

Complaint

Mr H's complaint is about a EIS portfolio investment he made with Octopus Investments Limited ("Octopus"). The investment made a significant loss and he says that loss was magnified by the gearing involved with the investment (i.e. the borrowing taken by the companies the portfolio invested in).

His complaint, in summary is:

- Octopus did not disclose any intention to gear the companies in which it invested in the systematic and extensive way it did.
- Octopus did not disclose the risk of gearing at any level.
- Octopus invested his money in investee companies which were highly geared without his authority.

Mr H says that if he had known of the level of gearing he would not have invested in the EIS portfolio.

Background

Mr H was sent a letter and associated documents by his independent financial advisor (IFA) on 9 June 2015. This correspondence detailed advice to roll over a previous EIS investment with Octopus to a new EIS investment with Octopus, in order to maximise tax benefits.

The correspondence included:

- Octopus' EIS brochure
- Octopus' EIS Terms and Conditions
- Octopus' investment transfer form
- The IFA's consent form
- The IFA's advice report – this had a page detailing general EIS risks and an appendix providing technical detail on EIS (both written by the IFA) attached.

The IFA told Mr H he should carefully consider all the documents. Mr H accepted the IFA's advice and the existing investment was subsequently rolled over. However, the new investment did not perform well – Mr H suffered significant losses.

Mr H made his complaint – through a representative - in December 2020. A detailed response sent to Mr H by Octopus in February 2021. It did not uphold the complaint, and provided a response to Mr H's complaint points alongside general commentary on the performance of the investment. In terms of Mr H's points of complaint Octopus said, in summary:

- In addition to its product brochures it also made adviser specific literature available, outlining further information on its EIS products and related considerations. And it provided detailed information to widely used industry publications, which advisers could access in the event they wanted to obtain further details during their pre-investment due diligence.
- The product brochure highlighted the key risks of investment throughout.
- Its literature was clear, fair and not misleading. It was therefore clearly understood by the IFA at the pre-investment recommendation stage, from both its literature and third-party reports, that capital preservation was the targeted objective and not a guarantee. And it was clearly understood the investment was a high risk investment.
- It was not required to provide the minutiae of the investments it would be making. It was instead required to explain the investment was a discretionary managed investment service. That this was a higher risk investment where capital and returns were not of a guaranteed nature. And that while EIS qualification was also being targeted, again there was no guarantee this objective would be realised either.
- It was the IFA's responsibility to conduct appropriate due diligence in respect of the investment, and make Mr H fully aware of all of the associated key risks and details. It was also the IFA's responsibility (and not Octopus') to determine which, if any, of the investments Octopus offered was suitable.
- As a discretionary investment manager, it selects investments at its discretion on behalf of investors, as explained in the agreement investors accept when applying. At its discretion, investments are allocated to portfolios based on their attributes closely fitting the objectives of the product as set out in the product brochure and other supporting literature.
- Debt financing is common for projects of this nature where EIS funding alone is insufficient due to the limits set by the UK Government. And debt financing is a natural and often necessary activity for actively trading companies to raise capital.
- Debt financing has been utilised for the significant majority of its renewable energy based EIS, including previous tranches into which Mr H had invested
- The use of debt financing was something it made clear was being considered at the pre-investment stage to enable larger scale opportunities to be considered. In addition, it relayed details of the investment propositions, including the perceived need for debt financing to industry reports.
- Its literature explained in clear terms, in several instances, that debt financing could be utilised where it considered it suitable. And, as the sources of financing could be linked to other investments managed by Octopus, it ensured that not only notification of the use of debt financing was communicated, but that the potential conflict was also.
- Where a request for additional information was received at the pre-investment phase, including requests for details about potential debt funding (or any other matter relating to investment propositions we were considering for inclusion), this was something it provided.

Mr H was not satisfied with this response, and his representative referred his complaint to us. When doing so he provided some comments on Octopus' response to the complaint,

which I have considered.

Our investigator considered the complaint and concluded it should not be upheld. He said, in summary:

- Octopus drew attention to gearing in the key risks section of its product brochure.
- The Terms and Conditions also confirm that debt financing is a possibility.
- It was down to Mr H's financial advisor to go into any further details as to how it could affect his investment.
- There is no information to suggest that Octopus knew prior to the investment how much debt financing would be used.
- It was however possible debt financing would be used to help with funding. It was a method under consideration to raise capital.
- The documents also didn't put a limit on how much debt financing could or would be used.
- Overall, he did not think the brochure was misleading.
- Octopus did inform all potential investors that the EIS was high risk. It was for Mr H's financial advisor to advise Mr H if the risk associated was suitable for his objectives and circumstances.
- Octopus had the right to manage the portfolio at its sole discretion. The management authority granted to Octopus is covered in the Terms and Conditions. These clearly state that Octopus would have sole discretion, without the need to run its decisions past investors or advisers.

Mr H did not accept this view. His representative made further submissions on his behalf. He said, in summary:

- The view does not take account of, or does not give sufficient weight to, the following important factors:
 - Octopus' duties under the FCA Principles
 - Octopus' responsibilities as the product provider under The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)
 - Octopus' special knowledge of gearing within EIS
 - The information Octopus should have given to Mr H and his IFA, but did not.
 - Octopus' lack of authority to buy highly geared investments for the portfolio Mr H invested in
- Its clear Octopus' literature was directed at potential investors, not at advisors, and the scope of Octopus' regulatory obligations was therefore at its widest.
- Under the RPPD Octopus was required to ensure information was sufficient, appropriate and comprehensible in substance and form, including whether it will

enable distributors to understand it enough to give suitable advice and to extract any relevant information and communicate it to the end consumer.

- Mr H and the IFA had the reasonable expectation that Octopus' literature gave all the information that was needed to understand the risks.
- As per the relevant Conduct of Business (COBS) rules, it was reasonable for the IFA to rely on the information provided to it by Octopus.
- Neither Mr H nor his IFA were aware of the high level of gearing and it is not accepted that a high level of gearing is common practice.
- Octopus had previously used high level of gearing, and failed to disclose it. Octopus' plans for investment of the portfolio subject to complaint would also likely have been well advanced by the time it began promoting it.
- We should ask Octopus about the previous levels of gearing used and material internal documents on the plans for the investment of the portfolio subject to complaint.
- Octopus' brochure does not do anywhere near enough to disclose the gearing risks associated with the portfolio.
- Octopus did not have absolute discretion to buy highly geared investments for the portfolio.
- In managing investments and in taking investment decisions Octopus was subject to the FCA rules and guidance on suitability applying at the time. This meant Octopus' had to ensure any decision to trade was suitable for its client.
- Octopus said it would select and manage investments which correspond with the objectives and principles of the portfolio set out in the brochure. But the high level of gearing in the companies it invested in was not disclosed, so Octopus cannot claim Mr H's investment objectives included investing in highly geared companies.
- The prime objective, after qualifying for EIS, was capital preservation. Investing in highly geared companies was not consistent with this.

As the view was not accepted, the complaint has been referred to me for consideration.

My findings

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

I appreciate that Mr H's representative has made detailed submissions and is clearly strongly of the view Octopus should compensate Mr H for the poor performance of his investment. But I am not persuaded it would be fair and reasonable to uphold this complaint.

It does not appear to be disputed the portfolio was understood to be a high risk investment and that this – as general point - was made clear by Octopus. What is disputed is whether all the specific risk factors associated with the investment were disclosed by Octopus – and the focus in particular is on the use of gearing or debt financing. And there is a further point about the extent of the discretionary mandate given to Octopus.

Turning to the first point - about the use of gearing or debt financing - I agree Octopus' brochure addressed the potential investor directly. But, in this case, Mr H was not a direct investor. He was being advised by his IFA, which sent him Octopus' brochure, alongside other information, which included a personal recommendation of the investment's suitability for Mr H, and the IFA's own assessment of the risks and features of EIS products – both set out in the IFA's advice report, which was addressed to Mr H personally. So Mr H was not relying exclusively on Octopus' brochure and was following a personal recommendation which had been set to him by the IFA – which had reviewed Octopus' product brochure before making that recommendation.

I note the only reference to debt financing in the risk factors section of Octopus' brochure was in the context of conflicts of interest. But, as the investigator noted, that conflict of interest section does refer specifically to debt financing, and there are references to debt financing elsewhere in the brochure. So I do not think there is sufficient evidence to show Octopus led Mr H or his advisor to believe there would not be *any* gearing, or that gearing would be limited to a particular level. Nor do I think there is sufficient evidence to show Mr H or the IFA were of that understanding at the time.

In my view, if the brochure was considered in its entirety, it ought to have been clear that the use of gearing was at least a possibility, even if the extent to which it was to be used or how it was to be used was not disclosed. I also think it is reasonable to say a competent advisor should have been aware, generally, that investments of this type may involve the companies in which they invested using debt financing. In any event, I note the advice report repeated the reference to debt financing made under the conflicts of interest section of the risk factors set out in Octopus' brochure:

Conflicts of interest: The companies in which Octopus EIS invests may also receive funding from other sources managed by Octopus Investments.

Which shows the IFA was aware the companies in which Octopus invested may not be funded exclusively by the investments of investors in Octopus portfolios. So the IFA does not appear to have relied on what the brochure said to conclude that there was *no* gearing. Rather, the IFA specifically highlighted to Mr H that funding could potentially come from other sources than portfolio investors in its advice report, but it does not appear to have explored that point further.

It was for the IFA to explore what risks Mr H was willing and able to accept and for Mr H to ensure, during that exploration, that his objectives were clearly relayed to the IFA. So if Mr H did not want to accept – or could not take - the risk of investment in something that involved gearing, or did not want to accept – or could not take – the risk associated with an investment which used gearing beyond a particular level, that was something that should have been explored with Mr H and considered by the IFA before the investment was recommended to him. And it would then have been for the IFA to ensure it had enough information to assess the suitability of the investment for Mr H.

I agree that the IFA could reasonably rely on information provided to it by Octopus, and note the COBS rules relating to this. But, in this instance, as noted above, it does not seem to be the case the IFA relied on Octopus' brochure to conclude there would be no gearing. It instead noted the reference to funding potentially coming from other sources than portfolio investors but does not appear to have then sought further detail about this. And I have not seen sufficient evidence to show that further information about gearing would not have been provided by Octopus if had been requested by the IFA or Mr H at the time.

There is also, in my view, insufficient evidence to show further detail in the brochure about gearing would have changed the course of things, in any event. Although the focus now is

on gearing, there is no evidence to show this was a particular point of concern at the time – as noted above, the IFA repeated the reference to funding potentially coming from other sources than portfolio investors but does not then appear to have explored this point further. And Mr H would have seen this reference in the IFA's advice report and Octopus' brochure, if he read them at the time – and he does not appear to have explored this point further either. So, whilst with the hindsight knowledge of how the investment has performed I can understand why Mr H feels he should not have invested, from the evidence available I am not persuaded he would have concluded at the time that he should not invest if he was told more about gearing, when awareness of the possibility of gearing does not appear to have been a concern to Mr H or the IFA at that time.

In the light of my above findings, I do not think I need to ask Octopus about the previous levels of gearing used and material internal documents on the plans for the investment of the portfolio in order to fairly decide the complaint. I am satisfied I have enough information to decide what is fair and reasonable in the circumstances.

Turning to the discretionary mandate given to Octopus, I am satisfied a broad mandate to make investments was given to Octopus by Mr H and I have not seen sufficient evidence to conclude Octopus acted beyond that mandate.

In its response to Mr H's complaint Octopus set out in detail the basis on which it selected investments for the portfolio. There, in my view, insufficient evidence to show the investments selected were inconsistent with the objective set out in the brochure. As mentioned above, Octopus did not say it would not invest in companies which used debt financing. And there is no evidence to show the investments it selected were otherwise inconsistent with the objectives set out in the brochure. It is clear Octopus thought the companies it invested in were ones which met the objectives of EIS qualification and being likely to generate a return of capital after a set period – but achieving these objectives was never guaranteed.

If Mr H feels the level of gearing, or the use of gearing generally, made the investment an unsuitable one for him, that is something he should take up with the IFA, if he has not already done so.

My final decision

For the reasons given, I do not uphold the complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr H to accept or reject my decision before 12 June 2023.

John Pattinson
Ombudsman