DRN-3024459

The complaint

The Trust ('T') says Smith & Pinching Financial Services Ltd ('S&P') gave its settlor ('S'), also a trustee, unsuitable advice in 2006 to invest 40% of a settled Discounted Gift Trust ('DGT') portfolio in the Glanmore Property Fund ('Glanmore'). T says the Glanmore fund was unregulated and was too risky for S (and T).

S&P disputes the complaint and, initially, said this service lacks jurisdiction to address it because it is out of time. An ombudsman then determined that the complaint is in time and that one of our investigators could look into its merits.

What happened

The investigator concluded that the complaint should be upheld, because he considered that the Glanmore fund was unsuitable for S/T. In the main, he found as follows:

- S was advised by S&P in 2006 with regards to inheritance tax ('IHT') planning; she sought to mitigate IHT and to provide herself with a fixed income for life; and her estimated estate was valued at £437,000, of which £152,000 would be subject to IHT (IHT liability estimated at £60,800).
- T says S was in her 80s, was inexperienced in investments and was a low risk investor.
- S was advised to settle the DGT and then to invest, through the DGT's portfolio, £15,000 in a cash fund, £75,000 in a balanced managed fund and then £60,000 in the Glanmore fund.
- The DGT was suitable for S' IHT planning objective, but the Glanmore fund was an unsuitable investment to recommend because it was unregulated and too risky for the 'low to medium' risk profile that S&P assessed for S (and mismatched its risk rating document's definition of the low to medium profile). The fund was vulnerable to illiquidity and was based on gearing and S&P's recommendation, at the time, was focused more on its potential benefits and less on its risks. The fund unsuitably put at risk S' objective.
- In the context of the DGT portfolio as a whole, 10% of it was in low risk cash; 50% of it was in the balanced managed fund (which was held mainly in equities); and then 40% of it was in the Glanmore fund (which was high risk); so, overall, 90% of it was exposed to higher risks that S wanted to take. Overall, the DGT portfolio was unsuitable. The Glanmore fund content in the portfolio was revised to a 25% allocation in 2007, but this did not alter the unsuitability of the fund and portfolio.
- In addition, and based on information about S' other holdings, it does not appear that she was wealthy or experienced in investments.

T accepted this outcome, but S&P disagreed with it and asked for an ombudsman's decision. In the main, it said:

- The Glanmore fund has been misrepresented by T and by the investigator.
- As of 2006, it was well structured and well managed; it had enjoyed excellent long term performance since its inception; it had high calibre tenants (around half of which held leases of more than 10 years), diversification across different property sectors

and geographical locations, and a dividend history of 5% to 6% over the previous six years; it was a medium risk fund that was suitable as part of the DGT portfolio; and the portfolio had lower volatility than the main UK indices.
- Being unregulated did not automatically make the fund unsuitable or too risky. Neither this nor the characteristics of the fund are to blame for the subsequent suspension of the fund, for the loss of the investment and/or for the depletion of S' income. The fund's failure was unforeseen, was unforeseeable and was due to the effects of the 2007/2008 financial crisis.
- Evidence from 2011 shows that S was not in need of income from the DGT and that the income it generated had accumulated in a deposit account. The 2006 suitability letter also reflected that she did not need additional income and that she was considering giving gifts from her income, in the context of IHT planning. She also held, at different times, a variety of investments that all had equities exposure; and her risk profile rose to medium in 2007, shortly after the initial investment.

T maintains that S needed income from the investment to assist with her living expenditure, that she was always relatively cautious with her investments, that she was not experienced in investments (instead she relied wholly on investment advice) and that she did not seek advice from S&P about high risk investments.

The matter was referred to an ombudsman.

What I've decided – and why

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

Having done so, I share the investigator's conclusions that the Glanmore fund and, overall, the DGT portfolio were unsuitable for S/T, and that T's complaint is upheld.

There are key and basic elements that determine the suitability (or otherwise) of an investment. A suitable investment should match an investor's objective and attitude to risk ('ATR'), it should match an investor's affordability profile (in terms of income and capacity for capital loss) and in many, if not most, cases it should also match an investor's investment experience. In addition, there is a need to establish that an investor's objective, ATR, affordability profile and investment experience were properly assessed and determined at the time of advice.

In the present case, I agree with the investigator's finding that the DGT was a suitable recommendation to match S' IHT planning objective. This might be viewed as a redundant finding, given that T does not appear to have complained about the DGT, in isolation, but I consider it helpful to begin with it because it leads into treatment of S' objective and of S&P's argument that she was not in need of income (or not as in need as the complaint alleges).

IHT planning can be achieved through different tools. Some are designed only/mainly to aid the passing of an estate to a beneficiary(ies) in a tax efficient manner, in which case the focus is on the beneficiary(ies). A DGT differs as it serves the interests of *both* the settlor and the beneficiary(ies). It is usually based on a settlor who wishes to bequeath an estate in the long term but, in the interim, also wishes to draw from the estate (usually for main or supplemental income). As such, it is an IHT planning tool that is used where income withdrawal is part of the objective.

S' income arrangements in 2011 are irrelevant. Suitability of the recommendation in 2006 is what matters, and I have not seen evidence that events in 2011 were foreseen and planned in 2006. S&P is correct that the 2006 suitability letter reflects that S did not need the DGT portfolio for income *at the time*. The letter also proposes that she could gift up to £3,000 per year from her drawings.

Nevertheless, the majority weight of evidence in the suitability letter and in the documentation for the portfolio (including illustrations) is that S was to use to DGT portfolio to draw *supplemental* income for life. Indeed, the suitability letter presented this, very clearly, as both her objective and its recommendation. In the letter, S&P advised her that the arrangement to draw the fixed level of £6,000 income per year from the portfolio was "… *essential in order to give* [her] *security for the future* …".

Overall, on balance, given the selection of a DGT for S' IHT planning objective and given available evidence affirming the nature of her wider objective, I am satisfied that the need for the fixed level of £6,000 income per year (for life) was firmly within S' wider objective, and was fully known to (and supported by) S&P.

With such an objective, particularly a long term objective, S' £150,000 capital needed to be invested in a way that provided reliable long term income (which required safety of capital) but provided enough capital growth to sustain such long term income (which required the undertaking of some exposure to risk to gain exposure to the potential for returns). It also had to be invested in a way that matched S' ATR.

S&P has referred to S' ATR being low to medium in 2006 and then medium in 2007, shortly after the investment in the Glanmore fund. It is worth noting that even though the recommendation from S&P was made in late 2006, and whilst the DGT was settled in November 2006 and the balanced managed and cash funds were set up in the same month, the Glanmore fund was invested in January 2007 – hence S&P's argument that the revised ATR followed shortly after the investment.

S was in her 80s at the time of the ATR assessment. I do not suggest that an investor's ATR is automatically determined by age. However, on balance, I consider that S' age lends itself to T's argument that she was inclined to low risk exposure at the time. It is not uncommon for retired investors, especially with advanced ages like S', to have such a low risk profile for investments. Nevertheless, I accept that S&P was entitled to apply its own professional assessment of the ATR she had for the particular IHT planning and DGT portfolio pursuit she was contemplating.

I am not satisfied with the reliability of S&P's assessment. Some answers to the assessment questions conflicted and should have been clarified. For example, in response to a question about losing a quarter of investment capital within a year S' selection was that this would make her "nervous", yet in response to a question about a fall in a portfolio's value (also by a quarter) within a year S' selection was that she would "do nothing and ride the storm". I appreciate that the former question was about an individual investment and the latter about a portfolio, but there remained enough in common between both questions (in terms of a 25% investment loss in a year) to create a contradiction in the responses. A contradiction that should have been clarified. Especially as, in response to another question, S said she was prepared for no more than a 10% portfolio value loss in a year – which is arguably in contrast to her supposedly being prepared to do nothing and ride the storm after a 25% portfolio value loss in a year.

I have not seen evidence that these contradictions were clarified. On balance, I consider that S' ATR was low to medium, not necessarily because of S&P's assessment but because it had to be in order to strike a compromise between what appears to have been her naturally low risk inclination and the need to expose her capital to enough potential for returns (and therefore exposure to some risks beyond a low ATR) in order to sustain the income for life element of her objective. I do not consider that S had a medium ATR and it is more likely (than not) that the untreated contradictions in the assessment contributed to the revised assessment that S&P has referred to.

In terms of affordability, I consider that S/T could not afford exposure to the risk of losses that would deplete capital and render the income related objective unsustainable. As such, and because of S' low to medium ATR, the DGT portfolio required a meaningful and broadly equal split between low risk (and relatively safe) holdings and medium risk holdings (for the potential of higher returns). I also note evidence that, in the course of S&P's suitability assessment, S was deemed to have "limited" investment experience.

I agree with the investigator's finding that the DGT portfolio was unbalanced, in the context of S' profile, and that it mismatched her ATR. Despite S&P's best arguments, the Glanmore fund was not comparable to a conventional medium risk investment. It was unregulated. I accept that my views should not get carried away solely because an investment is unregulated, but regulation has distinct value at least in terms of the regulator's view of an investment and protection for the retail clients who put money into an investment. It follows that an 'unregulated investment would lack such value. S was a retail client, so such distinct value would have benefitted her too, but it did not exist in the Glanmore fund.

Furthermore, it was a fund invested in commercial property and available evidence is that it did so on the basis of a broadly 50/50 equity and borrowing split, hence the gearing element that the investigator noted. Commercial property investments can be more vulnerable, than others, to illiquidity and downturns. The gearing element meant third party lenders shared vested interests in the fund's underlying projects and, in the event of defaults, potentially had better rights than an investor such as S. The fund's past performance, as of 2006, is a matter of fact, but objective good performance does not automatically equate to subjective suitability.

I also understand S&P's argument that the problems that arose in the fund (from around 2008) were unforeseeable and unforeseen. However, the issue to determine is about suitability of the Glanmore fund and the DGT portfolio as of the time of recommendation in 2006. The former could reasonably have been viewed as no less than a medium to high risk investment. It occupied 40% of the portfolio. The balanced managed fund was, by description and based on its factsheet, no less than a medium risk fund – in 2006, it appears to have allocated around 50% to UK equities, around 20% to Japanese/Asian/Emerging Markets/USA equities, around 10 to European equities, around 8% to structured products, around 4% to commodities and around 4% to fixed interest securities.

The only low risk content in the portfolio was the 10% cash holding. The remaining 90% of the portfolio was essentially exposed to medium to high risks. This does not match what I noted above about the portfolio requiring a meaningful and broadly equal split between low risk and medium risk holdings, and it does not match S' low to medium ATR. S&P might argue that it would not have considered an equal split capable of sustaining the income element of S' objective. If so, it ought to have advised accordingly, it ought not to have given the impression that an equal split approach was adequate – which is what the low to medium ATR would have conveyed to S – and it ought to have had a full and frank discussion with S about whether (or not) she could consider adopting a higher ATR.

Overall, on balance and for the above reasons, I do not consider that the Glanmore fund and the DGT portfolio were suitable for S/T, and I am not persuaded that the revision subsequently made to the fund's weighting in the portfolio – to 25% – altered the unsuitability of the portfolio and the imbalance between low and medium risk holdings.

Putting things right

fair compensation

I consider that fair compensation will be to put T as close as I can to the position it would probably now be in if it had not been given unsuitable advice. I take the view that it would have behaved differently. It is not possible to say *precisely* what it would have done differently but I am satisfied that what I have set out below is fair given S' circumstances and objectives at the time.

what must S&P do?

To compensate T fairly, S&P must:

- Compare the performance of the DGT portfolio with that of the benchmark shown below and pay T compensation in the form of the difference between the *fair value* and the *actual value* of the investment. However, if the *actual value* is greater than the *fair value*, no compensation for financial loss is payable.
- Pay T interest if set out below. Income tax may be payable on any interest awarded.
- Provide T with a calculation of compensation in a clear and simple format.

investment	status	benchmark	from ("start date")	to ("end date")	additional interest
The Discounted Gift Trust Portfolio	Still Exists	for half of the investment, the Bank of England average return from fixed rate bonds; and for the other half, the FTSE UK Private Investors Income Total Return Index (prior to 1 March 2017, the FTSE WMA Stock Market Income Total Return Index)	date of investment	date of settlement	Not applicable

actual value

This means the actual amount payable from the investment at the end date. If at the end date the investment (or any part of it) is illiquid the relevant *actual value* should be assumed to be zero. This is provided T agrees to S&P taking ownership of the investment, if it wishes to. If that is not possible then it may request an undertaking from T that it repay to S&P any amount it may receive from the investment in future.

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, S&P should use the monthly average rate for fixed rate bonds with 12 to 17 months maturity 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 payment out of the investments should be deducted from the *fair value* at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there are a large number of regular payments, to keep calculations simpler, I will accept if S&P totals all of those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because:

- S/T wanted capital growth and income, with some exposure to risk to capital.
- The average rate for fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to capital. The FTSE UK Private Investors Income Total Return Index is a mix of diversified indices representing different asset classes, mainly UK equities and government bonds, and would be a fair measure for someone who was prepared to take some risk to get a higher return.
- I consider that S' risk profile was in between, in the sense that she was prepared to take a small level of risk to attain her investment and IHT planning objectives. The 50/50 combination above would reasonably put T into that position and it broadly reflects the sort of return S/T could have obtained from a suitable investment.

compensation limit

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, £160,000, £350,000 or £355,000 (depending on when the complaint event occurred and when the complaint was referred to us) plus any interest that I consider appropriate. If fair compensation exceeds the compensation limit the respondent firm may be asked to pay the balance. Payment of such balance is not part of my determination or award. It is not binding on the respondent firm and it is unlikely that a complainant can accept my decision and go to court to ask for such balance. A complainant may therefore want to consider getting independent legal advice in this respect before deciding whether to accept the decision.

My final decision

For the reasons given above, I uphold The Trust's complaint. I order Smith & Pinching Financial Services Ltd to pay The Trust compensation as set out above and to provide The Trust with a calculation of the compensation in a clear and simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask The Trust to accept or reject my decision before 18 October 2021.

Roy Kuku
Ombudsman