DRN-5160198

## The complaint

Mr H has a self-invested personal pension (SIPP) with Westerby Trustee Services Limited ("Westerby"). Mr H's complaint is that Westerby did not make adequate checks – due diligence – on an investment made in his SIPP in 2014. That investment failed in 2017 and Mr H has lost the money he invested.

## What happened

Mr H took out a SIPP with Westerby in 2013 on the advice of his financial adviser. Mr H invested in two loan note investments and there is no complaint about those investments.

In September 2014 Mr H contacted Westerby to ask if he could invest in a loan investment with Colonial Capital Group PLC ("CCGP"). Mr H says the Colonial Capital Bond investment was introduced to him by an unregulated firm I will call the Introducer.

Westerby has said it told Mr H it had carried out due diligence on the investment and that it was an acceptable investment for its SIPP for sophisticated investors.

Mr H completed relevant forms to demonstrate to Westerby he was a sophisticated investor as it requested.

Mr H invested £20,000 in the Colonial Capital Bond in November 2014. He invested in a Bond called Colonial Series 10 12% Fixed Rate Secured Bond (interest rolled version) issued by Colonial Capital Group PLC ("the Bond").

A marketing brochure for the investment said the following as the only text on its front cover:

> *"Colonial Capital Group*
>
> ***Secured Fixed Rate Bonds"*** [original emphasis]

And the second page of text, after the contents page, included the following:

> ***Executive Summary***
>
> "[The] *restriction of credit is forcing not just those who have lost their homes into the rented sector but also first time buyers. This "perfect storm" has created* ***an excellent opportunity for the astute property investor*** *in the US housing market.*
>
> *The* ***Colonial Capital Group plc 3 year US Social Housing Bond*** *has been designed to allow both private and institutional investors an opportunity to benefit from these circumstances with returns of* ***12 % per annum****. This is asset backed and secured upon the shares of Colonial Capital LLC.*
>
> *The bonds benefit from a* ***first ranking*** *charge over the shares in Colonial Capital Property LLC, the company in the US that holds all of the properties funded by the*

> *bonds. In the event of non-payment, the bondholders would have the ability to enforce their security, take control of Colonial Capital Property LLC and* ***realise the value of its property portfolio*** *subject to the prior claims of any trade creditors of Colonial Capital Property LLC. More details can be found in the Information Memorandum."* [original emphasis]

Mr H says interest was not paid on the Bond as it should have been and CCGP went into administration in March 2017.

In May 2017 the Administrators of CCGP issued a report setting out its proposals. The report said Colonial Capital Ltd ("CCL") was the predecessor to CCGP. CCL similarly issued bonds for investments in properties based in Chicago. The properties were purchased, refurbished and rented to low income families with the rent paid under a Federal Government scheme.

The equivalent report on CCL in 2017 reported a number of problems or disputes CLL was involved in in 2013 including the disputed freezing of $300,000 held by solicitors, problems with refurbishing properties leading to burst water pipes in the harsh Chicago winter in over 30 properties at a cost of over $1.5 million, and the thefts of around $800,000 worth of rental guarantee monies by the person managing the company's property portfolio. It was also reported that many of the company's properties were in "rough areas" which meant there were problems such as fires, break-ins and contractors being held up at gun point. The company was also having difficulty selling properties as the time for repaying the loans in 2015 approached.

Returning to the Administration of CCGP, that report said:

> *"CCGP began to sell 3 year bonds which were supposed to provide an interest rate return of 12% per annum with the original capital invested being returned at redemption. The bonds were sold with the incentive that all funds invested were fully secured against a property portfolio. The operation was structured in such a way that properties were supposed to be purchased by the US subsidiary Colonial Capital Properties LLC. Security was held through a Security Trustee called* [name given]. *According to the Trustee agreement the Bonds issued are to be secured by a first fixed charge over the shares in Colonial Capital Properties LLC."*

And:

> ***"Failure to use funds for the purpose for which they were obtained***
> *The bondholder agreements of* [CCGP] *specify the purpose of raising funds from bondholders was for the investment in property in the USA.*
>
> *It is noted that the related entity CCL operated under a similar structure, with funds being raised from bondholders to loan to* [a US related/subsidiary company Colonial Capital LLC – "LLC"] *for the purpose of investing in social housing in the USA.*
>
> [An analysis by the administrators] *of the funds received from bondholders of CCL and* [CCGP] *compared with actual investment activity undertaken by LLC and its subsidiaries* [showed] *the amount of funds from investors significantly exceeds the funds spent on purchasing and rehabbing social housing projects in the USA.*
>
> *Since* [CCGP] *was incorporated on 4 February 2014, it has raised approximately £9,000,000 from bond holders and CCL raised approximately £3,500,000. During the same period, LLC and its subsidiaries have purchased eleven properties at a total cost of £652,314 and spent £2,415,282 on rehab and holding costs, mostly on*

*properties purchased prior to the incorporation of the Company with funds from CCL investors. That is, less than 25% of funds invested have been used for purchasing properties and to pay for rehab and holding costs.*

[CCGP's] *accounting systems are not sufficient to trace whether certain expenses have been paid out of investor funds from CCL or* [CCGP]*, as investor funds were commingled once received by LLC.*

*The majority of funds raised from investors in* [CCGP] *appear to have been paid to CCL for it to meet its expenses and bond holder interest payments…"*

The Report also outlined that the Security Trustee holds a registered charge over CCGP which grants security over CCGP's shares in Colonial Capital Properties LLC ("CCP"). The report said:

*"The purpose of the charge was to grant bondholders security over the property portfolio which was to be owned by CCP. In practice not all properties were purchased by CCP or its subsidiaries, and properties which were purchased by subsidiaries of CCP were done so with mortgages from short term lenders. Effectively making the Security Trustee secured over a worthless asset…*
*Our investigations disclose that the valuations communicated to* [the Security Trustee] *did not represent the true position of the portfolio."*

In 2018 Mr H contacted a claims management company (CMC). And in early 2019 it made a complaint to Westerby on Mr H's behalf. The CMC said Westerby was negligent in allowing the Colonial Capital investment. It referred to the due diligence Westerby had said it had carried out in a complaint about the same matter by one of its other clients.

The CMC also referred to an assessment made by an investigator in the other client's complaint. The investigator thought that other complaint should be upheld.

Westerby did not uphold Mr H's complaint. It issued its final response letter in reply to the complaint on 10 April 2019. It made a number of points including:

- It could not comment on the other case. It had not however agreed with the investigator and the matter was being referred to an ombudsman.
- As the investment was a non-standard investment, Westerby would only allow the investment if the member was a sophisticated investor. Mr H met that requirement. Westerby therefore concluded that Mr H would have sufficient knowledge and understanding to make an informed decision about the investment.
- There was nothing to indicate the Introducer was giving any investment advice.
- Westerby considered the offer document for the Bond. It had been approved by a regulated firm.
- There was no indication the funds would be used for any other purpose.
- Westerby has acted in good faith in accepting statements approved by an Financial Conduct Authority ("FCA") regulated firm.
- It was reasonable to allow the investment in the absence of any concerns raised about the investment in the due diligence process.
- Westerby also set out the way in which the Bonds were to be secured – which included a charge registered by the FCA regulated Security Trustee. It was reasonable for Westerby to believe the Bonds were secured at the time as the

security was being monitored by an FCA regulated firm.

- The offer document also made it clear the investment was a high-risk investment.
- It would normally have checked accounts as part of its due diligence process but they were not yet available which was not a cause for concern at the time.
- Westerby could not reasonably have anticipated the issues that have arisen from the information available to it at the time.

Mr H referred his complaint to the Financial Ombudsman Service with the help of a Claims Management Company ("CMC") in September 2019. (The CMC is, however, no longer acting in the complaint.)

Westerby has made a number of points to us including:

- Westerby has concerns about the timing of the signing of the complaint form and the submission of the complaint by Mr H and his CMC. It thinks the complaint may not have been referred to the Financial Ombudsman Service within the relevant time limit.
- Mr H opened his SIPP in 2013 and invested in loan notes issued by two different companies. When one of those loans matured in 2014 the proceeds were invested in the Bond.
- Westerby required Mr H to complete a non-standard investment questionnaire. Westerby was satisfied from the information Mr H provided that he was a sophisticated investor.
- Westerby does not provide advice. It does not have the regulatory permission to do so. And the contractual documents make it clear it does not give advice.
- The contract does give Westerby power to refuse to permit investments in its SIPP.
- The FCA's Conduct of Business rules have to be interpreted in light of the execution only service Westerby agreed to provide. In particular following the High Court decision in *Adams v Options UK SIPP LLP* it is clear Westerby did not act in breach of COBS 2.1.1R as referred to by Mr H's CMC.
- The regulatory publications referred to by Mr H's CMC have no legal status being suggestions only. Only a breach of (certain) rules but not guidance gives rise to a right to make legal claims.
- The FCA's interpretation of the rules was held to be wrong in the *Adams* case
- The *Adams* case reaffirmed the general principle that consumers should take responsibility for their own decisions. This must be taken into account by the Ombudsman.
- Mr H's investment was permitted on the understanding he had sufficient knowledge and sophistication as an investor to assess the risks associated with the investment and to have carried out his own research.
- Westerby's due diligence process was in line with that required by the FCA in its "Dear CEO" letter of July 2014.
- Westerby also took into account Financial Services Authority ("FSA") policy statement PS14/12 which said that while non-standard investments are unlikely to be suitable for most retail investors they may be appropriate for more sophisticated investors.

- Westerby restricted the Bonds to investors who had been advised by an independent financial adviser or sophisticated investors like Mr H.
- Westerby reviewed the offer document for the investment which had been approved by a firm regulated by the FCA.
- There was nothing to indicate funds would be used for anything other than the purposes stated in the offer document.
- The bonds were secured on Colonial Capital's shares in its US subsidiary. While the nature of the assets provided as security was in itself a risk, this would have been clear to an investor of any sophistication and therefore not a reason to reject the investment.
- The security was registered via a charge in favour of the Security Trustee – an FCA regulated firm.
- It was reasonable for Westerby to believe the bonds were secured at the time as the security was being monitored by an FCA regulated firm.
- It would normally have checked accounts as part of its due diligence process but the first year's accounts were not yet available at the time of the investment which was not a cause for concern at the time.
- In January 2016 Westerby was approached by CCGP who wanted to introduce new clients to it to open SIPPs to invest into CCGP investments. Westerby reviewed its due diligence and found a number of adverse comments on an internet search dated after its initial due diligence was completed. Westerby decided not to allow new investments into CCGP. But the information that decision was based on was not available when Westerby's initial due diligence was carried out.
- The firm that approved CCGP's offer does now have some restrictions on its register entry relating to non-standard investments. That information was not there when it checked that firm's entry as part of its due diligence process relating to the investment.
- There is a link between a director of CCGP and a company that had been wound up on the application of the relevant Secretary of State. But that was in 2010, five years before Mr H's investment. And the person had not been disqualified as a company director.
- There were business links between a director of Colonial Capital and the CEO of Harlequin Resorts. When Westerby became aware of this in 2016 it was one of the factors in its decision not to continue to accept investments from CCGP. Westerby is not aware of this information being publicly available at the time of Mr H's investment.

Mr H transferred most of his SIPP pension away from Westerby to another provider in 2020 but the Bond could not be transferred and so the Westerby SIPP has been kept just to hold that asset. The Westerby SIPP is however, in effect, inactive as the Bond has no value.

Mr H's complaint was considered by one of our investigators. She thought Westerby's points about when the complaint was referred to the Financial Ombudsman Service were tied in with when the complaint form had been signed. However for the relevant time limit, time stops when the complaint is "referred" and nothing in the rules requires the complaint to be referred only by means of a complaint form signed personally by the complainant. The investigator therefore was satisfied the complaint had been referred in time.

The investigator then set out her thoughts on Mr H's complaint. She made a number of points including:

- Westerby had said it had considered and partly relied on a third-party report on the Bond ("the third-party report").
- The report referred to a number of points of concern. Taken together they were cause for concern.
- Westerby ought to have known there was a high risk of consumer detriment in allowing the investment.
- Westerby did not act with due skill care and diligence and it did not treat Mr H fairly in accepting the investment.

The investigator also explained how she thought Westerby should put things right. Westerby did not agree with the investigator. It made a number of points including:

- Westerby did identify that despite the promotion of the investment not being restricted only to high net worth and/or sophisticated investors, it was a non-standard investment and high risk. This did not however mean it was unsuitable for acceptance into its SIPP.
- On top of its due diligence Westerby restricted the investment to only clients who were high net worth and/or sophisticated or those who received independent financial advice. And in this case Mr H had an independent financial adviser - although Mr H decided to proceed without paying them for their advice and his application was accepted on the basis Mr H is high net worth and a sophisticated investor.
- The nature of the investment and the risks involved will have been clear to Mr H. The offer document contained a number of risk warnings.
- Because it was a new company there were no historic transactions that could be investigated. Due diligence established that investors money was to be paid to an escrow account held by a reputable US law firm who were responsible for collecting the net rental income and to manage the payments for purchases and refurbishments. This arrangement gave cause for comfort.
- Nothing revealed by due diligence would reasonably cause a SIPP operator to refuse the investment.
- At the time of the due diligence there was no evidence to suggest the investment was not genuine or linked to fraudulent activity. If any evidence had been found Westerby would not have allowed the investment.
- The due diligence included reassurances from Counsel and other lawyers in the UK. The investment involved a legitimate company with legitimate advisers etc. The nature of the investment and the risks were clear on the documents. And the bonds were secured on an asset owned by CCGP with a legal charge correctly registered by an FCA regulated Security Trustee.
- The lack of a route to exit the investment was not a cause for concern with this type of investment. That is a point that goes to suitability which was not a matter for Westerby to judge and was a matter Mr H would have been aware of and understand.
- The high-risk nature of the investment does not make the investment unsuitable for investment in a SIPP. That was a matter dependent on the individual circumstances of the investor and not a matter for Westerby.

- Westerby could not reasonably be expected to have anticipated the issues that have a risen with the investment from the information available to it at the time.

Westerby also did not agree with the way in which the investigator suggested things should be put right. It says she wrongly assumed Mr H would not have a SIPP if he had not made the disputed investment and it overlooked the point that Mr H has since transferred his pension away from Westerby.

I issued a provisional decision on 15 October 2024 in which I explained why I thought Mr H's complaint should be upheld and how things should be put right.

Westerby initially asked for more time to respond to my provisional decision. After it had considered what I had said, Westerby said it had nothing further to add.

Mr H has made some points in response including:

- He had forgotten his SIPP with Westerby is still existing. He has another SIPP with another provider. He would prefer the redress is not paid into the SIPP with Westerby but is instead paid into his new SIPP or to him personally.
- If the redress has to be paid to his SIPP with Westerby he considers it equitable for Westerby not to charge any fees and to assist him in transferring away from Westerby.
- He arranges his tax affairs so that he does not pay income tax and has not done so for many years. He does not therefore consider it necessary to reduce the compensation to notionally allow for income tax. And in any event his personal arrangements mean he will be able to take the maximum tax-free cash so the reduction should only be 15%.
- He will require a tax deduction certificate if Westerby deducts income tax.

***What I've decided and why – jurisdiction:***

Westerby questions whether the Financial Ombudsman Service received a complaint form signed by Mr H within six months of its final response letter in reply to the complaint. It says if we did not the complaint is not within our jurisdiction and should not be considered.
The rules setting out the time limits for complaints to the Financial Ombudsman Service are set out in the DISP section of the FCA's Handbook. Rule DISP 2.8.2R provides:

> "The *Ombudsman* cannot consider a *complaint* if the complainant refers it to the *Financial Ombudsman Service*:
>
> > (1) more than six *months* after the date on which the *respondent* sent the complainant its *final response…*"

Words printed in italics are defined terms in the FCA Handbook. Words that are not printed in italics have their normal meaning relevant to the context in which the word is used.
The relevant time limit refers to the act of referring a complaint. There is nothing in the rules that says how that must be done and in particular there is no requirement that a referral may only be made by submitting a complaint form signed by the complainant. The Financial Ombudsman Service is an informal dispute resolution process, and we will accept referrals of complaints in ways other than by submitting a complaint form signed by the complainant. We will accept a referral of a complaint in a phone call, email or ordinary posted letter or by the submission of a complaint form by post, email or on-line. And we will accept a referral if it is made by the representative of the complainant on their behalf.

In this case Mr H seems to have contacted the CMC in 2018 and signed its terms of business on 29 November 2018. Mr H's CMC wrote to Westerby on 7 February 2019 to make a complaint on behalf of Mr H. Westerby did not dispute that the CMC was authorised by Mr H to make that complaint. Westerby responded to the complaint and issued its final response letter addressed to the CMC on 19 April 2019.

Mr H apparently signed a Financial Ombudsman Service complaint form on 17 May 2019. That is not however the version of the form that was originally sent to us by the CMC. It completed an electronic version of our form on 11 September 2019 and submitted that form to us that day. There does seem to have been some delay in referring the complaint as the cover letter that was sent with the complaint form is dated 17 June 2019.

The first submitted complaint form (that is the one dated 11 September 2019) did not include Mr H's signature, but it did not need to in order to amount to the referral of a complaint to us. There is no reason in the circumstances of this case to think the CMC was not authorised by Mr H to refer the complaint on his behalf when the CMC submitted the electronic complaint form relating to Mr H's complaint.

The complaint was therefore referred to the Financial Ombudsman Service on 11 September 2019 when the complaint form and the covering letter and other documents were sent to us electronically and this was within six months of Westerby's final response dated 10 April 2019 and so the complaint was not referred late and may be considered.

## 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've considered all of the points made by the parties. I have not however responded to all of them below; I have concentrated on what I consider to be the main issues.

### *Relevant considerations*

I'm required to determine this complaint by reference to what I consider to be fair and reasonable in all the circumstances of the case. When considering what is fair and reasonable in the circumstances, I need to take account of relevant law and regulations, regulator's rules, guidance and standards, codes of practice and, where appropriate, what I consider to have been good industry practice at the relevant time.

I have taken into account a number of considerations including, but not limited to:

- The agreement between the parties.
- The Financial Services and Markets Act 2000 ("FSMA").
- Court decisions relating to SIPP operators, in particular Options UK Personal Pensions LLP v Financial Ombudsman Service Limited [2024] EWCA Civ 541 (*"Options"*) and the case law referred to in it including:
    - Adams v Options UK Personal Pensions LLP [2021] EWCA Civ 474 ("*Adams*")
    - R (Berkeley Burke SIPP Administration) v Financial Ombudsman Service [2018] EWHC 2878 *("Berkeley Burke"*)
    - Adams v Options SIPP UK LLP [2020] EWHC 1229 (Ch) ("*Adams – High Court"*)
- The FCA (previously FSASA") rules including the following:

  - PRIN Principles for Businesses
  - COBS Conduct of Business Sourcebook
  - DISP Dispute Resolution Complaints
- Various regulatory publications relating to SIPP operators and good industry practice.

***The legal background:***

As highlighted in the High Court decision in *Adams* the factual context is the starting point for considering the obligations the parties were under. And in this case it is not disputed that the contractual relationship between Westerby and Mr H is a non-advisory relationship.

Setting up and operating a SIPP is an activity that is regulated under FSMA. And pensions are subject to HM Revenue and Customs rules. Options was therefore subject to various obligations when offering and providing the service it agreed to provide – which in this case was a non-advisory service.

I have considered the obligations on Westerby within the context of the non-advisory relationship agreed between the parties.

***The case law:***

I'm required to determine this complaint by reference to what is in my opinion fair and reasonable in all the circumstances. I am not required to determine the complaint in the same way as a court. A court considers a claim as defined in the formal pleadings and they will be based on legal causes of action. The Financial Ombudsman Service was set up with a wider scope which means complaints might be upheld, and compensation awarded, in circumstances where a court would not do the same.

The approach taken by the Financial Ombudsman Service in two similar (but not identical) complaints was challenged in judicial review proceedings in the *Berkeley Burke* and the *Options* cases. In both cases the approach taken by the ombudsman concerned was endorsed by the court. A number of different arguments have therefore been considered by the courts and may now reasonably be regarded as resolved.

It is not necessary for me to quote extensively from the various court decisions.

***The Principles for Businesses:***

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"* (see PRIN 1.1.2G). The Principles apply even when the regulated firm provides its services on a non-advisory basis, in a way appropriate to that relationship.

Principles 2, 3 and 6 are of particular relevance here. They provide:

> "*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 interests of its customers and treat them fairly*."

I am satisfied that I am required to take the Principles into account (see *Berkeley Burke*) even though a breach of the Principles does not give rise to a claim for damages at law (see *Options*).

***The regulatory publications and good industry practice:***

The regulator issued a number of publications which reminded SIPP operators of their obligations, and which set out how they might achieve the outcomes envisaged by the Principles, namely:

- The 2009 and 2012 Thematic Review Reports.
- The October 2013 finalised SIPP operator guidance.
- The July 2014 *"Dear CEO"* letter.

The 2009 Report included:

*"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…*

*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 clients and treat them fairly') insofar as they are obliged to ensure the fair treatment of their customers."*

I have considered all of the above publications in their entirety. It is not necessary for me to quote more fully from the publications here.

The 2009 and 2012 Thematic Review Reports and the *"Dear CEO"* letter aren't formal guidance (whereas the 2013 finalised guidance is). However all of the publications provide a reminder that the Principles for Businesses apply and are an indication of the kinds of things a SIPP operator might do to ensure it is treating its customers fairly and produce the outcomes envisaged by the Principles. In that respect, the publications which set out the regulators' expectations of what SIPP operators should be doing also go some way to indicate what I consider amounts to good industry practice, and I'm therefore satisfied it's appropriate to take them into account (as did the ombudsman whose decision was upheld by the court in the *Berkeley Burke* case).

Points to note about the SIPP publications include:

- The Principles on which the comments made in the publications are based have existed throughout the period covered by this complaint even where a publication post-dates events relevant to the complaint.

- The comments made in the publications apply to SIPP operators that provide a non-advisory service.

- Neither court in the *Adams* case considered the publications in the context of deciding what was fair and reasonable in all the circumstances. As already mentioned, the court has a different approach and was deciding different issues.

- What should be done by the SIPP operator to meet the regulatory obligations on it will always depend upon the circumstances.

***The July 2014 Dear CEO letter:***

Westerby has particularly referred to this letter when explaining its position, in effect saying it met the standards set out in that letter – in particular the five bullet points made in the Annex to that letter.

The letter said the following about the Annex:

> *"I would encourage you to review the key findings from our thematic review in the Annex to this letter, and ask you to take action to ensure that your business is able to demonstrate an appropriate degree of protection for consumers' pension savings."*

I set out below the five points referred to by Westerby setting them in the full section in which they appeared in the Annex, as follows:

> ***"Due Diligence on non-standard investment business***
>
> *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 despite being aware of the Financial Services Authority (FSA) guidance originally published in 2012 which clarified our expectations of firm conduct.*
>
> *Our review assessed due diligence processes in these five key areas:*
>
> - *correctly establishing and understanding the nature of an investment*
> - *ensuring that an investment is genuine and not a scam, or linked to fraudulent activity, money laundering or pensions liberation*
> - *ensuring that an investment is safe/secure (meaning that custody of assets is through a reputable arrangement, and any contractual agreements are correctly drawn up and legally enforceable)*
> - *ensuring that an investment can be independently valued, both at point of purchase and subsequently, and*
> - *ensuring that an investment is not impaired (for example that previous investors have received income if expected, or that any investment providers are credit worthy etc.)*
>
> *Please note that the due diligence necessary for individual investments may vary depending on the circumstances, and the five areas highlighted are not exhaustive.*
>
> *We found that most firms do not have the expertise or resources to assess this type of business, but were allowing transactions to go ahead. This increases the risk that a pension scheme may become a vehicle for high risk and speculative investments that are not secure assets, many of which could be scams. It is not acceptable for*

*firms to put consumers at risk in this way.*

*Although our thematic review focused on non-standard investments, it is important to note that guidance on due diligence applies to all investments.*

*Findings from our review included firms failing to:*

- *understand the nature of an investment, especially contracts for rights to future income, and sale and repurchase agreements*
- *check that money was being paid to legitimate businesses, and*
- *to independently verify that assets were real and secure, or that investment schemes operated as claimed*

*We found that typically, firms had difficulty completing due diligence for non-standard overseas investment schemes where the firms did not have access to local qualified legal professionals or accountants. 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.*

*We also found many SIPP operators accepted investments into their schemes without adequate consideration of how investments could be valued or realised. Finally, we found firms continuing to rely on marketing and promotional material produced by investment providers as part of the due diligence processes, despite previous guidance highlighting the need for independent assessment of investments."*

***What did Westerby's obligations mean in practice?***

I'm satisfied that to meet its regulatory obligations when conducting its operation of SIPPs business, Westerby was required to consider whether to accept or reject particular investments and/or referrals of business with the Principles in mind. I say this based on the overarching nature of the Principles (as is clear from the case law) and based on good industry practice.

I note that in practice this was also (broadly at least) Westerby's view since it did for example carry out checks on investments before deciding whether to allow them in its SIPP.

I am satisfied that a non-advisory SIPP operator could decide not to accept a referral of business or a request to make an investment without giving advice. And I am satisfied that in practice many non-advisory SIPP operators (including Westerby) did refuse to accept business and/or refuse to make investments without giving advice. For example I am aware that at around the time Westerby agreed to allow the investment in CCGP it decided not to allow a different investment for a different client as that investment had not passed its due diligence checks. (I will refer to this below as the refused 2015 fund.) Also Westerby has said that it decided not to allow further investments into CCGP after it had carried out further checks on it in 2016 and saw information about it that had not previously been available to it.

I am satisfied that, in order to comply with its regulatory obligations, a non-advisory SIPP operator should have due diligence processes in place to check the investments they are asked to make on behalf of members or potential members. And Westerby should have used the knowledge it gained from its due diligence checks to decide whether to accept or reject a particular investment.

***Westerby's position in broad terms:***

In broad terms Westerby's position is:

- It carried out due diligence to a degree that was appropriate for its role as non-advisory SIPP operator.
- Its due diligence did not reveal any cause for concern at the time, and while the Bond was a high risk investment, it was acceptable as a SIPP investment.
- Mr H is a sophisticated investor and it's unfair to hold Westerby responsible for his investment losses.

***Due Diligence carried out by Westerby:***

In 2015 (fairly soon after Mr H's investment) Westerby would not allow an investment in the refused 2015 fund as a result of its due diligence process. There may have been other investments it also decided it would not allow at around the time of Mr H's investment.

Westerby has also said that in 2016 it decided not to accept introductions of business from CCGP direct or further CCGP investments because of its due diligence checks. These points show Westerby was aware of the need to carry out and act on due diligence checks in order to protect itself and its members' and/or potential members' interests.

However despite the effectiveness of its processes in the case of the refused 2015 fund and in relation to CCGP in 2016, I have concerns about the checks it made on the Bond in 2014 when Mr H asked about investing in it.

Westerby has explained it carried out checks on the Bond which included checking the investment offer document, checking the firm that approved the offer, and was to act as Security Trustee, was regulated and authorised by the FCA, and considering (but not relying on it solely) a third-party due diligence report.

Westerby has made some other points about the checks it made including:

- It took comfort from the approval of the documents by a regulated firm.
- And from a regulated firm acting as Security Trustee.
- That it was not concerned about some of the points mentioned in the third-party report because they chiefly related to the point that there is no equivalent to Companies House at which checks on the US Professional Partners involved in the matter could be made.
- It would normally review a company's accounts as part of the due diligence process, but accounts were not available for CCGP because it was a new company.

***The view Westerby should have reached from its due diligence checks:***

In my view there were a number of issues that would reasonably cause concern in relation to the Bond, some of which were mentioned in the third-party report.

The Bond offer document explained the background to CCGP. It was therefore known by Westerby that although CCGP was a new company with no track record, CCL had been in existence since 2011 and had issued bonds in a scheme to investors in a similar arrangement.

The third-party report said:

> *"Colonial Capital was first formed in 2011 to take advantage of the dislocation taking place in the US housing and mortgage market. It has since been rebranded as Colonial Capital Group PLC, which is also the Bond Company vehicle for the issue of the US Social Housing Bonds."*

In relation to CCGP's last accounts, the third-party report said: "n/a".

This is essentially the point made by Westerby – CCGP was a new company, so no accounts were available for it. However "Colonial Capital" was not new, and CCL had been in existence since 2011, had issued similar bonds, had a similar business model and had a track record and accounts that could have been checked. This is not done in the third-party report. Nor was it done by Westerby.

Further it should be noted that although the investment was being offered in the UK by a UK company it was essentially an overseas investment scheme with the US subsidiary of CCGP working with partners in the US being the heart of the scheme.

In this case Westerby agreed to allow Mr H to invest in the Bond in September 2014. At that time Westerby was aware, or should reasonably have been aware, of the Dear CEO letter dated 21 July 2014 (and all the preceding publications). So when Westerby agreed to allow the investment it will (or should) have been aware of the following point made by the FCA:

> *"We found that typically, firms had difficulty completing due diligence for non-standard overseas investment schemes where the firms did not have access to local qualified legal professionals or accountants."*

Further it can be seen from the Administrator's Report on CCL that that company had encountered difficulties in 2013 with its business model and it seems very unlikely that at least some of those points would not have been discovered with appropriate checks on CCL especially if carried out by local qualified legal professionals or accountants. The discovery of weaknesses in the business model and CCL's choices of commercial partners while arguably matters of commercial/investment risk should nevertheless be cause for concern when the points were discovered through checks rather than candid disclosure by the Bond issuer.

It was also clear from the offer document that the CCL and CCGP business model involved working with a number of what CCGP called Professional Partners. The report drew attention to a number of shortcomings in relation to the checks made on some of those Partners. Details of certain Partners' names in the offer could not be verified. On checking with CCGP the third party was told a new renovation partner and realtor had been appointed since the offer document was published and no update had been provided to investors or potential investors. Nor did checks made by the third party verify the details of the new realtor.

There was also similar confusion in relation to the rental manager.

The third party said that notwithstanding what it called the vague public records systems in the US, the disclosures made by CCGP demonstrated:

> *"a certain sloppiness and lack of attention to detail on behalf of a Bond issuer seeking to raise up to $100 million".*

This lack of professionalism and attention to detail should have been a matter of some concern. It gives cause for some concern about whether it might indicate a deeper issue relating to competence and/or trustworthiness. I am not saying it meant the Bond issuer could not be trusted, only that it was a negative point to be weighed up with all other points when making a decision.

The third-party report went on to say:

> *"Having undertaken less than satisfactory due diligence on the US based Professional Partners listed in the Offer Document, it is also reasonable to add a WCS* [worst case scenario] *acknowledgment that the model could fall down (as per the default warning on page 26 of the Offer Document) if the commercial partners appointed by the company enter a default position or fail to deliver on their responsibilities, which could lead to a collapse of the model."*

Another point of note is that the investment was promoted in a way that gave prominence to the point the Bond was secured. Westerby has said that the security arrangement ought to have been considered and understood by a sophisticated investor such as Mr H. Westerby says the security arrangements are a risk factor for the investment which is not a matter for it.

The third-party report included the following:

> *"The security arrangements represent a cross-jurisdiction arrangement, which may not be as straight forward to activate than a set of arrangements within a single legal jurisdiction. The Security Deed and Bond Instruments are executed in the UK over the UK Company which currently owns Colonial Capital Properties LLC, a US company as the asset being charged (shares). That charged company will hold the individual real estate assets to be liquidated in the event of default. However, these company shares are registered in the US and the Security arrangements would be activated in the US.*
>
> *Finally, and most importantly, the investor and their advisor must understand that the Security is based on company shares, NOT a direct charge on actual real estate assets which cannot be superseded, and the value of those shares is by no means guaranteed to be adequate to meet Bondholder liabilities in the event of default or even at the point of redemption. The Risk factors section of the Offer Document outlines the general underlying risks to this position. However, the basic position is that if charges are applied by another party on the real estate locally in the USA (mortgage for example), those charges will take precedence over any UK charges in the company that owns them.* [original emphasis]
>
> *The bond instrument states that the asset owned by the US company cannot be used as collateral for anything other than the Security arrangements associated with the bond. Also, it is clearly not the company's stated intention to encumber the US real estate asset with charges. However, there is no legal mechanism in the US which would prevent the charges being lodged against these properties via a mortgage or other form of debt instrument if the Company found itself in a difficult position and the value of the shares is NOT guaranteed to protect in any way.* [original emphasis]

To sum up on the point the third-party report said:

> *"Value of the first charge over company shares is not protected. Subsequently, the value of the security arrangements are not Guaranteed to be adequate in the event of default."*

So the security arrangements were complex and of questionable value since any situation that would call for the security arrangements to be exercised are likely to also be a situation in which the value of the shares on which the bonds were secured would also be negatively affected. That CCGP would think this was either an effective form of security or a feature upon which the Bond should be promoted ought to have been another point of concern not as a matter of investment risk alone but also as a reflection on CCGP and whether it was an appropriate business to permit SIPP members to invest in.

Although there were shortcomings pointed out by the third-party, Westerby considers it was reasonably entitled to take some comfort from the point that a regulated firm had approved the promotion of the investment and was to act as Security Trustee. However this comfort could not go so far as to mean that Westerby should not subject matters to a reasonable level of scrutiny. They were points to take into account, but not points that necessarily outweigh all other concerns Westerby should reasonably have had.

It is my view that Westerby should have had concerns about the security arrangements, about the degree to which they would, if called upon, be effective. And about the point that the investment was being promoted as being secured, the implication being that it would have effective security arrangements, which give concern about whether investors might be being misled and about the reliability of CCGP.

Again this was a point to be weighed up with the known issues such as the gaps in disclosures about, and checks upon, some of the Professional Partners involved in the project despite the crucial role they had.

In addition there was the known issue of not having accounts to check for CCGP. Just accepting that gap in knowledge without taking steps to fill it by making checks on CCL is a concern particularly given the other areas of concern mentioned.

Also of concern to me is the thoroughness of the checks generally which seems to have consisted mainly of Westerby's review of the offer document supplemented by the third-party report.

The investment was a non-standard overseas investment arrangement that called for enhanced levels of due diligence that Westerby itself might not have the expertise to carry out without accessing local legal professionals and accountancy professionals which it did not do.

It may be that Westerby considers due diligence checks with that level of thoroughness would have been cost prohibitive. If so, it should have refused to allow the investment rather than allow it on the basis of the checks it did make.

Westerby should reasonably have decided that based on what it had found out for itself, taken cumulatively, there was enough cause for concern that it was unable to be sufficiently confident about points such as the investment being:

- genuine and not a scam or linked to fraudulent activity
- safe/secure,
- and/or not impaired in any way.

Since it could not be reasonably confident about those points from the checks it made, Westerby should reasonably have concluded there was a real risk of consumer detriment in allowing the Bond investment. And Westerby should have decided not to allow the investment as it had done in the case of the refused 2015 fund.

In my view Westerby should reasonably have had sufficient concerns to have decided that it was not prudent to allow the investment in the Bond – that it should not put its members at risk in that way - just as it had decided it would not allow an investment in the refused 2015 fund.

***Is it fair to ask Westerby to compensate Mr H?***

Rather than refuse to allow the investment in the Bond, Westerby decided to allow only investment by members who were sophisticated investors or who had been advised by an authorised independent financial adviser.

In this case Mr H was not being advised by an IFA. Mr H did agree to be categorised as a sophisticated investor and there is no dispute that Mr H could be defined as such in relation to this Bond investment.

Although Mr H is a sophisticated investor the Bond was introduced to him by a firm that promoted property-based investments and it is not clear that Mr H personally carried out any due diligence on the investment.

Mr H seems to have been aware that Westerby did carry out some form of checks on the Bond. He asked Westerby if he could invest in it. He was told his request was referred to a Director for "review" and was later told Westerby was "*happy to approve this investment"*.

I note that In the case of the refused 2015 fund Westerby said it was not prepared to allow the investment. Westerby had concerns about it, and as it has said, it thought it prudent not to allow the investment. It did not think it would leave the decision to IFAs or unadvised sophisticated investors like Mr H. It decided it was not prudent for it and its members to be involved in the refused 2015 fund. In my view it should have made the same decision in relation to the Bond.

If Westerby had decided not to allow the Bond investment I consider it more likely than not that Mr H would have accepted Westerby's decision and would not have insisted on making the investment either with Westerby or elsewhere. It seems likely he would have just looked for something else. In that case Mr H would not have suffered the loss on the investment he has suffered. And there is no reason to say that he inevitably would have suffered the same losses on any reasonable replacement investment that Westerby would reasonably have allowed in the SIPP.

So I am satisfied that it is fair and reasonable to conclude that Westerby should compensate Mr H for the losses he has suffered. It's not obvious what holdings, and in what proportions, Mr H's pension monies would have been invested if they hadn't been invested into the Bond. Given the lack of certainty on this point, for the purposes of quantifying redress in this complaint I think the fair and reasonable approach is to assume that the monies in question would have achieved a return equivalent to the FTSE UK Private Investors Income Total Return Index (prior to 1 March 2017, the FTSE WMA Stock Market Income Total Return index). I'm satisfied that's a fair and reasonable proxy for the type of return that could have been achieved over the period in question.

Westerby's failure and the loss Mr H has suffered will also have caused Mr H some worry and concern. As I understand it, Mr H's SIPP is his only pension and so any sizeable loss in it will have caused him concern and worry even though he was categorised as a sophisticated investor.

**Putting things right**

My aim is to return Mr H to the position he would now be in but for Westerby's failure to stop his investment in the Bond in his existing SIPP with it.

I'm satisfied the investment would not have gone ahead and Mr H would have invested his available funds differently in his Westerby SIPP. 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 H's circumstances when he invested.

**What must Westerby do?**

To compensate Mr H fairly, Westerby must:

- Compare the performance of Mr H's investment 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.

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

- If compensation is paid into Mr H's SIPP it will be held in the SIPP subject to the terms and conditions Mr H agreed as a result of opening the SIPP with Westerby. It will (subject to the comments I make below in the section headed SIPP fees) be subject to the charges and fees that apply to the SIPP in the normal way since the object of the fair redresss is to restore Mr H to the position he would have been with his existing SIPP not to turn the clock back to the time before he opened the SIPP with Westerby.

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

- If Westerby is unable to pay the compensation into a pension plan for Mr H, it should pay that amount direct to him. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore the compensation should be reduced to *notionally* allow for any income tax that would otherwise have been paid. This is an adjustment to ensure the compensation is a fair amount – it isn't a payment of tax to HMRC, so Mr H won't be able to reclaim any of the reduction after compensation is paid. And in these circumstances a tax deduction certificate is not appropriate

- The *notional* allowance should be calculated using Mr H's actual or expected marginal rate of tax at his likely retirement age.

- Mr H has arranged his affairs, as a business owner, in such a way as to not have to pay income tax now or for many years. However it's the position in retirement that is relevant. Given the likely size of Mr H's pension (based on the amount transferred to the SIPP with Westerby when it was set up, which was initially at least, expected to receive further regular payments) it seems likely Mr H will be an income tax payer at retirement, so an adjustment to take this into account is reasonable. However, as Mr H will be able to take a tax free lump sum, the reduction should be applied to 75% of the compensation, resulting in an overall reduction of 15%. (And it should be kept in mind that I am referring here to a payment if redress cannot be paid into Mr H's pension.)

- Pay Mr H £300 for the distress caused by Westerby allowing the investment to go ahead. The investment subsequently failed and I think this would have caused some distress and inconvenience to Mr H in seeing his Westerby pension significantly impacted.

- Westerby should provide Mr H with a copy of its calculations of fair redress in accordance with this decision in a form that should reasonably be understandable to him.

Income tax may be payable on any interest paid. If Westerby deducts income tax from the interest, it should tell Mr H how much has been taken off. Westerby should give Mr H a tax deduction certificate in respect of interest as he has asked 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 |
|---|---|---|---|---|---|
| The CCGP Bond | illiquid | FTSE UK Private Investors Income Total Return Index | Date of investment | Date of my final decision | 8% simple per year from the date of this final decision to the date of payment (if not paid within 28 days of Westerby being notified of Mr H'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. This is complicated where an investment is illiquid as in this case.

If Westerby is able to purchase the illiquid investment then the price paid to purchase the holding will be allowed for in the current transfer value (because it will have been paid into the SIPP to secure the holding).

If Westerby is unable, or if there are any difficulties in buying Mr H's illiquid investment, it should give the holding a nil value for the purposes of calculating compensation. In this instance Westerby may ask Mr H to provide an undertaking to account to it for the net amount of any payment the SIPP may receive from the relevant holding. That undertaking should allow for the effect of any tax and charges on the amount Mr H may receive from the investment and any eventual sums he would be able to access from the SIPP. Westerby will have to meet the cost of drawing up any such undertaking.

***Fair value***

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

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

Any withdrawal/money realised from the investment should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simple, I'll accept if Westerby totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically.

**Why is this remedy suitable?**

I've chosen this method of compensation because:

- Mr H wanted Capital growth and was willing to accept some investment risk.
- The FTSE UK Private Investors Income ***Total Return*** index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It's a fair measure for someone who was prepared to take some risk to get a higher return.
- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr H's circumstances.

*SIPP fees*

The calculation of the actual value above should take into account fees charged on the SIPP attributable to the investment.

If Mr H has paid any fees or charges attributable to the investment from funds outside of his pension arrangements, Westerby should also refund these to Mr H. Interest at a rate of 8% simple per year from date of payment to date of refund should be added to this.
If the illiquid investment can't be removed from the SIPP, and because of this it can't be closed after compensation has been paid, then it wouldn't be fair for Mr H to have to continue to pay annual SIPP fees to keep the SIPP open. So, if the SIPP needs to be kept open only because of the illiquid investment and is used only or substantially to hold that asset, then any future SIPP fees should be waived until the SIPP can be closed.

**My final decision**

For the reasons set out above, I'm intending to uphold Mr H's complaint and require Westerby Trustee Services Limited to calculate and pay fair compensation to Mr H, as set out above. As said above, Westerby is to provide Mr H with a copy of its calculations of fair compensation.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr H to accept or reject my decision before 18 December 2024.

Philip Roberts
**Ombudsman**