpose, prevents any argument being applied to him that he cannot decide to award compensation where there has been no breach of a specific rule, and the Principles are all that is relied on."

The BBSAL case was decided in 2018 but was a judicial review of an ombudsman decision provided in February 2017 which dealt with events that took place in 2011 - involving a client investing in an unregulated investment to be held in a SIPP administered by BBSAL, which investment turned out to be fraudulent.

The complaint in BBSAL was that the respondent had allowed a particular, exotic, investment to be admitted as an investment that could be offered to its SIPP clients,

including the complainant, whereas proper due diligence would have revealed that the investment was inappropriate for SIPP clients, and a fraudulent scam.

The ombudsman in that case stated that the Principles were relevant to his decision as to what was fair and reasonable, stating that Principle's 2 and 6 were of particular relevance and that these together meant that BBSAL was obliged to carry out due diligence on the investment held in the SIPP it administered.

The judgment of Jacobs J. included passages he cited from the BBA case, after which he stated at paragraph 104:

"These passages explain the overarching nature of the Principles. As the FCA correctly submitted in their written argument, the role of the Principles is not merely to cater for new or unforeseen circumstances. The judgment in BBA shows they are, and indeed were always intended to be, of general application. The aim of the Principles-based regulation described by Ouseley J. was precisely not to attempt to formulate a code covering all possible circumstances, but instead to impose general duties such as those set out in Principles 2 and 6."

And at paragraph 107:

"The passages in the judgment of Ouseley J. discussed above were essentially directed at the question of whether the FSA could use the Principles to augment the rules. The answer to that question was that it could and there is no suggestion that the concept of augmentation was to be limited in the manner BBSAL contended. However, it is also important that the present case concerns the decision of an Ombudsman, rather than the FSA. In that connection, it is clear from the judgment of Ouseley J. that the Ombudsman can permissibly take an even broader approach than the regulator."

And then, after citing more passages from the BBA case, Jacobs J. at paragraph 109 stated:

"I consider that these passages, too, are fatal to BBSAL's attempts to put limits on the extent to which the Ombudsman was entitled to use the Principles in order to augment existing rules or duties. The Ombudsman has the widest discretion to decide what was fair and reasonable, and to apply the Principles in the context of the particular facts before him."

This reinforces the position I think was already made clear by the BBA case that the Principles are a relevant consideration for me when determining what is fair and reasonable in a complaint.

Adams was a civil case about the liability of a SIPP provider to an investor who transferred his pension plan to the SIPP. Its general context was therefore somewhat similar to the present complaint, although the facts were quite different. However, the courts were limited to considering the case as presented and the law in relation to that case. I am not so constrained and can take account of matters the courts could not, including good industry practice. Moreover, the Principles were not in issue in either the High Court or Court of Appeal, presumably because no action in damages is given to person who suffers a loss as a result of a breach of the Principles.

In the High Court HHJ Dight referred to the judgment of Jacobs J. in BBSAL as not being of direct relevance in the case he was considering. One of the reasons given by HHJ Dight for this was that the specific regulatory provisions that Jacobs J. was asked to consider weren't those that formed the basis of the case before him. Given the Principles were regulatory provisions in issue in BBSAL this part of HHJ Dight's judgment made clear, in my view, that the Principles weren't a relevant consideration in his judgment.

HHJ Dight did consider another regulatory provision, COBS 2.1.1R (a firm must act honestly, fairly, and professionally in accordance with the best interest of the client) and rejected the argument that there had been a breach of that rule by Options SIPP. Although the Court of Appeal overturned his judgment, it didn't do so on the basis that his decision that there had been no breach of COBS 2.1.1R was wrong.

There is some overlap between COBS 2.1.1R and the Principles I have referred to above – as the investigator noted. However, the Principles are potentially wider than any specific rule such as COBS 2.1.1R. Moreover, the Adams case was decided on its own facts and it was acknowledged by HHJ Dight when giving his judgment in relation to COBS 2.1.1R that the 'factual context would inform the extent of the duty imposed by the rule'.

The facts of this complaint and the issues that arise are different to those raised in relation to breach of COBS 2.1.1R in the Adams case. In particular, this complaint (like BBSAL) raises issues about the quality of the due diligence in light of FCA guidance and good industry practice, as opposed to whether there has been breach of an actionable duty imposed under the FCA rules. At paragraph 155 of his judgment HHJ Dight explained there were several differences between the case before him and those in BBSAL, which meant the case was not relevant to his decision. Amongst these were the fact that BBSAL concerned an ombudsman' decision (which his case did not), that he didn't have to determine the question of the respondent's due diligence in accepting the investment, and that BBSAL concerned different regulatory provisions – namely the Principles - to those which were the basis of Mr Adams' case.

This complaint does not concern breach of COBS 2.1.1R but is directly concerned with IFDL's due diligence before accepting the bonds onto its platform, and with the regulatory Principles and industry good practice applicable to that due diligence. So, I don't find HHJ Dight's judgment of much assistance when it comes to deciding the issues at the centre of this complaint.

In summary, having considered the cases I have referred to above I am satisfied that the Principles are a relevant consideration in this complaint and something I should take account of in reaching a fair and reasonable determination of the complaint.

The regulatory publications

There are various publications from the regulator that make clear the need for SIPP operators to have in mind the Principles. In these publications the regulator identifies various failings by SIPP operators in terms of compliance with the Principles as well as examples of what amounts to good industry practice to help firms to comply with their obligations under the Principles.

These include the regulator's reports of September 2009 and October 2012 following its thematic reviews of SIPP operators, its October 2013 SIPP operator guidance, and a Dear CEO letter to SIPP operators in July 2014 following a further thematic review carried out after the publication of the 2013 SIPP operator guidance.

The 2009 thematic review report included the following:

"We are concerned by a relatively widespread misunderstanding among SIPP operators that they bear little or no responsibility for the quality of the SIPP business that they administer, because advice is the responsibility of other parties, for example Independent Financial Advisers (IFAs)."

"We are very clear that SIPP operators, regardless of whether they provide advice, are

bound by Principle 6 of the Principles for Businesses ('a firm must pay due regard to the interests of its customers and treat them fairly') insofar as they are obliged to ensure the fair treatment of their customers. COBS 3.2.3(2) states that a member of a pension scheme is a 'client' for COBS purposes, and 'Customer' in terms of Principle 6 includes clients.."

"It is the responsibility of SIPP operators to continuously analyse the individual risks to themselves and their clients, with reference to the six TCF consumer outcomes."

"We agree that firms acting purely as SIPP operators are not responsible for the SIPP advice given by third parties such as IFAs. However, we are also clear that SIPP operators cannot absolve themselves of any responsibility, and we would expect them to have procedures and controls, and to be gathering and analysing management information, enabling them to identify possible instances of financial crime and consumer detriment such as unsuitable SIPPs. Such instances could then be addressed in an appropriate way, for example by contacting the members to confirm the position, or by contacting the firm giving advice and asking for clarification. Moreover, while they are not responsible for the advice, there is a reputational risk to SIPP operators that facilitate SIPPs that are unsuited or detrimental to clients."

The 'TCF consumer outcomes' is a reference to the six outcomes that the regulator wanted its 'Treating Customer's Fairly' initiative to achieve. These were set out in a paper published by the FSA in July 2006. I am not going to refer to all six outcomes, but Outcome 2 is:

"Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly."

I think this is relevant in this complaint given the target market for IFDL's SIPP were ordinary retail clients using its services to invest their pension pots. In the circumstances I think the 2009 thematic review suggests that, as part of its duty to take into account its customer's interests and treat them fairly, it was for IFDL to take steps to understand the risks to their customers from the SIPP investments and ensure these were designed to meet the needs of the consumer group – retail clients investing their pension pots – its SIPP service catered to and targeted accordingly.

The 2009 report gave examples of measures that SIPP operators could consider that were examples of good practice that the regulator had seen whilst carrying out the thematic review. The examples included such things as: confirming initially and on an ongoing basis that intermediaries advising clients were authorised and regulated; routinely recording and reviewing the type and size of investments recommended; being able to identify anomalous investments such as unusually large or small transactions or more 'esoteric' investments such as unquoted shares.

The introduction to the 2012 thematic review report explains that it was undertaken to investigate concerns that the regulator had about poor firm conduct and the potential for significant consumer detriment and to determine the extent to which SIPP operators had adapted processes and procedures to reduce risks following the 2009 report. The regulator stated in the introduction that the findings of the review confirmed its concerns. The 2012 report states that all SIPP operators should review their business in light of the contents of the report.

The findings from the review included:

"inadequate risk identification processes and risk mitigation planning underpinned by poor quality management information (MI)."

"An increase in the number of non-standard investments held by some SIPP operators, with often poor monitoring of this."

"A lack of evidence of adequate due diligence being undertaken for introducers and investments."

The report stated that:

"In our 2009 report we identified that there was a relatively widespread misunderstanding among SIPP operators that they bear little or no responsibility for the quality of the SIPP business they administer, as this is the responsibility of clients and client's advisers……"

As we stated in 2009, we are very clear that SIPP operators, regardless of whether they provide advice, are bound by Principle 6 of the Principles for Business: a firm must pay due regard to the interests of its customers and treat them fairly', in so far as they are obliged to ensure fair treatment of their members."

And, under the heading 'Non-standard investments, due diligence and financial crime' the report states:

"Some SIPP operators were unable to demonstrate that they are conducting adequate due diligence on the investments held by their members or the introducers who use their schemes, to identify potential risks to their members or to the firm itself."

The review set out the regulator's expectation that SIPP operators review their business, paying particular attention to - amongst other things - whether their risk identification and risk mitigation planning is sufficiently robust to ensure that the firm has safeguarded its customer's interests and the level of non-standard investments held within their schemes.

The 2012 thematic review was followed by the regulator's finalised SIPP operator guidance dated 8 October 2013. It states that:

"This guide, originally published in September 2009, has been updated to give firms further guidance to help meet the regulatory requirements. These are not new or amended requirements, but a reminder of regulatory responsibilities that became a requirement in April 2007.

All firms, regardless of whether they do or do not provide advice must meet Principle 6 and treat customers fairly. COBS 3.2.2(2) is clear that a member of a pension scheme is a 'client' for SIPP operators and so is a customer under Principle 6. It is a SIPP operator's responsibility to assess its business with reference to our six TCF customer outcomes."

Under the heading 'Management Information (MI)' it states:

"Principle 6 of the FCA's Principles for Businesses requires all firms to pay due regard to the interest of its customers and treat them fairly. SIPP operators are not responsible for the SIPP advice given by third parties such as financial advisers. We would expect SIPP operators to have procedures and controls in place that enable them to gather and analyse MI (Management Information) that will enable them to identify possible instances of financial crime and consumer detriment."

The guidance goes on to give examples of MI firms should consider which includes; the ability to identify trends in the business submitted by introducers; ability to identify the number of investments; the nature of those investments; the amount of funds under management; spread of introducers; and the percentage of higher risk or non-standard

investments.

And, under the heading 'Relationships between firms that advise and introduce prospective members and SIPP operators, examples of good practice are provided which include:

"Being able to identify irregular investments, often indicated by unusually small or large transactions; or higher risk investments such as unquoted shares which may be illiquid. This would enable firms to seek appropriate clarification, for example from the prospective member or their adviser, if it had any concerns."

And under the heading 'Due Diligence' the FCA said the following:

"Principle 2 of the FCA's Principles for Businesses requires all firms to conduct their business with due skill, care, and diligence. All firms should ensure that they conduct and retain appropriate and sufficient due diligence (for example, checking and monitoring introducers as well as assessing that investments are appropriate for personal pension schemes) to help them justify their business decisions. In doing this SIPP operators should consider:

- *ensuring that all investments permitted by the scheme are permitted by HMRC, or where a tax charge is incurred, that charge is identifiable, HMRC is informed and the tax charge paid.*

- *periodically reviewing the due diligence, the firm undertakes in respect of the introducers that use their scheme and, where appropriate, enhancing the processes that are in place in order to identify and mitigate any risks to the members of the scheme*

- *having checks which may include, but are not limited to:*

    - *ensuring that introducers have the appropriate permissions qualifications and skills to introduce different types of business to the firm and*

    - *undertaking additional checks such as viewing Companies House records, identifying connected parties and visiting introducers*

    - *ensuring all third-party due diligence that the firm uses or relies on has been independently produced and verified*

    - *good practices we have identified in firms include having a set of benchmarks, or minimum standards, with the purpose of setting the minimum standard the firm is prepared to accept to either deal with introducers or accept investments, and*

    - *ensuring those benchmarks clearly identify those instances that would lead a firm to decline the proposed business, or to undertake further investigations such as instances of potential pension liberation, investments that may breach HMRC tax-relievable investments and non-standard investments that have not been approved by the firm.*

Following the SIPP operator guidance the regulator carried out a further thematic review. On 21 July 2014 it wrote a Dear CEO letter to the Chief Executives of SIPP operators about the findings of the review. In the letter the FCA said the review focused on the due diligence procedures SIPP operators used to assess non-standard investments and how well firms were adhering to the relevant prudential rules.

The letter went on to say that during the review it found a significant number of SIPP operators were failing to manage the risks and ensure customers were protected appropriately. The FCA encouraged SIPP operators to review the key findings in its thematic review, which were summarised in an annex to the letter, and asked them to take action to ensure their businesses were able to demonstrate an appropriate degree of protection for consumers' pension savings.

The annex stated that the thematic review identified significant failings in due diligence procedures to assess non-standard investments and that:

"Principle 2 of the FCA's Principles for Business requires all firms to conduct their business with due skill, care, and diligence. SIPP operators should ensure that they conduct and retain appropriate and sufficient due diligence, for example, assessing that assets allowed into a scheme are appropriate for a pension scheme. Our thematic review found that most SIPP operators failed to undertake adequate due diligence on high-risk, speculative and non-standard investments…."

The annex then states that the review assessed due diligence in five key areas, including firms correctly establishing and understanding the nature of an investment, and that typically firms had difficulty completing due diligence for non-standard investments.

The annex refers to the definition of non-standard assets as set out in the FCA's Consultation Paper - CP12/13. The definition is by way of a list of standard assets with all assets not on the list being categorised as non-standard assets.

The list includes corporate bonds but also included the following explanation for standard assets:

"Standard assets must be capable of being accurately and fairly valued on an ongoing basis, readily realised whenever required (up to a maximum of 30 days) , and for an amount that can be reconciled with the previous valuation."

The annex also includes the following statement:

"Also, since the last review of SIPP operators, we noted an increase in the number of opaque investment structures, such as special purpose vehicles and limited companies, created to pool investment monies and finance other businesses. Firms had difficulty establishing where money was being sent, and whether underlying investment propositions were genuine."

The investigator stated that the only formal guidance in the above documents is the SIPP operators guidance of 2013. However, it is worth noting that this stated that the guidance was originally published in September 2009 and had been updated to give firms further guidance to help meet the regulatory requirements. It made clear that it didn't provide new or amended requirements but was a reminder of regulatory responsibilities that became a requirement in April 2007.

In any event, the reports of 2009 and 2012 and the Dear CEO letter of 2014 explained what the regulator thought SIPP operators should be doing to comply with their obligations under the Principles and deliver the outcomes the regulator envisaged. I am satisfied that the publications I have referred to which didn't amount to formal guidance nevertheless provide examples of what amounts to good industry practice. I am therefore satisfied that they are relevant and something I should take account of in reaching a fair and reasonable decision in this complaint.

However, I also think it is important to keep in mind that the SIPP guidance of 2013 and other publications I have set out only provide examples of good industry practice, not the limits of what might amount to such practice or what SIPP operators should do to comply with their regulatory obligations.

I note that IFDL has said that the investigator didn't explain how the SIPP operator guidance operated specifically in the context of the advised-only platform market and its business structure, and that the guidance doesn't extend to how SIPP operators ought to behave in relation to DFM's. However, I am not persuaded that there is any reason to think the SIPP operator guidance should be looked at differently for IFDL because of its business model. There is nothing in the guidance which suggests this.

The 2009 report referred to the relatively widespread misunderstanding on the part of SIPP operators in thinking they didn't have responsibility for the quality of the SIPP work they administered because advice is the responsibility of other parties, such as IFAs. This was referred to again in the 2012 report. Moreover, the 2013 SIPP operator guidance explicitly stated it applied to all SIPP operators and there is nothing that suggests it applied differently to IFDL because of its business model. On the contrary, the regulator specifically emphasised its concerns that some SIPP operators wrongly believed that they were relieved from their client related duties under the Principles just because they themselves didn't provide advice and their clients had other financial advisers.

What was IFDL obliged to do in practice

IFDL is a platform provider and SIPP operator providing services to retail clients and as such I am satisfied that as part of its regulatory responsibilities as set out above it needed to decide whether particular investments and/or referrals of business should or shouldn't be accepted on its platform.

To be able to make that decision it needed to carry out due diligence that was in accordance with good industry practice that allowed it to understand the nature of investments it was asked to accept on the platform and the risk of consumer detriment they might pose. It also needed to carry out due diligence on firms that wanted to provide their services through the platform.

In this case, that means IFDL needed to carry out due diligence on CFB bonds and CCM that allowed it to correctly identify the nature of the bonds and the risk of consumer detriment arising from its retail SIPP clients investing in them through a CCM model portfolio. Having carried out such due diligence it needed to decide, based on the conclusions it should reasonably have come to, whether it should accept or decline the investment and the business from CCM.

IFDL's due diligence on CCM

IFDL's due diligence on CCM before initially accepted it onto the platform consisted of it considering a due diligence questionnaire completed by CCM in 2015, IFDL completing an approval form, and it considering CCM's 'Report and Financial Statements' dated 31 March 2015 - as I have set out in more detail in the background above.

Its ongoing due diligence consisted of CCM completing a further DFM questionnaire in January 2017. CCM had at this point requested that IFDL accept CFB series 8 on its platform for use within its model portfolios, so IFDL knew CCM intended to use the bond series within its models. However, the questionnaire was in the same format as the original questionnaire and provided broadly the same limited information so there was no consideration of CCM's proposed use of the bonds within the portfolios. CCM's accounts for

the end of March 2016 were also available at this time, showing it was still operating at a loss.

CCM completed a further DFM questionnaire in the first part of 2018 providing the same sort of limited information as previously. By this time not only had CCM created two tranches of its model portfolios that showed it intended investing at least 30% of every model in the bonds, IFDL would by this time also have accepted a significant number of applications for the model portfolios from its retail clients showing the proportion of their pension monies actually invested in the bonds. It is apparent that this wasn't something considered by IFDL in the course of its due diligence on CCM.

The accounts for the financial year to the end of March 2017 were also available at this time, showing that CCM was still operating at a loss.

IFDL's due diligence on the bonds

IFDL was asked by CCM to accept the bonds on its platform in July 2016 and was provided with listing particulars for the bond programme and the bond brochure at the time. It accepted CFB series 3 onto the platform in August 2016 following completion of its vetting process. However, as the series was an interest bearing note it couldn't be accepted within CCM's model portfolios on the platform. This led to CFBL creating CFB series 8 as a zero coupon note to address this.

There was a meeting of IFDL's Finance and Investment Committee on 13 December 2016 to discuss CFB series 8. The minutes of that meeting include the following:

"Currently we have the Corporate Bond Fund listed on the Platform however because it is a Bond it cannot be held within a model (interest payment issue). This new proposition will remove the interest payment issue and allow the Bond to be included in model and could bring £4 million onto the Platform. (name anonymised) confirmed that the product would be held in CREST and would be exclusively made available to Clear Capital DFM only (and their Adviser firms)."

And

"Both JK and JB advised that we need to be looking to add this product because it is already available on Transact and we need to be competitive. (name anonymised) confirmed that it would need to be fully vetted to ensure that we could operationally hold the asset. JK confirmed that (name anonymised) was happy we could trade the product. (name anonymised) confirmed that there were other operational aspects to consider."

I note the reference to the bonds being available on 'Transact'. I have been provided with no further information in relation to that. However, I don't think this is likely to be a reference to CFB series 8 given it had only just been created for IFDL's platform so that it could be used within CCM model portfolios. In any event, even if CFB series 8 had been accepted on another platform, this didn't change IFDL obligations so far as its own due diligence was concerned.

The above meeting notes provide a clear indication that IFDL had decided to accept CFB series 8 as long as it could be held 'operationally'. What is meant by this is shown by the vetting sheet subsequently completed for the bonds, which I refer to further below. There is no suggestion in the meeting notes that IFDL considered the risks to its clients if it accepted the bonds on the platform.

On 23 December 2016 SAL/CFBL emailed IFDL stating that CFB series 8 had been built

"specially to your requirements to allow it to be held in a model portfolio..". The email enclosed the pricing supplement and a fact sheet for CFB series 8 along with listing confirmation from the Irish Stock Exchange.

The email response from IFDL the same day states:

"I confirm that this has now been passed across to my Fund and Stock teams to get the vetting done and the asset added to the platform (which provided all boxes are ticked should not prove an issue!)"

CFB series 8 was thereafter vetted in January 2017 and IFDL's vetting process can be seen in the 'vetting sheet' that was completed. This consists of a series of questions referred to as terminal tests under the heading 'business case'. The questions include; does the asset settle in CREST? (a reference to the settlement system that allows shares that have been sold between members of CREST to be transferred electronically); is it depositable or withdrawable from CREST?; is the asset suspended?.

These 'terminal tests' are followed by a 'business risk assessment' with questions about the asset type, where the investment is listed, where it is incorporated, and what exchange it trades on - a risk level of 'G1' is given in relation to the answers for asset type and place of incorporation.

The investments within the G1 risk category are shown as stocks, investment trusts, corporate bonds, and UK Gilts. The nature of the assets included in this category, as compared with those within other risk categories in the vetting sheet, indicates the G1 risk category denoted lower risk investments. There was nothing in the vetting process that suggests IFDL distinguished between standard and non-standard investments that came within the G1 risk category.

The vetting sheet completed for CFB series 10 in June 2017, mirrors the answers shown in the vetting sheet for CFB series 8 – the answers to the terminal tests are the same as are the answers to the questions under the business risk assessment, with the asset risk and place of incorporation risk again being given a risk category of 'G1'.

Both CFB series 8 and CFB series 10 were accepted by IFDL and available for its retail clients to invest in through a CCM model portfolio following the completion of the respective vetting sheets.

Was the due diligence carried out by IFDL in accordance with good industry practice and its regulatory obligations?

IFDL doesn't appear to argue that its due diligence was in accordance with the examples of good industry practice referred to by the regulator that I have identified. Rather, it argues that its due diligence was in accordance with good industry practice at the time for a "SIPP/platform operator that used an advised-only execution-only model".

In other words IFDL seeks to distinguish itself from SIPP operators who provide advice. Its argument suggests that it is of the view that because Mr J was advised to invest in a CCM model portfolio - which included the bonds - by another firm, the good industry practice I have identified didn't apply to it.

However, whilst IFDL wasn't responsible for considering the suitability of the portfolio or of the bonds for Mr J, there is nothing in what the regulator said in the various regulatory

publications that suggests that its expectations of SIPP operators and the examples of good industry practice it referred to didn't apply to IFDL because of its business model.

To the contrary, as I have said, the regulatory publications I have referred to made clear that the examples of good practice referred to applied to all SIPP operators – the 2013 SIPP operator guidance explicitly stated as much and the 2009 thematic review referred to the misunderstanding on the part of SIPP operators that because other parties are responsible for advising the client they bear no responsibility for the quality of the SIPP business provided.

IFDL accepted the bonds on the platform and allowed CCM to provide its services through the platform having assessed only its technical ability to hold the bonds and its own business risk and needs. It didn't consider the nature of the bonds or the risks to its clients if they were invested in a CCM model portfolio that included them or their appropriateness for a SIPP. I think it is fair and reasonable to find that its limited due diligence was inadequate and wasn't in accordance with good industry practice and its regulatory obligations. I explain in more detail why I have come to this conclusion below.

The conclusions that IFDL should have reached through carrying out due diligence in accordance with good industry practice.

The examples of good industry practice I have already referred to included SIPP operators correctly establishing and understanding the nature of investments and identifying higher risk investments that might be illiquid and whether investments are appropriate for pension schemes.

IFDL was first approached by CCM about the bonds being accepted on the platform in around July 2016 and was provided with the listing particulars and bond brochure from CFBL.

The listing particulars included the following information:

- *"Notes (i.e. the bonds) may have no established trading market when issued, and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at a price that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Notes especially sensitive to interest rate, currency, or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Notes generally would have a more limited secondary market and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Notes."*

- *"The Borrowers (i.e. to whom the issuer of the bonds, CFBL, intended to makes loans) may be (a) wholly or partially owned subsidiaries of the Issuer, (b) affiliated entities of the Issuer, or (c) other third parties. There will, in respect of each Series of Notes, be more than 5 borrowers and the principal amount of each Borrower Loan will not account for more than 20% of the aggregate principal amount of all Borrower Loans outstanding per series of Notes."*

- *The proceeds from the bonds would be used to advance secured or unsecured loans to small and medium sized companies.*

CFBL's bond programme brochure stated that the investment programme was only available to certain categories of client - such as professional clients and certified sophisticated investors.

IFDL was asked to accept CFB series 8 in December 2016 and was provided with information about the series through various documents, including a fact sheet and pricing supplement. The return on the bonds is shown as 6.25% per annum payable at the end of the five-year term in the documents.

The fact sheet refers to loans being made to as few as five borrowers. This isn't consistent with the listing particulars, which referred to more than five borrowers, but it is the pricing supplement that takes precedence. There are a very broad range of potential borrowers in various markets referred to, with no real detail about what CFBL intended to do with the money clients invested in the bonds beyond this.

The security position for the bonds was also unclear. The listing particulars stated that bonds could be secured or unsecured. However the fact sheet refers to security being provided by a fixed or floating charge over all assets or a specific asset whilst also stating a charge would be taken over all assets by way of debenture.

But even if a debenture over all assets was obtained, the lack of detail about what CFBL intended to do with the bond proceeds meant this gave little assurance that security would be meaningful and provide any real degree of protection for clients investing in the bonds through a CCM model portfolio.

IFDL was also aware that CFB series 8 was developed as a zero coupon note for CCM model portfolios on IFDL's platform. This was made clear both in the fact sheet for the series – which stated "Series developed exclusively for Ascentric platform with raise of £4 million" – and an email from SAL/CFBL to IFDL dated 23 December 2016 which referred to this being built to IFDL's requirements.

The meeting notes of 13 December 2016 from IFDL's Finance and Investment Committee refers to the bond being made available exclusively to CCM and there was nothing to suggest to IFDL that anyone other than CCM would be purchasing the bonds for retail clients investing in its model portfolios. So, as far as IFDL was aware at the time, the £4 million that CFBL was seeking to raise through CFB series 8 would only be achieved through CCM purchasing the bonds within its model portfolios.

In summary:

- *The listing particulars made clear the type of client the bonds were aimed at, indicating that the bonds weren't a standard investment meant for ordinary retail clients.*

- *The listing particulars warned that a secondary market may not develop and that if it did it might be illiquid - again pointing to the bonds not being a standard investment and at the outset making it clear that there could well be liquidity issues.*

- *The listing particulars warned that the risk of illiquidity was greater if bonds were designed for specific investment objectives or structured to meet the investment requirements of limited categories of investors and CFB series 8 was developed as a zero coupon note exclusively for use within CCM model portfolios.*

- *The fact sheet and pricing supplement specified a return of 6.25% per annum at a time that standard five-year bonds were offering around 2% making clear the high-*

risk nature of the lending that CFBL was proposing and warning that the bonds had a higher risk of loss to make and again showing the bonds weren't a standard investment.

- *The fact sheet identified a broad range of potential borrowers and that the purpose of the lending was so borrowers could 'build sustainable revenue streams' but there was a lack of information about what CFBL was actually doing with client money and about the security.*

I think it is fair and reasonable to have expected IFDL in the circumstances to have concluded from the above that the bonds were a non-standard, speculative, and illiquid investment which wasn't appropriate for most retail client pensions, or at least not in any significant proportion.

I am mindful that Mr J's complaint isn't about CFB series 8 but about CFB series 10 but the above points are equally applicable to that series given it was part of the same bond programme and the documents provided to IFDL about the series in May 2017, in the main, mirrored the information about CFB series 8 – as I explain below. So it is reasonable to have expected IFDL to have reached the same conclusions about CFB series 10.

The documents for CFB series 10 included a fact sheet titled 'Terms and Information' which referred to; a return of 6.25% per annum over five years; prospective lending being to as few as five borrowers; the same broad range of potential borrowers as for CFB series 8 -but again with no information to show what CFBL was actually going to do with the money raised other than in broad terms; security to be by way of a registered debenture secured against all assets of the borrower – 'usually'.

IFDL was also provided with the pricing supplement for CFB series 10 which included an 'important notice' that wasn't included in the information about CFB series 8. This stated, amongst other things, that the investment opportunity is only available to certain categories of investor – such as certified sophisticated clients. This confirmed what the bond brochure had already made clear – namely that the bonds weren't aimed at ordinary retail clients.

IFDL was also sent the 'Investment Committee Submission' provided by CFBL for both CFB series 9 and CFB series 10. This refers to the bonds being wholesale bonds issued under section 21 approval of CCM – again making clear CCM's involvement with the promotion of the bonds. The submission goes on to state:

"Clear Capital Management, a Discretionary Investment Manager, is now commencing allocating assets to the Bond Series following approval of uniquely designed Series for UK platforms. This initiative means that the Corporate Finance Bonds Programme is the only fixed interest investment of this type that can be accessed via a model portfolio on a platform in the UK – a major market edge."

There isn't specific reference to the bonds being developed for use by CCM on IFDL's platform, as was stated for CFB series 8, but CCM is the only DFM referred to in relation to the bonds and there is nothing to suggest to IFDL that any firm other than CCM would be purchasing the bonds within its model portfolios. So, although IFDL may not have been informed that CCM was the only purchaser of the bonds, it didn't have any information to the contrary. In short, as far as IFDL was aware from the information available to it, CFBL was dependent on CCM to achieve the raise of £25 million in the same way it was dependent on it for the raise of £4 million for CFB series 8.

The only difference of any note between CFB series 8 and CFB series 10 is that CFB series 10 was indicatively rated by a ratings agency. The rating is prominently displayed on the fact

sheet and pricing supplement as "Public 'A' (sf(ind) rating with Stable Outlook by ARC Ratings S.A". This is something that CFBL emphasised in its promotion of the bonds and clearly placed great reliance on.

A good final rating from a credit rating agency provides an assurance that the business issuing the bond will be able to meet its financial obligations. However, the same cannot be said of an indicative rating - which is what CFB series 10 had.

ARC Ratings makes clear that an indicative rating is assigned when a final rating is dependent upon the fulfilment of specific contingencies or a review of the draft documentation. IFDL didn't know what information CFBL had provided for it to be granted an indicative rating or that a review of the documentation would lead to a final rating being issued - or whether there were contingencies it would be able to fulfil. In the circumstances no great reliance should have been placed on the bonds being indicatively rated.

Furthermore, ARC Ratings states that the maximum period that an indicative rating should continue for is six months. So, IFDL should have expected a full rating within that period and when this wasn't forthcoming it should have realised this was unusual and caused it to question what was going on. It should also have been aware that the indicative rating was withdrawn by ARC Ratings in April 2018 at the request of CFBL. This should have caused IFDL to question why CFBL didn't want to proceed with the process and whether this meant it might not be able to meet its financial obligations. In any event, the indicative rating didn't change the nature of the bonds or make them appropriate for retail client pensions.

The nature of the bonds - a non-standard, speculative, and illiquid investment which wasn't appropriate to be held in most retail client pensions - should have led IFDL to consider carefully CCM's proposed use of the bonds within its models.

CCM created its first tranche of model portfolios at the end of January 2017 showing its intention to invest at least 30% in CFB series 8 within every model, from cautious to adventurous. It created its second tranche in September 2017, again showing that it intended to invest at least 30% in CFB series 10 within every model, regardless of the type of portfolio or its risk. In January 2018 CCM created its third tranche of model portfolios which once again showed its intention to invest at least 30% of every model in the bonds.

The proposed concentration of at least 30% of a client's portfolio in the securities of one issuer is hard to justify in any retail pension portfolio but to give such a weighting to securities of the risk and liquidity characteristics I've described in respect of the bonds, and irrespective of the type of portfolio, isn't reasonable and was an obvious red flag.

IFDL should have realised that it was unlikely that CCM was acting in the best interests of its clients when IFDL was first made aware CCM intended that at least 30% of all model portfolios would be invested in the bonds. The picture only became clearer as CCM created further tranches which showed the same exposure to CFB bonds, regardless of the type of portfolio or its risk. The information was consistent in showing that CCM intended that at least 30% of every portfolio would be invested in either CFB series 8 or CFB series 10.

I note that IFDL has argued that the proportion of CFB bonds and other assets in a model portfolio wasn't static and would have fluctuated over time, as clients invested and disinvested from the model portfolios and in line with market movements. In an email from CCM to IFDL dated 7 October 2016 CCM made clear that once held within a portfolio, the bonds wouldn't be used for rebalancing, and would effectively remain static until maturity. In other words once CCM invested its clients in the bonds within one of its model portfolios they would likely remain invested in the bonds for the full five-year term.

Moreover, whilst the concentration of CFB bonds in a model portfolio might fluctuate, IFDL didn't have any basis for thinking there would be any appreciable divergence from the weighting in CFB bonds shown when CCM created each tranche of its model portfolios on IFDL's platform.

IFDL appears to have paid no regard to the proposed use of the bonds within the model portfolios, its argument being that it was for CCM to determine the composition of its model portfolios. I accept IFDL wasn't responsible for deciding what the composition of the portfolios should be but that isn't the same as saying that it didn't need to consider the composition and the consumer detriment that might arise from this.

The SIPP operator guidance indicated that as part of their obligations under Principle 6 firms should have procedures and controls in place that enable them to gather and analyse MI that in turn will enable them to identify possible instances of consumer detriment.

IFDL had in place systems that allowed it to gather the relevant information about the composition of the portfolios but on its own case it didn't then consider the proportion of CFB bonds in the models. So, it didn't analyse this information, as I think it should have done in accordance with good industry practice and its obligations to treat its customers fairly under Principle 6.

Another significant feature is that the fact sheets made clear CCM's involvement in the creation of both CFB series 8 and CFB series 10 – it was named as the investment adviser and as having approved the fact sheets as a promotion for both series'. Moreover, IFDL was aware that CFBL and CCM were part of the same group of companies and that on the face of it CFBL was reliant on CCM to achieve the raise of £4 million for CFB series 8 and the raise of £25 million for CFB series 10.

This raised an obvious risk CCM might put the interests of CFBL - which was both its commercial client and an associated company - before that of its investment clients when making decisions about the use of the bonds within its model portfolios. In the circumstances IFDL shouldn't have simply relied on CCM complying with its own regulatory responsibilities.

IFDL should have recognised that there was a significant risk of consumer detriment if CCM's retail clients invested 30% or more in CFB bonds within its model portfolios. It is fair and reasonable to have expected IFDL, in accordance with good industry practice and its regulatory responsibilities, to have identified this risk, and having done so, to have concluded that it was such that it shouldn't accept the CFB bonds on the platform or allow CCM to provide its discretionary management service through the platform.

In summary, I am upholding this complaint for the following key reasons.

- *In accordance with good industry practice and its regulatory obligations IFDL should have carried out due diligence that allowed it to understand the nature of the bonds and whether they were appropriate for retail client pensions and the risk of consumer detriment that might arise from its retail clients being invested in them through a CCM model portfolio.*

- *IFDL's due diligence was limited to considering whether it could technically hold the bonds and its own business risk and needs and wasn't in accordance with good industry practice. In treating the bonds as it would a standard investment following its vetting process it failed to understand the nature of the bonds.*

- *If IFDL had carried out due diligence in accordance with good industry practice it should reasonably have concluded that the bonds were a non-standard speculative*

and illiquid investment that wasn't appropriate for most retail clients to invest any, or any significant part, of their pension pots in.

- *Given the bonds could only be purchased through a CCM model portfolio IFDL should have assessed the use of the bonds within the portfolios and having done so concluded that investing at least 30% of every type of model portfolio in the bonds – a speculative and illiquid investment – was anomalous and posed a significant risk of consumer detriment.*

- *IFDL should have concluded that this risk was such that it shouldn't accept the bonds on the platform nor allow CCM to provide its services through the platform. It is arguable it should have reached this conclusion when CCM created its first tranche of model portfolios in January 2017 showing its intention to invest 30% of every model portfolio in CFB series 8 - as it should have realised at this time that it was unlikely that CCM was acting in the best interests of its clients. It should certainly have reached this conclusion in September 2017 when CCM created its second tranche of model portfolios showing its continued intention to again invest 30% or more of every model in the bonds - this time in CFB series 10.*

- *In failing to carry out due diligence that was in accordance with good industry practice and in accepting the bonds and allowing CCM to provide its services through which it intended to invest at least 30% of every model portfolio in the bonds, IFDL was in breach of the Principles, in that it failed to: (a) act with due skill, care, and diligence (b) take reasonable care to organise and control its affairs responsibly (c) pay due regard to the interests of its customers and treat them fairly.*

I have noted that IFDL has taken issue with the investigator referring to the CFB bonds as 'effectively a mini-bond – illiquid debt securities marketed to retail investors'. It has said that there was little awareness of mini bonds in 2016 and that the risks with such investments weren't recognised by the industry and regulator until late 2019. It has further said the bonds weren't obviously unsuitable.

I don't think the fact that the bonds might now be categorised as mini-bonds, or something equivalent, is important in this case. Regardless of whether CFB bonds are called mini-bonds or not, the information IFDL had indicated they were a non-standard, speculative, and illiquid investment involving high-risk lending that wasn't appropriate for most retail client pensions.

The risk of significant consumer detriment arising from its retail clients being invested in the bonds through a CCM model portfolio should have been obvious to IFDL if it had carried out due diligence in accordance with good industry practice as it should have done.

I note that IFDL has referred to the number of financial advisers that recommended CCM act as DFM and manage their investments in line with one of its model portfolios and argues that this wide acceptance by different industry participants gave comfort that its assessment wasn't erroneous. This was a false comfort given my findings above and in any event the involvement of other firms isn't evidence it satisfied its own regulatory obligations.

IFDL has said that it isn't clear whether we consider that it ought not to have permitted the CFB bonds and/or CCM on to the investment platform at all or that it ought not to have accepted Mr J's application for a SIPP. I will try and be clear about the position as I see it.

Mr J shouldn't have been able to apply for a SIPP in July 2018 through which he invested in a CCM model portfolio that included the bonds because IFDL should have concluded long before his application – at the latest when CCM created its second tranche of model

portfolios in September 2017 – that it shouldn't accept the bonds on the platform as used within CCM model portfolios or allowed CCM to provide its services on the platform.

It is only because IFDL didn't comply with its regulatory obligations in the first place that Mr J was able to apply for a SIPP through which he invested around a third of his pension pot in the bonds within a CCM model portfolio. It shouldn't have accepted his application because it should have concluded that the bonds as used within CCM model portfolios wasn't appropriate for most retail client pensions, including his.

Standing back from the detailed analysis

Before I go on to set out what redress I think should be payable, I think it is worth taking a step back from the detailed analysis I have set out above and look in simple terms at what the information provided to IFDL showed.

In CFBL IFDL was dealing with a company that had no previous history of successful lending.

In the CFB bonds it had a non-standard, speculative, and illiquid investment recently created by CFBL which was inappropriate for most retail clients investing their pension monies and where it had no proper idea of what CFBL was going to do with the money except in very broad terms and where the security position was far from clear.

In CCM it had another new business which had no significant history as a discretionary manager, was running at a loss and was closely associated to CFBL as the issuer of the bonds - being part of the same group of companies. It was also the named investment adviser for the bonds and approved their promotion, so was very closely linked to the bonds as well.

CCM made clear its intention to invest at least 30% of every model portfolio in the bonds, regardless of the type of portfolio or its risk, when it created the first tranche of its model portfolios and its creation of subsequent tranches showed the same intention.

Given the above information it seems to me the risk of significant consumer detriment that might result from IFDL's clients being invested in CFB bonds through CCM model portfolios was clear.

What should IFDL do to put things right?

IFDL argues that CCM was largely responsible for deciding that CFB bonds were suitable for inclusion in the cautious model portfolio Mr J invested in and that Hunstman Hawkes as his IFA was primarily responsible for advising him about the suitability of individual investments and the model portfolio. It therefore argues that they are the firms that are predominantly responsible for Mr J's losses arising from his investment in the bonds.

However, even if those firms did fail in their own respective duties to Mr J, that doesn't break the causal connection between Mr J's losses and IFDL's own failings in accepting the bonds on its platform and allowing CCM to provide its services through which he was invested in the bonds.

If there was another complaint before me that was against another regulated firm that involved the issues I have considered in this complaint then the rules allow me to determine how much each firm should pay towards the overall amount payable. However, both CCM and Huntsman Hawkes have been dissolved and there is no complaint before me in relation to any other business that is connected to the issues raised by Mr J.

I have considered whether there is any other reason why IFDL should not pay all of Mr J's losses arising from his investment in CFB series 10 and I am satisfied there isn't. I have already said that there is no break in the causal link between its failures and Mr J's losses resulting from the involvement of other regulated firms which had their own distinct obligations to Mr J. I am also satisfied that all of the losses fall within the scope of IFDL's responsibilities to Mr J and there is no evidence that would support a finding that he has any responsibility for his losses that would justify a reduction to what IFDL should pay.

Mr J has received compensation from the FSCS in respect of the claim he put forward to it in relation to CCM. There is a reassignment of rights agreement between him and the FSCS, which is what has allowed him to bring his complaint about IFDL to us in the first place. Under that agreement he has to repay the FSCS the compensation it has paid to him plus interest. So, there is no basis for me reducing the redress payable by IFDL to take account of the compensation Mr J has already received.

Turning to what otherwise would have happened if Mr J's SIPP application hadn't been accepted, he has said he had decided to withdraw from his final salary pension scheme having made the decision to retire early and that he opted out of this on 31 March 2018. This was before he received any written advice from Huntsman Hawkes about investing in a model portfolio with CCM through IFDL's platform.

In the circumstances, based on the limited information I have seen in relation to this, it doesn't appear he opted out of his final salary pension specifically to move his pension to IFDL's SIPP. The evidence doesn't suggest he would simply have remained in his original pension if he hadn't applied for IFDL's SIPP and as such I think it is more likely than not he would have applied for a SIPP with a different provider.

As such, awarding redress based on the assumption that Mr J would have remained in his original pension is not a reasonable basis for calculating redress. However, I equally have no way knowing exactly what Mr J's portfolio would have consisted of if he had used a different SIPP provider, save that I think such portfolio would likely have consisted of standard investments.

I have also taken note of IFDL's argument that the redress awarded by the investigator was unfair because the only investment within his SIPP portfolio with which any issue was taken was the CFB bonds and the rest of the investments were standard investments.

Although I can't identify a specific alternative SIPP Mr J would have invested in and as such the specific investments he would otherwise have invested in, I think it is reasonable to find that this was likely to include the sort of standard investments that his SIPP portfolio included. In the circumstances I think the most appropriate basis for calculating redress is by reference to the inappropriate CFB bonds that his SIPP portfolio should not have included, rather than by reference to the whole portfolio.

I therefore think redress should be based on a comparison between the performance of CFB series 10 and a benchmark. In choosing an appropriate benchmark I have considered that Mr J was invested in a cautious model portfolio. I acknowledge that this does not mean that his portfolio could only be invested in investments that had a cautious level of risk. However, in the absence of any other evidence that would assist me in deciding what Mr J would otherwise have invested in I think the most appropriate benchmark is the one we typically use for investors who wanted a low level of risk."

I gave both parties the opportunity of responding and providing any further information they wanted me to consider before making my final decision.

Mr J responded and in short made the following key points:

- He isn't a 40% taxpayer as referred to in the provisional decision as he didn't take 25% lump sum from his pension but left this invested in a General Investment Account within his pension and started drawing from this in April 2020 and hasn't had to pay income tax to date. The lump sum amount when Huntsman Hawkes was his adviser was much larger and it was expected to last much longer.

- If IFDL deduct a notional 40% from the amount paid to him this would put him in a worse position than he would otherwise have been and he needs to know whether this would be deducted from the award limit of £160,000 or the total amount payable.

- If IFDL do pay the award into his pension this should be his current pension with Fisher Investments. He still has an account with IFDL because of the bonds and doesn't want payments into that account.

- He has received a total of £170,000 from the FSCS in respect of Huntsman Hawkes and CCM and if IFDL only pay him £160,000, the limit of the redress we can award before interest, he would end up worse off than the position before he complained and he would also need to sell funds in his SIPP to pay back the FSCS and would incur a tax liability in doing so.

IFDL also responded setting out why it didn't agree with my provisional decision. In summary it made the following key points.

- Mr J's losses arose from poor suitability advice provided by Huntsman Hawkes and CCM and at its core the provisional decision makes IFDL responsible for the quality of the suitability advice it didn't have FCA permissions to provide.

- If the FOS is right, it effectively requires platforms to underwrite the risks of unsuitable assets being recommended to customers and this will have a profound effect on the execution only advised only platform market which relies on FCA regulated firms to take responsibility for the suitability of investments.

- If the provisional decision is upheld FOS will have failed to comply with its obligations to act rationally, properly apply the law and give proper reasons for its decisions.

- The finding that IFDL owed a due diligence duty to Mr J is flawed because:

    - The FOS has relied on its previous decision in the Berkely Burke case without taking account of important factual differences.

    - The FOS has relied on the Principles coupled with FCA guidance as giving rise to a duty which does not and cannot exist in law and has therefore erred in law.

- If it did owe a duty which justified an obligation to pay compensation the extent of the duty was more limited than FOS contends.

- The losses that IFDL is required to compensate Mr J for are outside the scope of the duty owed.

- Insofar as Berkely Burke is correct, the finding in the provisional decision that IFDL owed the same duty as in that case, which relates to very different facts, contains an error of law and is irrational.

- Berkely Burke involved an unregulated introducer and an asset which turned out to be an investment scam whereas in this case there was no unregulated introducer and clients can't invest on IFDL's platform without a regulated adviser.

- This is a crucial and material distinction between Mr J's complaint and the cases heavily relied on in FOS's reasoning.

- In the absence of a regulated adviser there is a heightened risk that the client isn't receiving regulated advice and is being led astray and this is the essence of the FCA guidance.

- There is no attempt in the provisional decision to explain why the duty owed by SIPP operators being introduced by unregulated introducers also applies to a SIPP operator operating an execution only advised only platform.

- IFDL doesn't accept it owes a due diligence duty to Mr J and the question of whether FOS can rely on the Principles to establish a duty is the subject of judicial review in the case of Options SIPP v FOS.

- IFDL recognises that FOS is required to consider the application of the Principles and guidance from the FCA when deciding what is fair and reasonable but it is also required to consider relevant law and reach a decision that is rational and lawful.

- The position at law is that IFDL owed no duty of care in law or contract and no statutory duties arose under COBS or section 138D of FSMA.

- IFDL recognises that FOS can consider the Principles to augment or elaborate on existing duties owed by IFDL; but it cannot use the Principles to establish new duties that are contrary to the existing contractual, tortious, and statutory duties between IFDL and its clients.

- FOS relies on the FCA guidance to support its approach, but this falls foul of the same flaw in that the guidance is prefaced on what the FCA considers SIPP operators need to do to comply with the Principles without considering whether the Principles give rise to a duty in the first place.

- FOS should consider whether the FCA guidance has any relevance to the question in front of it.

- The relevant considerations of FOS are:

    - The FCA deliberately chose not to implement mandatory rules to establish a due diligence duty instead offering short generic guidance as to what it considered the position to be.

    - If the FCA had wanted execution only SIPP operators to be liable to their customers, it would have created a specific section in COBS that applies to SIPP operators – in much the same way it introduced COBS 19 to deal specifically with pension transfer advice – and which would have created civil liability under section 138D of FSMA.

    - The High Court in Adams v Carey held that FCA guidance – at least in respect of the 2009 thematic review – cannot properly be described as a set of rules or even guidance and cannot give rise to a claim for failing to follow the suggestions which it makes.

- So, while FOS should consider FCA guidance that doesn't mean it should follow it without question.

- It isn't permissible to assert that guidance and evidence of industry practice creates or imposes duties that have not been set out in the FCA's mandatory rules and regulations or contracts between firms and their clients.

- If the FOS is right then it means that all the FCA needs to do is issue some guidance which FOS can rely on to circumvent the restrictions of contract, statute, and common law and that can't be what parliament intended when it provided FOS to decide complaints on the basis of what is fair and reasonable.

- The provisional decision doesn't go as far as to say that the CFB bonds could never be suitable, the highest FOS puts it is that the bonds as used within CCM model portfolios wasn't appropriate for most retail client pensions.

- In practical terms the consequence of the provisional decision is that IFDL is required to:

    - Pre-judge whether the CFB bonds are by their nature inherently unsuitable for any client who might be advised to invest in them by a regulated FCA adviser and so pre-determine the suitability advice from the customer's IFA;

    - Then determine how many of these notional customers are sufficient to constitute most retail client pensions;

    - Prejudge the advice on suitability that the various IFAs using its platform will give irrespective of the IFA's assessment of the relevant characteristics of that client, their attitude to risk and their needs and objectives and without any consideration to the position of the CFB bonds in the overall portfolio of investments the IFA may have advised the client to invest in;

    - Assume that most IFAs would get their suitability advice wrong and recommend CCM model portfolios to clients for whom it wasn't suitable.

- This imposes an obligation on IFDL in the widest possible terms to ensure as part of its due diligence expectations that CFB bonds were suitable, and this cannot be correct.

- Even if IFDL did owe a duty of due diligence there is no justification for deciding the duty is as extensive as FOS suggest.

- IFDL's duty isn't equivalent to the duty set out in the Berkeley Burke case but there is no attempt in the provisional decision to explain why the extent of the duty it owed is the same owed by SIPP operators introduced to clients by unregulated introducers.

- IFDL's view is that if it owed a due diligence duty it could only be liable to compensate Mr J if it failed to:

    - confirm that introduces that advise clients are authorised and regulated by the FCA.

    - ensure that investments are permitted by HMRC for tax purposes and are genuine and not a scam.

- It satisfied both the above and therefore any duty it had to Mr J in respect of due diligence.

- There must be a nexus between the duty owed and the loss – see Manchester Building Society v Grant Thornton UK LLP.

- The purpose of any due diligence duty it owed was to i) ensure clients were being advised by regulated advisers ii) ensure client SIPP's only contained assets permitted to be held within a SIPP iii) warn clients if it detected signs of criminal or unlawful behavior.

- It is clear that the purpose of any duty owed by IFDL wasn't to protect clients from the risk they might receive unsuitable advice and loss resulting from such advice is the responsibility of the IFA.

- It is the unsuitable advice which has led to Mr J suffering a loss and FOS cannot assert IFDL was responsible for the loss without asserting that it was responsible for the suitability of the advice – which it has not done and cannot do.

- Parliament legislated for the situation whereby regulated firms were liable for losses resulting from unsuitable advice through section 27 of FSMA but this only applies where an unregulated person acts in breach of the general prohibition not where there is poor advice forma regulated firm.

- In the circumstances FOS must consider the legal principles of scope of duty and if departing from them give good reasons for doing so. In failing to do this FOS is acting irrationally and erring in law.

- It is irrational to states that because Huntsman Hawkes and CCM have been dissolved FOS is unable to consider whether IFDL should be held responsible for a loss that has been proximately caused by the failures of two other firms.

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.

I have considered everything that IFDL has said in response to my provisional decision having previously considered everything it said before I issued that decision. Nothing it has said previously or in response to my provisional decision persuades me that the findings I made in my provisional decision, which for the avoidance of doubt form part of the findings in this final decision, were wrong.

Given the nature of the arguments put forward by IFDL, I think it is important to reiterate that my role is to determine Mr P's complaint by reference to what is, in my opinion, fair and reasonable in all the circumstances of the case based on the information provided by the parties. In doing so I will take into account, but am not bound by, relevant: law and regulations; regulator's rules, guidance, and standards; codes of practice; good industry practice at the time - where I consider it appropriate to do so. My findings of fact are made on a balance of probabilities – what is more likely than not – and it is for me to decide how much weight to give to evidence provided by the parties.

IFDL argues that it didn't have a due diligence duty when it came to Mr J's application for its SIPP and that my finding that it had such a duty is flawed for two reasons' Firstly, that in relying on the Principles coupled with FCA guidance as giving rise to a duty which doesn't,

and cannot, exist in law I have erred in law. Secondly, I have relied on the BBSAL case without taking account of the factual differences between that case and this complaint.

Regarding the first point that IFDL has made, it says it accepts that I am required to consider the Principles and guidance from the FCA when deciding what is fair and reasonable. However it also argues that we need to consider relevant law and with that in mind it says that it owed no duty of care in contract or law and no statutory duties arose under COBS or s138D of FSMA. It argues that we can consider the Principles when these augment, or elaborate on, existing duties owed but that we can't use the Principles to establish new duties that are contrary to the existing contractual, tortious, and statutory duties between IFDL and its clients.

However, I haven't used the Principles to establish a new duty that IFDL needed to comply with. I have simply applied the established rules set out in my provisional decision – particularly Principle 2 and Principle 6 – to the circumstances of this complaint. It is important to understand that the Principles have the status of regulatory rules, and that they provide the overarching obligations of general application that authorised firms are required to comply with. It is for me to decide how those Principles apply in all the circumstances of this complaint and it is my view that in order to comply with its obligations under those Principles IFDL was required to carry out due diligence that was in accordance with good practice on CCM and the CFB bonds. Its failure to carry out such due diligence means it failed to comply with its obligations under the Principles.

The fact that IFDL might not have owed an actionable duty, whether under contract, tort, or statute to carry out due diligence on investments which it accepts within a SIPP doesn't then mean that it cannot have been obliged by the Principles to do so. My decision is that IFDL had precisely such a regulatory duty to carry out due diligence on firms that use its platform and on investments it accepts within its SIPP and that for it do so was in accordance with good industry practice.

Nor can I find support for IFDL's argument in the caselaw, which shows that the Principles are a source of obligations in their own right, including an obligation of due diligence, rather than being confined to embellish more specific obligations created by other rules. Thus, in BBSAL, Jacobs J said:

"94 …it also seems to me that there is another artificiality in BBSAL's approach, namely the characterisation by BBSAL of the supposed new "rule" as a duty to investigate. The concept of "due diligence" in Principle 2 inevitably brings to mind the concept of enquiry or investigation. They are not such distinct concepts that an Ombudsman's conclusion – that the exercise of due diligence involved enquiry or investigation – involves the creation of a new rule.

"101…..the augmentation argument also involves the proposition that, within an existing regulatory framework, the Principles should only be used to "augment, clarify or enlarge existing duties, rather than to create new unexpected duties that have not been the subject of consultation". The premise of the argument, therefore, was that there were limitations in the extent to which the Principles could augment the existing rules, with a distinction to be drawn between the augmentation of "existing duties" and the creation of "new unexpected" duties. I do not consider that this argument is consistent with the decision of Ouseley J. in BBA, and in substance it seeks to advance the case that was rejected in that case."

"104 These passages explain the overarching nature of the Principles. As the FCA correctly submitted in their written argument, the role of the Principles is not merely to cater for new or unforeseen circumstances. The judgment in BBA shows that they are, and indeed were always intended to be, of general application. The aim of the Principles based regulation

described by Ouseley J. was precisely not to attempt to formulate a code covering all possible circumstances, but instead to impose general duties such as those set out in Principles 2 and 6. To my mind, the decision in BBA, and in particular the passages set out above, are inconsistent with BBSAL's proposition that it is necessary or appropriate to search for an answer to the rather elusive question of whether there has been an augmentation of an existing duty or the creation of a new unexpected duty."

"109 I consider that these passages, too, are fatal to BBSAL's attempts to put limits on the extent to which the Ombudsman was entitled to use the Principles in order to augment existing rules or duties. The Ombudsman has the widest discretion to decide what was fair and reasonable, and to apply the Principles in the context of the particular facts before him."

The second argument that IFDL makes as to why I was wrong about its due diligence duty is that I have relied on the BBSAL case without taking account of the factual differences between that case and this complaint. That case did involve an execution-only SIPP operator, as in this complaint, although I acknowledge that in BBSAL the client was introduced to the SIPP operator by an unregulated introducer and the investment turned out to be a fraud - whereas this complaint doesn't involve an unregulated introducer or a fraudulent investment.

However, I am not satisfied that these factual differences demand a different approach. It seems to me that IFDL is looking at the judgment the wrong way around. There is nothing in the judgment that suggested that Jacobs J thought that a due diligence duty could only arise under Principle 2 and Principle 6 where a SIPP operator was dealing with unregulated introducers and/or fraudulent investments. To the contrary, he emphasised the generality of the Principles and the very wide discretion the Ombudsman has in applying them and deciding what was fair and reasonable in the context of the particular facts before him.

A case involving unregulated introducers may well have provided an increased risk that consumer detriment might arise from investments that clients could invest in through a SIPP compared to the situation in this complaint wherein Mr J could only apply for the SIPP through a regulated financial adviser. However, there is nothing in the materials to which I have referred to suggest that the requirement to undertake due diligence starts and ends with ascertaining the regulated status of the introducer – it can be one potential indicator of consumer detriment but there may be a number of others.

In all the circumstances I am satisfied that under Principle 2 and Principle 6 IFDL was required to carry out due diligence on CCM and the CFB bonds that was in accordance with the good industry practice I referred to in my provisional decision. I am not persuaded that the fact that it provided an execution-only service and clients could only access its SIPP through a regulated financial adviser and/or DFM means that it didn't have to carry out such due diligence.

I note the argument that if the FCA had wanted execution-only SIPP operators to be liable to their customers it would have created a specific section in COBS that applied to SIPP operators, as it did with pension transfer advice through COBS 19. However, the fact that the FCA chose not to introduce a specific due diligence rule for execution only SIPP operators doesn't mean a due diligence duty cannot have arisen under Principle 2 and Principle 6, as I have found it did in this complaint.

IFDL argues that the effect of my findings is to make it responsible for the suitability advice given by Huntsman Hawkes when it didn't have any permission from the FCA to provide suitability advice. It further argues that the wider consequences of my findings on this issue are that platforms will have to underwrite the suitability of products customers are recommended by advisers,.

I don't accept those arguments and am satisfied that my findings make clear that IFDL had its own separate regulatory obligations as a SIPP operator which arise from Principle 2 and Principle 6. Its obligations in relation to carrying out due diligence are quite different from the regulatory obligations of Huntsman Hawkes as the financial adviser to provide suitable advice - or of CCM as a discretionary manager to ensure the investments it included within the portfolio were suitable - which obligations arise from COBS 9.

IFDL due diligence obligations required it to carry out due diligence in accordance with good industry practice so that it could correctly identify the nature of investments and the risk of consumer detriment that could arise from an investment and determine whether they were appropriate for a SIPP. The fact that an investment it determines isn't appropriate for a SIPP might at the same time also be unsuitable for a client doesn't then mean that it is underwriting the suitability of investments recommended by other regulated firms.

IFDL's due diligence duty wasn't to protect its clients from the risk they might receive unsuitable advice and the losses that might arise from that - as it has pointed out – and my findings don't suggest it had such a duty. By carrying out due diligence in accordance with good industry practice it wasn't protecting clients from unsuitable advice but ensuring that the investments that were available for its clients to invest in were appropriate for the SIPP it administered.

It follows from what I have said that I don't accept IFDL's suggestion that the scope of any due diligence duty it owed was limited to ensuring clients were advised by regulated advisers and investments were permitted by HMRC for tax purposes and to warn clients if it detected signs of criminal or unlawful behaviour. As I have already made clear, it is my view that to its due diligence duty extended to it needing to understand the nature of the investments it accepted within its SIPP, so that it could identify if they posed a risk of consumer detriment and whether they were appropriate for its SIPP.

I am satisfied that if it had carried out due diligence in accordance with good industry practice it would have concluded that the CFB bonds were a non-standard and speculative investment and that the intention on the part of CCM to invest at least 30% of every clients model portfolio in the bonds, regardless of the type or risk level of the portfolio, meant there was a serious risk of consumer detriment such that it shouldn't have accepted applications for a SIPP through which its clients would be invested in the bonds through a CCM model portfolio.

Contrary to IFDL's argument, my findings don't make it responsible for losses arising from unsuitable advice. It is responsible for losses arising from its own failure to carry out reasonable due diligence on CCM and CFB bonds which led to it accepting Mr J's application for a SIPP - which was invested in a CCM model portfolio through which over 30% of his pension monies were invested in the bonds – when it shouldn't have done. The losses stem from its own failures.

I note what IFDL has said about my reference to CFB bonds not being appropriate for most retail client SIPPs. The point I was making is that it should have been apparent to IFDL that investing 30% of every model portfolio in CFB bonds was anomalous given the bonds were non-standard, illiquid and of a speculative nature and weren't directed at ordinary retail clients – by which I mean clients that didn't fall into the limited categories of client that the bonds were directed at, such as certified sophisticated investors as referred to in the bond brochure. The nature and characteristics of the bonds was entirely incompatible with them being used in the way proposed. i.e as 30% of standardised pension portfolios for all types of retail customers. And the fact that the issuer, CFBL, had close commercial and ownership ties to CCM, the DFM which offered these portfolios, compounded the inappropriateness of accepting them on the platform.

In short, the bonds as CCM intended to use them in all its model portfolios was never going to be appropriate for their target market. IFDL has argued that my findings impose on it, in the widest possible terms, an obligation to ensure, as part of its due diligence obligations, that the CFB bonds were suitable for every customer. However, that isn't the result of my findings. If IFDL had done what it should have done the CCM model portfolios that included the bonds wouldn't have been included with IFDL's SIPP.

IFDL argues that it is irrational to state that because Huntsman Hawkes and CCM have been dissolved I am unable to consider whether IFDL should be held responsible for a loss that has been proximately caused by the failures of those firms.

It is not irrational for me to award Mr J all of his losses where I have found that IFDL is responsible for these. This isn't a case where it is only responsible for part of the losses with other firms having responsibility for the rest of his losses wherein it would be appropriate for it pay only part of the overall losses.

The fact that other firms - that were regulated at the time but which are now dissolved - might at the same time have been in breach of their own separate regulatory responsibilities and by virtue of this responsible separately for Mr J's overall losses doesn't mean that it isn't fair or reasonable for me to award Mr J his losses in full in this complaint.

I also note that when a number of parties independently cause a claimant's loss, the courts don't regard it as viable defence for one negligent defendant to blame the others. In Grant v Sun Shipping (1948) 2AC 549, it was said:

"My Lords, I regard it as a well-settled principle that when separate and independent acts of negligence on the part of two or more persons have directly contributed to cause injury and damage to another, the person injured may recover damages from any one of the wrongdoers, or from all of them……If the negligence or breach of duty of one person is the cause of injury to another, the wrongdoer cannot in all circumstances escape liability by proving that, though he was to blame, yet but for the negligence of a third person the injured man would not have suffered the damage of which he complains……. Cases in which independent acts of negligence on the part of two drivers cause injury to a third person must be heard almost daily, and they are not, in my experience, decided by considering whose act of negligence was the last link in a chain of causation. As Lord Herschell said in your Lordships' House in Mills v. Armstrong (The Bernina): "If by a collision between two vehicles a person unconnected with either vehicle were injured, the owner of neither vehicle, when sued, could maintain as a defence, 'I am not guilty, because but for the negligence of another person the accident would not have happened'.""

I have considered what IFDL has said regarding there needing to be a nexus between the duty owed and the loss and its reference to the case *of Manchester Building Society v Grant Thornton UK LLP*. The case involved a claim in negligence where the Supreme Court set out six questions which needed to be addressed when considering what damages are payable in negligence cases - one of which was whether there was sufficient nexus between the harm the claimant seeks damages for and the subject matter of the defendant's duty.

This isn't a legal claim for damages and I must award the redress that I consider fair, rather than seek to apply the legal rules relating to recovery of damages. But, even so, I find nothing the Manchester building Society case to change my view. The main purpose of a SIPP provider conducting due diligence into the investments it consider accepting onto its platform is to prevent companies pension monies being exposed to obviously inappropriate investments. That is precisely the risk that materialised in this case and the cause of Mr J's losses. So, there is in my view sufficient nexus between IFDL's failure and Mr J's losses in any event.

Turning to the issues raised by Mr J, he firstly refers to the agreement he has with the FSCS to repay the compensation it has awarded to him - amounting to a total of £170,000. This relates to two claims Mr J made to the FSCS one in relation to CCM and the other in relation to Huntsman Hawkes - I referred in my provisional decision to the claim in relation to CCM only. Mr J says that if he has to repay the FSCS from the redress payable by IFDL in accordance with the agreement he made with the FSCS then he will be worse off.

My role is to make a fair and reasonable decision in this complaint and award redress accordingly where appropriate and any obligation he has to repay monies received form the FSCS as a result of claims he made has no bearing on my award. However, I would comment that I don't think he would be in a worse position as a result of my award because of the repayment agreement he has with the FSCS – if he only receives £160,000 from IFDL then this is the maximum he would have to repay to FSCS.

IFDL has also suggested that because of the possibility of double recovery I should make provision for it to be provided with the necessary information to ensure this doesn't happen and to ensure any sums payable to the FSCS are repaid.

Mr J has entered into an agreement with the FSCS under which he has agreed to repay the compensation it has paid him from the proceeds of any claim he makes against IFDL. There is no reason to think that if he receives the full amount of his losses from IFDL that the FSCS won't require him to repay the amounts due to it under the agreement he has entered into with it and I am not persuaded I need to give any directions for IFDL to be kept informed of the position.

In any event, it seems to me that given the likely total amount of Mr J's losses and the award limit that applies to the redress I award, the possibility of double recovery only arises if IFDL agrees to my recommendation it pay the full amount of his losses. If IFDL was to agree to my recommendation it pay the full amount of redress I can see no reason it couldn't make it a condition that any payment to Mr J above the award limit is conditional on him satisfying it that this doesn't result in him making a double recovery.

The second point raised by Mr J is in relation to the notional deduction of tax from the redress payable by IFDL. He makes various points in relation to this but I think the key point he makes is that if IFDL only pay him the award limit of £160,000 and deduct an amount for notional tax from this then he will be worse off. I think this is a reasonable point and I have addressed it in the redress methodology set out below.

He makes a further point that he is currently taking income from his pension and isn't paying any tax on this as he left his lump sum in the pension so is currently able to draw on those monies. It seems to me that this doesn't change the position regarding the tax payable on the award of redress as I think an amount to represent the tax payable on 75% of the total amount payable to him should still be made.

Putting things right

My aim in awarding fair compensation in this complaint is that Mr J should be put as closely as possible into the position he would probably now be in if he had not been invested in CFB series 10.

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

What must IFDL do?

To compensate Mr J fairly, IFDL must:

- Compare the performance of Mr J's investment in CFB series 10 bonds with that of the benchmark shown below. If the *actual value* is greater than the *fair value*, no compensation is payable.

If the *fair value* is greater than the *actual value* there is a loss and compensation is payable.

- IFDL should also add any interest set out below to the compensation payable.

- If there is a loss, IFDL should pay the amount it calculates is due into Mr J's preferred pension plan with Fisher Investments to increase its value by the 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 IFDL is unable to pay the compensation into Mr J'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 partly taxable income. Therefore, the compensation should be reduced to *notionally* allow for any income tax that would otherwise have been paid subject to the paragraph below.

- The adjustment referred to above is to ensure the compensation is a fair amount and as such IFDL should only apply the reduction to compensation where it pays Mr J the full amount of his losses, not where it only pays the award limit of £160,000, as I don't think that would then lead to Mr J receiving a fair amount. So, it is clear to Mr J, if a reduction is made this isn't a payment of tax to HMRC, so he won't be able to reclaim any of the reduction from HMRC after compensation is paid.

- The *notional* amount of the reduction should be calculated using Mr J's actual or expected marginal rate of tax at his selected retirement age.

- It's reasonable to assume that Mr J is likely to be a higher rate taxpayer at the selected retirement age, so the reduction would equal 40%. However, if Mr J would have been able to take a tax-free lump sum, the reduction should be applied to 75% of the compensation, resulting in an overall reduction of 30%.

- If either IFDL or Mr J dispute that this is a reasonable assumption, they must let us know as soon as possible so that the assumption can be clarified and Mr J receives appropriate compensation. It won't be possible for us to amend this assumption once any final decision has been issued on the complaint.

- Pay Mr J £800 for distress and inconvenience caused by losing a significant portion of his pension moneys which are needed for his retirement.

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

Investment	Status	Benchmark	From ("start date")	To ("end date")	Additional interest

name					
CFB Series 10 (now the Heritage Recovery Bond)	Still exists but illiquid	For half the investment: FTSE UK Private Investors Income Total Return Index; for the other half: average rate from fixed rate bonds	Date of investment	Date of my final decision	8% simple per year from final decision to settlement (if not settled within 28 days of the business receiving the complainant's 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 given the investment is illiquid - meaning it could not be readily sold on the open market. In the circumstances the actual value should be assumed to be nil for the purposes of calculation.

IFDL may require that Mr J provides an undertaking to pay IFDL any amount he may receive from the investment in the future. That undertaking must allow for any tax and charges that would be incurred by him on drawing the receipt from the pension plan.

IFDL will need to meet any costs in drawing up the undertaking.

Fair value

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

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, IFDL should use the monthly average rate for one-year fixed-rate bonds as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any additional sum that Mr J paid into the investment should be added to the *fair value* calculation at the point it was actually paid in.

Why is this remedy suitable?

I’ve chosen this method of compensation because:

- The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to his capital.
- 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.

- It isn’t possible to know with any certainty what that part of Mr J’s portfolio invested in CFB series 10 would otherwise have been invested in. However, given he was invested in a cautious model portfolio I think using a benchmark that is appropriate for someone willing to take a small amount of risk is reasonable in the circumstances.

My final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £160,000, I may recommend that Investment Funds Direct Limited pays the balance.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My provisional decision is that Investment Funds Direct Limited should pay the amount produced by that calculation up to the maximum of £160,000 (including distress or inconvenience but excluding costs) plus any interest on that amount as set out above.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £160,000, I recommend that Investment Funds Direct Limited pays Mr J the balance plus any interest on the balance as set out above.

If Investment Funds Direct Limited does not pay the recommended amount, then any investment currently illiquid should be retained by Mr J. This is until any future benefit that he may receive from the investment together with the compensation paid by Investment Funds Direct Limited (excluding any interest) equates to the full fair compensation as set out above.

Investment Funds Direct Limited may request an undertaking from Mr J that either he repays to Investment Funds Direct Limited any amount Mr J may receive from the investment thereafter, or if possible transfers the investment to Investment Funds Direct Limited at that point.

Mr J should be aware that any such amount would be paid into his pension plan so he may have to realise other assets in order to meet the undertaking.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr J to accept or reject my decision before 1 April 2024.

Philip Gibbons
Ombudsman