DRN-2873707

Financial Ombudsman Service

The complaint

Mrs L, Mrs G and Mr L, as trustees of the J Trust, complain that Sesame Limited gave unsuitable advice to the trustees, which has created a second trust and leaves them unable to access funds that were to be held in the original will trust for its beneficiaries.

What happened

On the late Mr L's death, his will created a discretionary trust which provided for a legacy of the Inheritance Tax ('IHT') nil rate band (then £263,000) to be given to the trustees. The trustees of the will were the late Mr L's wife - Mrs L; his daughter - Mrs G and his son - Mr L.

The late Mr L's estate was worth approximately £250,000, but this included his interest in the matrimonial home, worth £120,000. Mrs L was advised by her solicitors to purchase her late husband's half share of the property from the trust, which meant that all of the trust fund would be represented by cash. Mrs L accepted this advice and £250,000 was left in the solicitor's client account to be used to satisfy the legacy due to the trustees.

The trustees sought investment advice from a representative of a business, which for simplicity, I will call Sesame throughout this decision. On 30 January 2006 the advisor produced a suitability report, recommending that Mrs L invest £240,000 into a Sterling investment bond and to write the bond into trust, using a discounted gift trust ('DGT').

The report noted that the purpose of this recommendation was to provide Mrs L with a monthly income of 5% of the total value (equating to £1,000) for her lifetime. Upon her death the remaining funds were to be paid to the beneficiaries - Mrs G and Mr L, who were also the trustees.

In 2012 the adviser recommended the bond be encashed and the proceeds, £165,000, were reinvested into another Sterling investment bond within a DGT. The same income of £1,000 per month was to be paid to Mrs L.

In 2020, Mrs G required access to some of the funds. However, she was informed it wasn't possible to access the funds until Mrs L passed away.

The trustees were concerned the advice provided may not have been suitable. After speaking to an independent adviser, they realised that Sesame had treated Mrs L as the settlor, advising her to invest the funds as if they were her own, rather than advising the trustees of the will trust about how to invest the funds. The trustees were also concerned that the investment was too high risk for them. They added that the arrangement in 2012 triggered chargeable gains because the income being paid to Mrs L was more than 5% of the sum invested. So, they complained.

Sesame agreed that the investment was too high risk and that the switch of investments in 2012 couldn't be justified. But it said Mrs L hadn't suffered any tax consequences as a result. This was because although the funds were placed into a new trust, Mrs L had survived seven years so they were outside of her estate for IHT purposes. It also said that although the arrangement in 2012 increased the income to 7% and had caused the issue of chargeable gain certificates, Mrs L was not a higher rate tax-payer, so hadn't suffered a financial loss. To compensate Mrs L for the loss resulting from the unsuitable investment, Sesame offered Mrs L redress based on a low risk benchmark, which equalled £61,397.36.

The trustees referred their complaint to our service. They weren't prepared to accept the offer because it didn't address the main issue, which was that the trustees couldn't access the capital because of the DGT arrangement. Furthermore, they couldn't stop the income being paid to Mrs L, despite it no longer being needed, which would reduce the capital value over time. And in fact it was now adding to Mrs L's estate. They also questioned whether this had had an impact on the tax due because of the chargeable gains.

Our investigator ultimately upheld the complaint – he was satisfied that Sesame's adviser was aware of the existence of the will trust and that the funds to be invested were trust funds, not Mrs L's own funds. So, he didn't think the DGT was suitable as a second trust was not required, and it meant that the funds held under the will trust could not be accessed by the beneficiaries as intended. He invited Sesame to suggest a way of putting things right. He also thought that Sesame should recalculate the redress it had previously offered to bring it up to date and that Sesame should pay £400 to the trustees for the distress and inconvenience caused.

Sesame agreed to recalculate the redress as proposed by the investigator but it didn't think it needed to do any more to put things right. It said the purpose of the trust was always to provide an income for Mrs L, not to provide access to the capital for the other trustees. It also said it was satisfied that the bond had residual value that could be made available at the discretion of the trustees and it didn't think the trustees had been disadvantaged in terms of taxation.

As Sesame disagreed, the complaint was passed to me to make a final decision. I informed both sides that I intended to ask Sesame to cover the reasonable costs the trustees incurred to seek independent financial, legal and/or tax advice to enable them to wind up the DGT and to reflect the original will trust arrangements as far as possible. I thought that this was likely to result in tax charges to Mrs L or the trustees, and I thought that Sesame should cover any avoidable tax charges that arose as a result of dismantling the trust that would not have otherwise arisen had the funds been invested suitably within the will trust. I thought Sesame's offer in respect of the unsuitable investment was otherwise fair.

Sesame didn't agree as it thought I was asking it to write a 'blank cheque' and the proposal left the matter open ended. It asked for a finite redress figure to be reached by allowing the trustees to seek advice so I could take a view on whether the costs were reasonable.

The trustees also didn't agree. They didn't think the burden of finding the legal solution should be placed on them given it was Sesame's mistake that caused the problem. The trustees asked what would happen if no legal solution could be found. They also asked what liability Sesame would have if HMRC imposed any penalties in future. The trustees added that the extra income placed into Mrs L's estate, which potentially increased her own IHT liability, hadn't been addressed. They also wanted a 'clean settlement' to bring the matter to a close.

As no agreement could be reached, I'm now providing my final decision on the complaint.

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.

The suitability of the DGT

Based on the evidence I've seen, which includes correspondence between the trustees' solicitor and the adviser at Sesame from 2005 and 2006, I'm satisfied that Sesame's adviser was fully aware of the discretionary trust created by Mr L's will when he gave Mrs L advice. I'm also satisfied that he knew the funds that the trustees were seeking investment advice on represented the late Mr L's estate, which were held within the discretionary trust, and were not Mrs L's personal funds.

Despite this, the adviser treated Mrs L as the settlor; his advice aimed to mitigate her IHT liability, whilst providing for investment growth and income. This is why he recommended a DGT. However, the funds were in fact given to the trustees upon Mr L's death. So, the trustees didn't need advice to mitigate IHT, instead they simply needed a means of investing the funds so that they would continue to grow for the benefit of the beneficiaries of the will trust. The will stated that Mrs L was a beneficiary, as well as the late Mr L's children, Mrs G and Mr L, and remoter issue.

It is clear to me that placing the funds within a DGT, with Mrs L designated as settlor, was unsuitable. This arrangement was inflexible; the withdrawals were fixed and it did not allow access to the capital invested until Mrs L's death. That does not meet with the arrangements specified in Mr L's will, which said that the funds were to be held for the benefit of all of the beneficiaries. The suitability report said that the policy was to be written in trust so that in the event of Mrs L's death, the proceeds would be paid to Mrs G and Mr L without the need for probate. But that wasn't necessary because the investment should've always been held within the will trust.

Although the trustees were all party to the advice, I don't think they could've reasonably been expected to identify the mistakes in the adviser's approach with regard to treating Mrs L as the settlor and him recommending a DGT. And in any event, the adviser was paid for his expertise. Furthermore, the adviser's suitability report didn't contain any warnings about the inflexible nature of the arrangement he'd recommended – he didn't say that the withdrawals were set for the remainder of Mrs L's life, or that the capital sum couldn't be accessed until Mrs L's death. There also isn't any reference to the key features of the product having been provided. So, I don't think there was any opportunity for the trustees to identify any problems with the advice before they raised their complaint.

Sesame's mistake needs to be rectified so that the trustees can have access to the capital, as the will trust intended. That can only be achieved by the DGT being wound up. This isn't something Sesame can do – legal advice will need to be taken, so that a suitable deed can be drawn up. Tax advice is also required so as to understand the tax consequences of winding up the DGT and so that any future potential liabilities can be mitigated. Further financial advice will also need to be sought to ensure that the remaining funds are suitably invested in line with the requirements of the discretionary trust created by the late Mr L's will. I think it is reasonable that Sesame covers the cost of obtaining this advice and the cost of the work required to put things right.

The trustees feel that Sesame should be required to source and engage the experts to put things right, given that the issue has only arisen due to its mistakes. However, the steps needed to put things right will need significant input from the trustees – the DGT can only be unwound at their direction. So, I think it is fair that the trustees seek out the advice needed.

As a result of the DGT being unwound, I think there will likely be tax consequences. Some of the tax consequences will be unavoidable, which I don't think Sesame should be held liable for. I say this because even if a suitable investment had been made within the structure of the discretionary trust created by the will, income tax would still likely be due when the investment was cashed in on whatever chargeable gain the investment made. So, I don't think Sesame needs to compensate the trustees for this, as this tax charge would've always been payable.

However, I think it's possible that there will also be avoidable tax charges, that is, charges that are purely as a result of the unsuitable advice, which could have been avoided if suitable advice had been given at the outset and withdrawals had been made in a tax efficient manner. Without going through the process of winding up the DGT, I don't know what charges there could be. So, if the trustees feel that they are required to pay tax charges that they would never have faced but for the unsuitable advice, evidence of this should be presented to Sesame and it should cover the cost of this.

I appreciate that both sides have asked for a definite settlement that draws matters to a close now. But unfortunately that isn't possible. I cannot direct Sesame to unwind the DGT as it has no power to do so. And the tax consequences of unwinding the DGT cannot be known until the trustees go through the process of doing so. It is for this reason that I think the relevant experts should be engaged by the trustees so that things can be put right as far as reasonably possible. And it is fair that Sesame covers the costs of this.

Sesame is concerned that I am asking it to provide a blank cheque, but that isn't the case. The trustees should provide Sesame with invoices and evidence if they believe they have paid additional tax that wouldn't have otherwise been payable. If Sesame believes the costs to be unreasonable/excessive, or not attributable to the initial mistake, then it can take this view. However, the trustees would be able to bring a new complaint if they feel Sesame's stance over the costs is unreasonable.

Tax consequences of bond income being paid to Mrs L

Placing the funds in the DGT hasn't had any IHT consequences for Mrs L in terms of the capital sum invested. But the trustees say that although Mrs L initially required income of £1,000 per month, she no longer needs it. And because the income withdrawals cannot be stopped, the excess income she's received remains in her estate and could be liable to IHT. The trustees say that this issue hasn't been addressed.

But I'm not persuaded that this problem can reasonably be attributed to the initial unsuitable advice. The trustees accept that Mrs L needed £1,000 per month from the investment – and the advice was based on this need. If Mrs L's circumstances have since changed, such that she no longer needs the income, I don't think that is Sesame's responsibility.

I don't know from what date the income was no longer required, but Mrs L would've been aware of it accumulating in her account and so I think it would've been reasonable to expect her to have considered this as part of her own IHT planning. For example, if Mrs L could've reduced her income from other sources I would've expected her to do so to mitigate her IHT liability. The trustees have also made the point that Mrs L is in her seventies and is in good health – so, I would still expect Mrs L to make arrangements now to ensure any capital she has that isn't required can be gifted or invested in a tax-efficient way. Finally, the income Mrs L is currently receiving will be stopped once the DGT is unwound and the bond encashed – so this will address the problem going forwards.

The trustees are also concerned about the impact of the 2012 advice – the income being paid to Mrs L remained at £1,000 per month, which, because of the reduced value of the investment, represented more than 5% of the investment. So, this triggered a chargeable gain. Sesame said that this hadn't had an adverse impact on Mrs L. I also don't think that Mrs L has been disadvantaged by this, because she's already been treated as having paid tax at the basic rate on the amount of the gain. So, she would only be liable to pay additional tax if she was a higher rate tax-payer, and I don't think she is. However, if that assumption isn't correct, I believe I've already accounted for this above where I've said that Sesame should compensate the trustees for any avoidable tax they have to pay.

Compensation for the unsuitable investment

It is not in dispute that the investment recommendation was unsuitable – the trustees had a low attitude to risk, but the investment strategy recommended by Sesame was based on a medium attitude to risk.

Sesame has offered compensation based on a comparison of how much the investment would be worth if it had been invested in line with the trustees' attitude to risk with the value of the bond now. It has used the same benchmark that I would have recommended it use for comparison purposes. So, I'm satisfied that this is a fair method of calculation to put things right. However, this calculation will need to be brought up to date.

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put the trust as close to the position it would probably now be in if the trustees had not been given unsuitable advice.

I take the view that the trustees would have invested differently. It is not possible to say *precisely* what the trustees would have done differently. But I am satisfied that what I have set out below is fair and reasonable given the trust's circumstances and objectives when the trustees invested. This is the same calculation method Sesame has previously undertaken.

What must Sesame do?

To compensate the trust fairly, Sesame must:

- Compare the performance of the trust's investment with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investments. If the *actual value* is greater than the *fair value*, no compensation is payable.

- Sesame should also pay interest as set out below.

- Pay to the trustees £400 for the distress and inconvenience caused as a result of the unsuitable advice, which meant the trustees couldn't access the capital when they needed to.

- Income tax may be payable on any interest awarded.

Investment name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Sterling Bond	Still exists and liquid	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.

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, Sesame 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 withdrawal, income or other distributions paid out of the investments 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 simpler, I'll accept if Sesame totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically. If any distributions or income were automatically paid out into a portfolio and left uninvested, they must be deducted at the end to determine the fair value, and not periodically.

Why is this remedy suitable?

I have decided on this method of compensation because:

- The trustees wanted capital growth with a small risk to the trust's capital.
- 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 the trust's 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.
- I consider that the trust's risk profile was in between, in the sense that the trustees were prepared to take a small level of risk to attain the trust's investment objectives. So, the 50/50 combination would reasonably put the trust into that position. It does not mean that the trustees would have invested 50% of the trust's money in a fixed

rate bond and 50% in some kind of index tracker fund. Rather, I consider this a reasonable compromise that broadly reflects the sort of return the trustees could have obtained from investments suited to the trust's objective and risk attitude.

Sesame should also cover the reasonable costs incurred by the trustees to seek legal and tax advice in order to unwind the DGT. It should also cover reasonable costs incurred by the trustees to seek new investment advice once the funds have been released.

Sesame should also consider and compensate the trustees for any avoidable tax consequences of unwinding the DGT, subject to the trustees providing evidence that the costs are a direct result of the unsuitable advice.

Where I uphold a complaint, I can award fair compensation of up to £160,000, plus any interest and/or costs that I consider are appropriate. Where I consider that fair compensation requires payment of an amount that might exceed £160,000, I may recommend that the business pays the balance.

My final decision

Determination and Award: I uphold this complaint and I require Sesame Limited to pay to Mrs L, Mrs G and Mr L as the trustees of the J Trust the compensation amount as set out in the steps above, up to a maximum of £160,000.

Where the compensation amount does not exceed £160,000, I would additionally require Sesame Limited to pay the trustees any interest on that amount in full, as set out above.

Where the compensation amount already exceeds £160,000, I would only require Sesame Limited to pay the trustees any interest as set out above on the sum of £160,000.

Recommendation: If the compensation amount exceeds £160,000, I also recommend that sesame Limited pays Mrs L, Mrs G and Mr L as the trustees of the J Trust the balance. I would additionally recommend any interest calculated as set out above on this balance to be paid to the trustees. If the trustees accept this decision, the money award becomes binding on Sesame Limited. My recommendation would not be binding. Further, it’s unlikely that the trustees can accept my decision and go to court to ask for the balance. The trustees may want to consider getting independent legal advice before deciding whether to accept any final decision.

Sesame Limited should provide details of its calculation to the trustees in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mrs L, Mrs G and Mr L as trustees of the J Trust to accept or reject my decision before 13 April 2022.

Hannah Wise
Ombudsman