DRN-4715842

The complaint

Mrs A complains Hargreaves Lansdown Asset Management Limited (HL) mis-represented the risks of two funds, which she invested in through an ISA. She was convinced by heavy promotion and marketing to put her savings in the funds but has now suffered losses.

What happened

The first investment relevant to Mrs A's complaint is the units she bought from HL in a fund called the Woodford Equity Income Fund (WEIF). She has also referred to losses made on another fund – the Woodford Income Focus Fund (WIFF). Both funds were managed by Neil Woodford, who left Invesco Perpetual in 2013 to set up Woodford Investment Management ("WIM"). The WEIF was launched in May 2014, with a £1 per unit fixed offer price until 18 June 2014. The Authorised Corporate Director (ACD) of the fund was Capita Financial Managers, later known as Link Fund Solutions.

The WEIF broadly tracked the benchmarks (albeit whilst providing a greater return and experiencing some more volatility) until the second half of 2017, when there was a significant fall which was not experienced by the benchmarks. It began to significantly underperform benchmarks from early 2018 and the performance followed a very different pattern to the benchmarks from early 2019 to the date of suspension.

Alongside this, the fund began to see significant outflows from mid-2017, falling from around £10bn of assets under management to around £3bn in two years.

In June 2019 the extent of those outflows - and the portion of the WEIF's assets which were not liquid - led Link to decide to suspend trading in the fund. Link removed WIM as the investment manager around this time.

The fund did not trade again. Later in 2019, Link decided to liquidate the fund. Investors have since received payments as and when the fund's assets have been sold. A small amount remains invested in assets which are not liquid i.e. cannot currently be sold. A scheme of arrangement between investors and Link has now been sanctioned by the court and will conclude the wind up of the fund with further distributions being made to investors who held units in the fund at suspension.

The WIFF was launched in April 2017 as a separate fund under a different strategy to the WEIF. The WIFF suffered also from poor performance, and in October 2019 the ACD of the WIFF suspended dealing in the fund to protect it from an expected increase in redemptions due to the fund manager resigning. A new investment manager took over the management of the fund on 31 December 2019, and from February 2020 the suspension was lifted by the ACD and the fund was again tradable.

HL's communications relating to the WEIF and WIFF

HL's relationship with WIM and the WEIF began prior to the fund's launch. HL met with WIM in early 2014 and decided to promote the WEIF to its customers and visitors to its website ahead of the fund's launch.

The WEIF was the subject of, or featured in, many communications from HL over the period from the fund's launch to its suspension. HL's communications relating to both the WEIF and WIFF can be categorised broadly as follows:

- Promotion of the launches by letter and through website articles and emails.
- Ongoing promotion of the funds through website articles (and, in some instances, emails alerting the recipient to the article).
- Updates on the funds through website articles (and emails alerting the recipient to the article).
- The inclusion of both the funds in "best buy" lists – called the Wealth 150 (which had a subset of discounted funds called the Wealth 150+) and, later, the Wealth 50 both of which were shared on its website, through emails and via Wealth Reports, which were included in the Investment Times sent to its clients by post.

The Wealth List

HL published a list of what it considered, in its view, to be the "best" or "favourite" funds. This was initially called the Wealth 150 (and a subset of this, featuring discounted management charges for HL clients, the Wealth 150+) then later the Wealth 50 – I'll refer to these generally as the Wealth List. The WEIF featured on the Wealth List from its launch until its suspension. The WIFF featured but was removed from the Wealth List in June 2019.

I understand the list was available on HL's website to any visitor and also sent to all customers on its general mailing list who had elected to receive communications, alongside the bi-annual Wealth Reports published by HL. HL says the list was updated from time-to-time with funds being added or removed as a result of the ongoing cycle of review, monitoring and analysis of funds by its investment team.

As part of its ongoing research HL met with WIM to discuss the funds on a number of occasions.

Mrs A's dealings in the WEIF and WIFF

Mrs A first invested in June 2014 when she bought around £12,000 worth of units in the WEIF to be held in her ISA. She held units in the WEIF up to the point the fund was suspended. She has received some capital distribution payments but still lost capital as a result of the demise of the fund.

Mrs A also purchased units in April 2017 in the WIFF. She sold her units in the WIFF in April 2019 at a loss of £904.

Mrs A's complaint to HL and its response

In December 2019, Mrs A raised a complaint with HL about its promotion of the funds and its communications around them, in particular she felt it had mis-represented the risks of the funds and said they were invested in unsuitable assets to achieve the aims for income.

HL looked into the complaint but didn't think it had done anything wrong. In summary it said:

- The Wealth 50 (and the Wealth 150 before it) is a rigorously constructed list of funds, provided as a useful tool for clients to use in making decisions when choosing from the full range of funds available on its platform.

- It acknowledged the funds had experienced a difficult period of performance, but it had a reasonably held conviction in the prospects of outperforming benchmarks.

- It provided Mrs A with an execution-only service, which meant that it was not providing investment advice or making personal recommendations.

- It was satisfied it complied with its obligations to provide information that is clear, fair and not misleading when issuing research communications on the funds.

- Regarding the investment style of the funds, Neil Woodford had a history of successfully investing in such small / unlisted stocks, and it was disclosed to investors that he would be investing in such assets from launch. It communicated when it identified there had been an increase in the proportion of unlisted shares in the WEIF and entered into an active dialogue with him to ensure that he had plans to reduce such holdings within a reasonable timeframe.

Mrs A remained unhappy and the complaint was referred to this service for an independent review.

One of our investigators looked into the complaint but didn't consider it should be upheld. In short, she concluded that HL's communications in respect of the WEIF met its regulatory obligations and were clear, fair and not misleading. In respect of Mrs A's investment in the WIFF, she also found HL met its obligations. She noted HL communicated in November 2018 the fund had 'struggled', but that Woodford was sticking to his philosophy. Mrs A didn't disinvest straight off the back of this commentary despite being made aware, by HL, that the WIFF was not performing to HL's expectations.

Mrs A didn't agree and asked for an ombudsman's decision. In summary she said:

- Her complaint against HL is not simply the 'misrepresentation of risk', it is a systemic failure by HL to perform to the highest standards of corporate governance expected and required of a quoted company engaged in the provision of financial services towards their customers and the public.

- When she first invested it was proposed a likely 4% dividend and investments in quoted companies. She viewed the risk level as modest and applied on an execution only basis on the strength of HL's heavy promotion and publicity at launch.

- There was a catastrophic withdrawal of funds under management from £10b to £3b from the WEIF. HL would be monitoring this, and it was a red flag that was not widely communicated.

- The WEIF continued to be included in the Wealth List right up until its suspension. HL must have known the fund was no longer representative of what was sold at launch to her and was no longer appropriate for her with the small non-dividend paying unquoted companies held in the portfolio.

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 understand Mrs A's strength of feeling on the complaint and why she considers HL is responsible for the losses suffered on her investments. However, for the reasons I set out below, I'm not persuaded she was misled into investing (or remaining invested) in the WEIF or WIFF – and consequently, I'm satisfied the issues arose due to the poor performance of the investments and their underlying holdings, which HL had no responsibility for.

I've first set out what I consider the relevant regulatory obligations that HL's communications needed to meet.

What are the relevant regulatory obligations?

I think the following regulatory requirements are of particular relevance to my assessment of whether HL acted fairly and reasonably in its dealings in this case.

The Principles for Businesses, which are set out in the FCA's handbook "are a general statement of the fundamental obligations of firms under the regulatory system" (PRIN 1.1.2G). I consider that Principles 6 and 7 are of particular relevance to this complaint.

They say:

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

- Principle 7 - Communications with clients – A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

I have also taken into account the FCA rules for firms carrying on investment related business set out in the Conduct of Business Sourcebook (COBS). In particular, COBS 4.2.1R, which sets out the requirements on authorised firms, like HL, when communicating with clients. COBS 4.2.1R(1) says:

"A firm must ensure that a communication or a financial promotion is fair, clear and not misleading."

COBS 2.1.1R (1) (the client's best interests rule) is also relevant to this complaint. It says: "A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule)."

Findings

Firstly, I note HL has explained it provided Mrs A with an execution-only service in respect of her ISA investments. I also haven't seen that she received personal advice to invest in the WEIF or the WIFF from HL. This means there was no ongoing obligation on HL in this respect. So, I've considered the communications HL *did* issue over the relevant period.

The rules I've set out above show the obligations that HL was required to adhere to when making communications to investors like Mrs A. HL was required to issue communications which were clear, fair and not misleading. This means that as long as HL's communications during the relevant period were factual and gave a balanced view of its assessment of the funds, then I would be unable to reach a finding that it did something wrong.

I will focus initially on the WEIF as this is where Mrs A first made an investment into a Woodford fund. There is insufficient evidence to say HL's communications about the WEIF from launch to 2016 – a period over which HL did not have any significant concerns about the fund - did not meet its regulatory obligations. The communications it produced in 2014 (around the time Mrs A first invested) were enthusiastic about the WEIF and went to some lengths to encourage customers to consider investing. They also show the WEIF was presented as something which might be used as a core investment holding, which was suitable for most investors and would invest in larger companies which paid a sustainable or rising income (although not exclusively so). Given what was known about Neil Woodford and the WEIF at this time, I do not think this was unreasonable. If HL wished to promote the fund heavily that was a decision it was free to make. And, given what was known about the WEIF and Neil Woodford at this time, I do not think it would be fair and reasonable to say the communications HL made at this time were inconsistent with its regulatory obligations. So, I do not think it would be fair and reasonable to say HL had done anything wrong at this time.

In December 2016, HL said on its website that the WEIF was "*not a typical equity income fund*" and said that unlike most equity income funds which were exposed to large high-yielding companies, "*only around 50%*" of the WEIF was invested in this area. The remainder was "*invested in small and medium sized companies, or those not listed on the stock market*".

So I think it's fair to say that Mrs A ought to have known that the WEIF had certain risks associated with its investment strategy. HL was explicit that the fund had *a "significant bias to smaller companies relative to the FTSE All Share Index which adds risk, and also has more invested in medium sized companies than the index"*. Ultimately HL's view was that this approach would "*add significant value for investors able to withstand the additional risk and volatility that comes from investing in smaller and unquoted companies."*

Having reviewed the evidence of HL's meetings with WIM in 2016, I can see that in summary it was aware that the WEIF was no longer a typical equity income fund. I can also see that it knew there had been a shift towards small cap and growth stocks which it had not expected – and it recognised that in the event of significant outflows, that proportion would increase and potentially affect WIM's ability to invest further. HL was also aware that its customers might not know how the fund had changed – and it agreed to take steps to address this. It's clear to me that the update above was designed to draw these concerns to their customer's attention.

But HL also continued to hold the view that the WEIF was still an investment that would add value for investors – and I'm satisfied it held that view internally and so it was clear, fair and not misleading to have continued to say that in its updates. It was for Mrs A to decide whether she wanted to stay invested (and continue to make contributions) based on the risks and the features of the WEIF which HL was describing to her.

I acknowledge that in 2017 the WEIF began to underperform its benchmark, but I'm satisfied that HL's continuing communications about the fund remained balanced. It was clear that it viewed the WEIF as a long term investment and explained in its June 2017 update that Woodford had "*a long history of making big stock or sector bets, and while these decisions have at times taken time to come to fruition, they have added significant value for investors over the long term*".

In an article it published in September 2017 on its website, it explained that "*judging a fund manager over a time period of a few months is folly, especially one with such a long and distinguished track record*". This article explained that Woodford had experienced poor performance in the past, and that it was *"quite right to question any fund manager on their performance"* which HL said it had done. But it explained that his approach involved seeking out undervalued companies and this strategy had "*seen his investors well-rewarded over the long term*".

In its November 2017 Wealth Report HL said that performance "*over the past year has been disappointing relative to the FTSE All Share Index*" and that some of Woodford's stock selections had under-performed. But HL continued to have "*faith in his abilities to deliver for investors*". In my view HL was entitled to continue to believe in the long term prospects of the WEIF – and I'm not persuaded it was misleading for it to communicate its view that, over the long term, the WEIF would still be a good investment. I'm not persuaded that this belief, and its communication of it, was inconsistent with the obligations I've set out above.

In December 2017 it said on its website that the WEIF wasn't "*a typical equity income fund*" and highlighted that around 9.5% of the fund was in unquoted companies. HL explained clearly that "*small and unquoted businesses are typically considered higher-risk because their shares are difficult to sell*". And it concluded that Woodford's approach would "*result in periods of poor performance*" but it was "*premature to write Neil Woodford off*".

The key issue here is that none of these updates differed markedly from the concerns HL was expressing to Woodford throughout the year and from its internally held view that whilst the fund was suffering from a period of poor performance, HL remained of the view that over the long term the investment would come good.

And I'm satisfied that HL's communications in 2018 and 2019 were equally clear, fair and not misleading. In March 2018, for example, HL published an update following WEIF's change of sector. It clearly explained how almost "*40% of the fund is invested in small and mid-sized lower-yielding companies*" with "*an additional 10% invested in companies not yet listed on the stock market*". And the same update was clear that HL accepted Woodford's approach would "*lead to tough periods of performance*" but that it remained "*comfortable with the inclusion of unquoted companies*" although it did not "*want to see them increase as a proportion of the fund from here*". It reminded investors to "*ensure they are comfortable with the investment approach and risks*".

The evidence I've seen of HL's internal views and the meetings it had with WIM during 2018 show that HL was largely reassured that WIM had taken onboard its feedback, particularly in relation to continued investment in unquoted stock. And this is clearly reflected in the communication above. Internally it continued to believe that the fund would come good in the long term, but it acknowledged that it needed to ensure clients were aware of the nature of the fund, the need to diversify and the strategy WIM was following. In my view, the updates I've quoted above achieve this in a clear, fair and not misleading way.

In 2019 HL issued an update in January in which it explained its recent catch-up with Woodford. It said that although it had been a long-term supporter of Woodford, "*his funds have recently performed poorly*" and so it had been "*an uncomfortable time to hold the fund and our own conviction has been tested*". The update then went on to explain why it continued to keep the fund on its Wealth 50 and provided a detailed explanation of how the WEIF had changed since its launch, and some of the inherent risks of Woodford's approach to investing. And it said it was clear that some of Woodford's investments hadn't "*paid off*" and importantly highlighted to investors "*the importance of having a diversified portfolio, spreading your investments amongst managers that invest differently*".

It concluded by saying that it was "*understandable that some investors are getting impatient with Woodford*" and that it had also "*been disappointed with recent performance*". But it said that its approach was to back proven managers for the long-term and "*as part of a diversified portfolio, we still think Woodford has a place*". It acknowledged it could be wrong but didn't think it needed to change its opinion at this time.

Further updates in March highlighted that Woodford was experiencing "*his worst spell of performance"* and the fact that HL had been urging Woodford to *"address the weighting* [of unquoted] *stocks in his portfolio"* – and overall it said that Woodford had "*shown an ability to make the big calls right, and when he does, investors profit"*.

During this period, the evidence shows that HL was in regular contact with Woodford in a bid to understand the challenges he was facing in managing the fund and to ensure that its faith in his ability to turn things around wasn't mis-placed. The suspension of three stocks on the Guernsey exchange was a significant cause for concern – but this suspension was only temporary. Furthermore, although it discussed whether the time had now come to remove the WEIF from its Wealth List, it's clear that internally it also considered the likelihood that the WEIF would recover. It had been reassured by WIM that it would deal with the level of unquoted stock in the portfolio – and HL told its clients this. I'm satisfied at this point, HL was clearly finding a way to balance communicating the risks and its concerns to consumers, while at the same time being open that it continued to believe that the WEIF would recover in the longer term.

When looking at the updates it provided, I think it's clear from HL's updates that there were risks in remaining invested in the WEIF, and the performance had now been disappointing for some time. But it was entitled to tell its clients that it believed the fund would recover – because that is what it believed internally at the time, for reasons which it gave in its updates.

Overall, it's clear that there were periods between 2016 and 2019 when HL raised concerns with Woodford, for example around the level of unquoted stock in the WEIF, but it explained these concerns in its public updates or Wealth Lists – at the same time, it held the view that whilst there were some concerns in the short term, over the long term the WEIF would end up being a good investment for its clients. HL was entitled to hold that view, and I've seen insufficient evidence that it came to that conclusion unreasonably or in a way that was not genuinely based on its assessment of the WEIF and its future prospects. Whilst I appreciate HL's view has turned out to be wrong, largely as a result of the liquidation of the fund which was not something it had anticipated, I don't consider that means its communications were not clear, fair and not misleading.

In my view it clearly explained the risks of the fund, the areas where it had concerns and the reasons why it thought it was still worthwhile to hold it as part of a diversified portfolio. It was then for individual investors to decide, for themselves, whether in light of that information, the risks as described as well as the ongoing period of under-performance, holding the WEIF remained suitable for them.

Mrs A has also questioned the inclusion of the WEIF on the Wealth List right up until its suspension. As I've explained HL did consider whether to remove the WEIF from its Wealth List but decided not to as it accepted the reassurances received from WIM. I don't find it was actively seeking to treat this fund in a different way, but rather assessing its position before communicating to investors. But it is clear from the correspondence between HL and WIM (and meeting notes) I've seen that HL considered the key factor to be what was best for its clients and took the decision to continue to include the WEIF on the Wealth List having challenged WIM and received reassurances, and on the basis of a genuinely held view the WEIF was likely to recover and perform well. There was of course no guarantees that the WEIF would perform well, and that investors had to also accept a level of investment risk when deciding to invest.

Furthermore, as I've noted above, HL was upfront about the challenges relating to the WEIF – including its performance and at times the investments Woodford had chosen. In my view

HL's intention was clearly for investors to take into account both the WEIF's presence on the lists as well as the commentary it was providing about it. I'm satisfied from the evidence available it was considering what was best for its clients when including the WEIF on the Wealth List and providing the detailed commentary that it did. For these reasons, and the other points I've set out above, I haven't found HL failed to meet its obligations to act in the best interests of its customers.

I acknowledge the point Mrs A makes about HL's lack of information given to investors relating to withdrawals from funds under management. She sees this as a red flag that was not widely communicated. I accept the communications don't refer to outflows, which I'm aware HL did have concerns about. But I don't find this means it would be fair to say that meant the communications were inconsistent with HL's regulatory obligations. The consequence of the fund decreasing was what was key (i.e. the impact this had on the make-up of the fund) and that was communicated to investors, and I've already set out why I think HL did enough in this respect.

I've reached a similar conclusion in respect of the WIFF investment Mrs A made for similar reasons. So I also don't find HL failed to meet its obligations here either.

Firstly, although different funds with different strategies, Mrs A's decision to invest in the WIFF was after HL had started to communicate about the WEIF not being a typical equity income fund and changes to the types of businesses it was invested into, indicating additional risk. This isn't directly relevant to Mrs A's decision to invest in the WIFF, but it is apparent from her complaint that she saw similarities between the funds and the ability to produce income based on the asset classes held within the funds. So, I think I can draw some relevance to this when thinking about Mrs A's decision to invest in another of Woodford's funds in April 2017 – specifically the concerns that were emerging through HL's communications about Woodford's management of the WEIF.

The WIFF was included in HL's Wealth List for the November 2017 edition and this noted Woodford's rationale behind the management of the fund. But the June 2018 Wealth 150+ report clearly noted that it was his rationale, combined with 'some stock specific disappointments' that had 'held back performance'. And in November 2018 the Wealth 150+ report noted that the fund had 'struggled', but that Woodford was sticking to his philosophy. So, I find HL did provide information about concerns with the WIFF.

Mrs A didn't disinvest off the back of this commentary immediately, this didn't happen for a further six months. And whilst I accept that it was reasonable for her to place some weight on what HL was telling her, including its belief that the WIFF remained a good long-term investment, I'm not persuaded it was reasonable, in the particular circumstances of this case, for her investment decisions to be based solely on this commentary. And even if she did, it's clear to me that she did so fully knowing that the WIFF was not performing to HL's expectations – so she was informed by HL that this fund was also underperforming. I'm not persuaded that the mere presence of the WIFF on the Wealth List ought to have overridden the commentary that HL actually provided on the WIFF within that list.

In addition to this, the fact Mrs A sold units in the WIFF in April 2019, when the fund was still on HL's Wealth List, suggests she was evaluating the performance of the WIFF herself, and not relying solely or entirely on HL's communications. So, I find she had sufficient information to make her own investment decisions about the WIFF – including HL's concerns about its performance, its reasons for continuing to think it remained a good investment, what it told her about the fund manager and what she knew about the fund itself and what was in it – as well as its overall performance. So HL gave her fair clear and not misleading information about the WIFF, and it was then for her to make her own investment decisions –

or seek advice if she needed it. She decided for herself, in April 2019, that the WIFF was no longer suitable for her and sold her units in it.

I appreciate my conclusions will be disappointing to Mrs A and I understand why she feels HL ought to be responsible for the situation she finds herself in respect of the investments she made. But I'm satisfied that any losses she has experienced were not caused by something HL did or didn't do or because it misled her in anyway. I'm satisfied any losses were caused by the performance of the underlying investments in both the WEIF and the WIFF.

My final decision

For the reasons I've given, I don't uphold Mrs A's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs A to accept or reject my decision before 2 September 2024.

Daniel Little
Ombudsman