

The complaint

The estate of the late Mr R complains Telford Mann Limited (“Telford”) gave unsuitable advice when it recommended Mr R invest in an Enterprise Investment Scheme (“the EIS”).

What happened

According to Telford’s final response letter, Mr R first consulted its adviser in 2012 and the relationship continued until Mr R’s death in late 2018. He was concerned about his liability to IHT and as well as making gifts to relatives he had discretionary trusts set up in 2006 and 2012 and invested in 2013 in a portfolio of unlisted shares to obtain business relief from IHT.

A meeting note of 24 April 2017 says Mr R was selling a UK property for £160,000 he had bought for £12,000 and capital gains tax (CGT) would be due in January 2019 on the gain. It said £100,00 would be left after tax and short-term expenditure and Mr R wanted advice on how best to invest this *“to generate growth and income above the levels currently available on deposit”*. It said he would want income every six months but wanted to maintain and grow the capital, to which it said he wouldn’t require access for the foreseeable future.

The note said Mr R *“still considers himself a very balanced investor”* and wanted to *“maintain the risk score of 4, Moderate, approach for his investments...”* It said he *“understands that investments will rise and fall in value and has experience of years of capital losses but is confident that these investments remain long-term and that any short-term losses will not have an impact on his standard of living in retirement. [He] would like to give his money opportunity for real capital growth above inflation and believes that the Moderate risk profile will provide him with the returns that he is looking for over the medium-to longer-term.”* The note said Mr R would contact Telford again once the sale date of the property was known.

The 24 April 2017 note made no reference to inheritance tax (IHT). But a meeting note for a 4 July meeting to *“discuss options for his investment of £100,000”*, said Mr R *“would like to mitigate his potential IHT liability whilst also delaying/deferring the capital gains tax liability he will have on the property gains”*. These are benefits offered by the EIS. The note said the EIS was compared to Mr R’s existing estate planning investment and he was happy to invest into either. Telford recommended the EIS *“as this better meets his objectives”*.

Telford’s final response letter said the capital gain was around £120,000 and would have incurred CGT of around £30,000. It said putting £100,000 into the EIS deferred £25,000 of this and as Mr R didn’t need to access the capital this tax would never be paid because the liability would be extinguished when Mr R died. Telford estimated Mr R received £12,000 in income tax relief. It said he would’ve received 100% relief from IHT had he survived for two years (IHT is charged at 40% on assets above the IHT threshold).

The 4 July 2017 meeting note says Telford explained the EIS, the tax advantages and the risks. It says Telford gave Mr R the literature to read and agreed to return on 7 July to complete the applications and pick up the cheque. It said Telford’s written advice would follow as soon as possible and Mr R could contact Telford if he had questions about this.

The note said Mr R *“feels that the risks associated with this plan are consistent with his*

overall attitude to investment risk and he believes that any capital loss he could incur would not have a detrimental impact on his standard of living now or in the future as he does not intend to use this money to supplement his other investments.”

The advice report followed on 14 July 2017. Our investigator noted from this that Mr R was in his late 80s and retired with income from rents and pensions of around £30,000 a year which he supplemented by drawing around £18,000 from his investments. He had around £335,000 in a share portfolio in trust, around £170,000 in an offshore bond in a discretionary trust, around £87,000 in an estate planning service, a stocks and shares ISA worth around £100,000, another ISA worth around £43,000 and £50,000 in cash. His property and chattels were worth around £230,000 and his main residence around £350,000.

Mr R also had the £100,000 he was investing. The report said: *“You seek a solution which will assist in reducing your immediate liability to Capital Gains Tax and one which will further improve your overall tax position from an Inheritance Tax and Income Tax perspective.”* It said his ‘specific requirements’ were *“to invest in order to assist in managing your overall tax liabilities and diversifying your investment portfolio”*. It noted that he wouldn’t need access to the capital and also wouldn’t need income from it as he would increase regular withdrawals from other sources instead.

The advice report said Mr R’s risk profile was “4 – Moderate” based on a risk-profiling questionnaire he had completed. It described this as follows: *“You accept that an increased investment risk is inevitable if you are to achieve attractive real returns. Investments in this category usually offer reasonable growth potential in the medium term. Although risk is reduced through diversification across markets, the Fund Manager can use this wide choice of assets to adjust exposures according to specific market conditions. You should note that these funds are subject to market movements and currency risk.”*

The report said: *“Ordinarily I would recommend an investment portfolio to meet the above stated risk profile, however, given your circumstances and objectives, I do not think it appropriate to recommend a diversified portfolio of investment funds to meet this particular need at this present time.”*

Instead the advice report said a £100,000 investment in the EIS *“most appropriately matches your stated objectives and specific requirements, as evidenced by our research”*. It said this would *“further diversify”* his overall portfolio and provide tax benefits. It also said:

“We have discussed the risks associated with investment monies into an EIS and you are happy to consider investing this capital for the longer term. You are aware that by investing deposit monies into the recommended EIS, you are increasing the level of risk that the monies are exposed to, from a no risk cash asset to an EIS with a specific investment focus. You understand the increase in risk and are happy to proceed with the investment based on the objectives detailed previously.”

When recommending the EIS, the advice report said the EIS *“aims to reduce risk by investing across three investee companies per investor, but the nature of the investment strategy is specialised so risk can only be mitigated to a limited extent. [The EIS] believe that their chosen sector will provide good growth potential and exit options for investors based on their experience of investing in this sector of the past five years.”*

The advice report said the EIS wasn’t rated by third party ratings agencies for its financial strength but it said this wasn’t unusual for EIS schemes. It said the provider of the EIS had been established in 2008 and Telford had known it since launch and had monitored the progress of its investments. The report said: *“We feel that they have now built up a track record and sufficient experience in the sector to support an investment...”*

The advice report said the £100,000 investment would allow Mr R to defer £18,000 of CGT. It noted the potential to claim up to £30,000 in income tax relief and the potential for IHT relief of £40,000 after two years.

The report said: *“Whilst it would’ve been possible to invest in other EIS schemes, these tend to be higher risk in nature due to their more specialist remits and the lack of management pedigree, which means that although returns may be higher, the potential risk to your investment is also greater. EIS’ are by their very nature inherently risky, but [the EIS] aims to reduce the risk wherever possible”.*

The report had a section for *“Specific Risk Associated with EIS”*. This said: *“EIS’ are for higher risk investors and should be held for the long term, but during our discussions, you confirmed that you consider yourself to be an experienced investor. With this in mind, I feel that the recommended EIS meets your objectives and provide[s] a spread of investment strategies as detailed later in this report.”*

The report also said – under the heading *“Limited Advice”* – *“...you would like us to limit our advice and you require no advice on the suitability of the products within your overall financial circumstances.”*

The advice report ended by thanking Mr R for his business (he had already handed over his cheque, which was received by the EIS on 11 July 2017 according to an acknowledgment letter dated 14 July). But there was also an appendix which explained the tax treatment of the EIS in more detail and also had a number of *“Risk Warnings”*, including:

- *“EIS’ invest in young growth oriented companies. To this end, they are considered to be high risk investments, and the possibility of losing all of the invested capital is greater”.*
- *“The EIS aims to invest all investor funds in a target of three companies, but special circumstances may apply to certain investors which mean that they hold investments in few[er] investee companies than this. Such investors will not benefit from the same diversification and consequently, their investment in the EIS will carry a higher risk.”*

In its final response letter Telford said the main objective of the investment was to save tax, and this was achieved for CGT and income tax, with a potential for IHT benefits too. It said the EIS represented only around 10% of Mr R’s assets, excluding his principal residence – and Telford said this wasn’t excessive. It said his overall position was still in line with a moderate attitude to risk. It rejected Mr R’s complaint.

Our investigator thought the complaint should be upheld. Our investigator said Mr R’s gain was £108,700 and tax of £19,566 - around 18% of the gain - was due. But our investigator thought the advice meant Mr R risking all the £100,000 in a high risk product. He said it wasn’t possible to guarantee the success of any company or accurately foresee market conditions or regulatory changes that might affect its prospects.

Our investigator thought Mr R understood the EIS as riskier than some investments but our investigator didn’t think Telford had made the high risk nature of the EIS sufficiently clear to Mr R. He said some of the literature mentioned the high-risk nature of EISs, but this wasn’t given sufficient prominence in the advice as a whole.

For example the risk of the loss of all the capital was mentioned but only in an appendix. Our investigator didn’t think Telford’s records showed Mr R understood how the risk level of the EIS varied from his recorded attitude to risk.

Our investigator thought Telford had promoted the EIS to Mr R on the basis it didn’t carry as

much risk as other EISs. He thought most of Telford's recorded comments about risk caveated or downplayed the risk – and this likely reflected what was said at the meetings.

Our investigator accepted that other options for addressing the tax liability Mr R wanted to address had been explored but not found to be suitable. Overall our investigator thought the EIS wasn't suitable for Mr R's attitude to risk and involved higher risk than Mr R wanted. He didn't think Mr R's investment experience made the advice or the EIS suitable for Mr R.

Our investigator noted that the EIS was capable of achieving Mr R's objective of saving tax. This included inheritance tax savings after two years, income tax relief of up to 30%, the facility to defer capital gains and to offset capital gains made elsewhere in future against losses made on the EIS. But the EIS was still unsuitable for Mr R on the grounds of risk. So our investigator thought the position Mr R's estate was in, having taken the EIS, should be compared to what that position would've been if Mr R had instead put the money into an investment taking a small amount of risk.

Telford didn't agree with our investigator's conclusion. It said, in brief summary:

- The conclusion wasn't based on the circumstances at the time of the advice but with the benefit of hindsight based on the poor investment outcome.
- *"Mr R was aware the risks associated with the EIS were greater than his mainstream investments. It is inevitable that investments offering such tax concessions carry greater risk. The tax reliefs are to encourage investment in new, innovative companies that would otherwise be unable to obtain the necessary funding."*
- From Mr R's point of view the tax benefits of the EIS did outweigh the risks. This was also Telford's view and this was adequately documented. The EIS was suitable for Mr R and in line with his objectives and overall circumstances.
- The investment was affordable for Mr R and he was able to withstand the full loss of capital without this affecting his standard of living.
- The CGT deferred was likely saved entirely since CGT wasn't payable on death and Mr R knew he wouldn't need the invested sums and so he would never need to pay the CGT. The investigator overlooked this and also underestimated the rate of CGT that would've been payable - as it would've mostly been paid at 28%. Mr R also received income tax relief and would've saved on 40% inheritance tax if he had survived for two years.
- Taking the EIS didn't change the risk profile of Mr R's portfolio of investments overall, which continued to match his attitude to risk and capacity for loss.
- Those bringing the complaint for the estate weren't at the meetings or in any position to know Mr R's feelings towards the investment and its risks.

In addition Telford had made a number of other points, including:

- Mr R was in a position to make an informed decision about investing in the EIS. The discussions took place between April and July and funds weren't allocated for three months after that. So there was plenty of time for him to consider things before he decided, and to change his mind and withdraw if he had concerns. He confirmed in writing his receipt of Telford's meeting notes, its suitability report and the EIS information memorandum.
- A lack of liquidity in Mr R's assets was referenced in the complaint, but apart from his properties all Mr R's other assets were liquid at the time of this death.

As the matter couldn't be resolved informally it has been passed to me to decide.

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.

Mr R had a history of taking out investments that had IHT benefits. The EIS offered the prospect of greater IHT savings sooner than could be made from other methods such as potentially exempt transfers. It also offered the prospect of a CGT saving. So the EIS offered significant benefits for Mr R that other investments wouldn't offer. Mr R didn't need the invested funds to meet his own living expenses – so he could afford to make the investment and afford to take the risks of the EIS in order to secure its potential benefits. The issue is whether Mr R understood the degree of risk this meant taking and whether that degree of risk was suitable for Mr R given his willingness to take risk.

It seems to me that if Mr R understood the degree of risk involved, then the fact he was willing to take the EIS shows he was willing to take that degree of risk with the money he was investing. On that basis the investment would be suitable, since there is nothing in Mr R's circumstances that made taking that risk unsuitable for him if he wanted to take it – he could afford to lose the money and taking the risks of the EIS allowed Mr R to secure benefits that were directly relevant to his particular circumstances at the time.

He decided to draw income from other investments, so his initial income need noted in April was no longer there in July. I'm content this was the case and Mr R didn't need access to the invested funds.

It follows that the key question is whether Telford made clear to Mr R the degree of risk involved in taking the EIS. From what I've seen, Telford accepts the EIS was a higher risk investment. As Telford has said, "*the risks associated with the EIS were greater than his mainstream investments*". The significant tax advantages offered by EISs are offered to provide some compensation for taking that risk, to encourage, as Telford says, investment in new companies that might otherwise not obtain funding. The possibility of losing most or all the money invested was real, and this was so from the outset. It isn't something that was only known with hindsight after the investment lost, as I understand it, much of its value.

So I've thought carefully about whether what I have supports the view that Telford made the high risk nature of the EIS sufficiently clear to Mr R. On balance I share our investigator's view that that the evidence suggests Telford didn't make this clear enough to Mr R.

In saying this I note the advice report referred to EISs in general as being “*considered to be high risk*”. This isn’t the same as saying that they are high risk. Also it appears only in the appendix. More importantly, the report had already distinguished the EIS from other EISs in general, saying the latter were “*higher risk in nature due to their more specialist remits and the lack of management pedigree*”. The report had noted the pedigree it considered the provider of the EIS to have, referring to having monitored the provider since 2008 and saying the provider as having “*now built up a track record...*” It is plain that Telford recommended the EIS to Mr R on the basis that it carried less risk than EISs ordinarily carried. As such generalised statements about the risk of EISs would’ve carried less significance for Mr R.

I think it was clear that Telford wasn’t recommending something that matched the risk profile description it had quoted in the letter – but only insofar as what was recommended was not a diversified portfolio of investments. Whether or not the EIS otherwise matched Mr R’s risk attitude wasn’t made clear enough in my view. The report said by making the investment the risk to which the money was exposed to was increased from that of a no risk cash asset – which was self-evident – up to “*an EIS with a specific investment sector focus*” but there was no clear statement that this involved more risk than would ordinarily be suitable for someone with Mr R’s moderate risk attitude.

Also I think it noteworthy that when referring to attitude to risk the only risk profile description given was for the moderate risk attitude Mr R was assessed as having. There wasn’t any description of the higher risk attitude that would have matched the EIS investment Telford was recommending.

I don’t overlook that Mr R had previously been advised by Telford to invest in a portfolio of unlisted shares – and I note that Telford discussed the possibility of paying more into that portfolio and compared it to the EIS at its meeting, with Mr R being happy to invest in either. But even if Telford was clear about the risks of that portfolio at the time it recommended it to Mr R, I’m not persuaded any risk warnings given would’ve been clear and fresh in Mr R’s mind four years later when Telford recommended him the EIS. Also despite having what on the face of it would appear to be a risky investment of unlisted shares, there is no suggestion that this shows Mr R was a speculative or high risk investor in general or wanted speculative or high risk investments when he met with Telford in 2017. When pointing out that EISs are for higher risk investors, the advice report didn’t say Mr R was such an investor but rather than he was an experienced investor and it said the EIS suited him on that basis.

I note that Telford says Mr R’s overall position was still in keeping with a moderate attitude. It says he invested only around 10% of his wealth (excluding his home) in the EIS. In my view 10% is still a high proportion and I also note Mr R already had some of his money invested in unlisted shares before the 2017 advice. Also the advice increased Mr R’s risk exposure overall as the funds had previously been in property and were to be invested in speculative business enterprises through the EIS.

In any case, the key issue in my view remains whether Telford made Mr R sufficiently aware of the degree of risk involved with the EIS when it recommended it to him in 2017. For the reasons I’ve given above, I’m not persuaded that it did.

Telford says Mr R was given plenty of time to read the literature and to make up his mind. The EIS was explained to Mr R on 4 July 2017 and presented to him as an option at that time (along with the option of putting more into something he already had) and he signed for the investment three days later. So I don’t find what Telford says about this persuasive. But even if I were to accept that Mr R had been mulling the EIS since February and reviewed it further in the months running up to October after signing for it in July, this wouldn’t in itself mean Telford presented the risks to him properly or advised him of the risks properly, nor would it follow that Mr R understood the risks.

With all this in mind, what Telford says about the length of time the transaction was spread out over, doesn't persuade me the advice to invest in the EIS was suitable – in light of what I've already said above. Also I accept that those bringing the complaint weren't party to the discussions Telford had with Mr R but this doesn't change my view of the suitability of the advice Telford gave.

I note what Telford says about our investigator miscalculating the rate or amount of CGT payable. I note the 18% rate mentioned was the rate mentioned in Telford's advice report, which also referred to a £18000 figure. Even if the actual benefit had been higher than this, like Telford now says it was, this wouldn't change my view that Mr R wasn't made sufficiently aware of the degree of risk involved in investing in the EIS.

In light of all I've said above, for the reasons I've given, I've decided to uphold the complaint.

Putting things right

I've decided Telford Mann Limited was at fault and should put things right as set out below.

Fair compensation

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

I take the view that Mr R would have invested differently. It is not possible to say *precisely* what Mr R would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr R's circumstances and objectives when he invested.

What must Telford do?

To compensate the estate of Mr R fairly, Telford must:

- Compare the performance of Mr R'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.
- Telford should also add any interest set out below to the compensation payable.

Income tax may be payable on any interest awarded.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
The EIS	Still exists but illiquid	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 date of my decision.

If at the end date the EIS (or any part of it) is illiquid (meaning it could not be readily sold on the open market), it may be difficult to work out what the *actual value* is. In such a case the *actual value* should be assumed to be zero. This is provided the personal representatives of Mr R agree to Telford taking ownership of the illiquid assets, if it wishes to. If it is not possible for Telford to take ownership, then it may request an undertaking from the personal representatives of Mr R that they repay to Telford any amount they may receive from the portfolio 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, Telford 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 tax relief Mr R received as a result of holding the investment, including any CGT avoided, should be considered a return on the actual investment. To reflect this addition to the actual value Mr R received, such sums should be deducted from the fair value at the point at which Mr R received the reliefs so that these sums cease to accrue any return in the calculation from that point on.

If the continued existence of the EIS incurs charges for the estate that are not met from the EIS itself, and these can't be ended by Telford taking over the illiquid assets, I think it's fair that Telford pays the estate of Mr R an upfront lump sum equivalent to five years' worth of those charges (calculated using the charges in the previous year to date). This should provide a reasonable period for the parties to arrange for the EIS to be closed.

Why is this remedy suitable?

I have decided on this method of compensation because:

- Mr R wanted capital growth with moderate risk to his capital. He wanted real growth above inflation and above that available on deposit. But the investment time horizon was necessarily limited by his age.
- 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 his 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 Mr R's risk profile was in between, in the sense that he was prepared to take a moderate level of risk to attain his investment objectives. So, the 50/50 combination would reasonably put the estate of Mr R into that position in my view.

- This does not mean that Mr R would have invested 50% of his 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 Mr R could have obtained from investments suited to his objective and risk attitude. In reaching this view I take into account that Telford has raised no objection to this benchmark and what I've said above about Mr R's investment time horizon.

My final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £160,000, I may recommend the business to pay the balance. I include this reminder about our award limits here because in this case I do not know what amount the calculation will find to be due.

Telford Mann Limited should provide details of its calculation to the estate of Mr R in a clear, simple format.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £160,000, I recommend that Telford Mann Limited pays the estate of Mr R the balance plus any interest on that amount as set out above.

This recommendation is not part of my determination or award. It does not bind Telford Mann Limited. It is unlikely that the estate of Mr R can accept my decision and go to court to ask for the balance. The estate of Mr R may want to consider getting independent legal advice before deciding whether to accept this decision.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Telford Mann Limited should pay the estate of Mr R the amount produced by that calculation – up to a maximum of £160,000 plus any interest set out above.

If Telford Mann Limited does not pay the full fair compensation, then any portfolio currently illiquid should be retained by the estate of Mr R. This is until any future benefit that it may receive from the portfolio together with the compensation paid by Telford Mann Limited (excluding any interest) equates to the full fair compensation as set out above. Telford Mann Limited may request an undertaking from the personal representatives of Mr R that either they repay to Telford Mann Limited any amount the estate of Mr R may receive from the portfolio thereafter or if possible, transfer the portfolio at that point.

Under the rules of the Financial Ombudsman Service, I'm required to ask the estate of Mr R to accept or reject my decision before 15 January 2024.

Richard Sheridan
Ombudsman