DRN-3800903

The complaint

Mrs V complains that Cathedral Independent Financial Planning Ltd (Cathedral) gave unsuitable advice to invest into an Enterprise Investment Scheme (EIS).

What happened

In August 2015 Mrs V received advice from Cathedral to invest £442,980 into an EIS. Mrs V was looking to secure inheritance tax (IHT) efficiencies that would benefit her estate. By 2020, Mrs V had lost around half of the capital sum invested. Mrs V complains that she was exposed to more risk than she wanted to take, the recommendation being high risk and lacking in diversification. Mrs V seeks compensation for her capital losses.

Cathedral say that the recommendation was suitable, Mrs V's main objective was to reduce IHT liability and this objective was met. The suitability report evidenced discussion around alternative options that were discounted. Mrs V had indicated that she was prepared to invest into higher risk assets to gain IHT savings and the EIS enabled deferment of her capital gains tax liabilities. Cathedral also highlighted that Mrs V's daughter had been involved in discussions about the recommendation.

Our investigator considered the complaint. He thought the recommendation to invest in this EIS wasn't in keeping with Mrs V's normal attitude to risk and the risks were heightened by investment into a single EIS in one industry sector. The recommendation lacked diversification, exposing Mrs V to more risk in the event of sector downturns. Our investigator also took into account that Mrs V did not recall completing risk assessments and those relied upon by Cathedral were completed very early in the morning, were inconsistent in content and were completed by the adviser. Also, no notes of the meeting had been provided, so our investigator also placed weight upon Mrs V's and her daughter's recollection of events. Our investigator agreed that there were some risk warnings within the suitability letter but accepted Mrs V had relied upon Cathedral's description in discussions that the investment was more risky than her usual investments, not that it was high risk.

Our investigator also considered that whilst Mrs V had some capacity for loss, she was advised to invest a significant proportion of her funds into the EIS. Mrs V already had some tax mitigation in place and it appeared she wished to retain access to her funds, whereas by investing in the EIS, her funds became illiquid with the earliest exit being in four years. Our investigator concluded that the recommendation was unsuitable for Mrs V. Had Mrs V been appraised of the full circumstances, he thought she would have invested differently. He thought it was fair and reasonable for Cathedral to pay the difference between the fair value of the investment (assessed against a FTSE UK Private Investors Income Total Return Index benchmark) less the actual value of EIS (to be assessed as zero if the investment remained illiquid) less tax reliefs. Undertakings were suggested, if Cathedral wished to take on the investment. In addition, our investigator thought £500 should be paid in compensation for distress caused to Mrs V by the unsuitable recommendation.

Cathedral disagree with the view and further reasoning provided by the investigator. They say Mrs V had investment experience and was content to accept a higher risk exposure in order to obtain IHT efficiencies and other tax benefits. Cathedral rely predominantly on the suitability letter, which they say accurately disclosed the risk profile of the product and highlight that the risks were discussed with Mrs V and her daughter separately. Mrs V understood the risks and had likely discussed matters with her daughter, who was providing support. Cathedral also say that the risk assessments were completed by the adviser following a meeting with Mrs V and accurately reflected her views. Mrs V's objectives were IHT mitigation and CGT deferral, she had not wished to discuss other tax efficient options. Further, Mrs V had not wished the administrative paperwork with multiple EIS providers, hence only one provider had been selected. Cathedral also highlight that Mrs V's objectives should not be ignored when considering redress and care should be taken not to redress in a vacuum.

As the parties do not agree, the matter has now come to me for a decision.

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 think it is helpful to highlight at the outset that I've made my decision based upon the balance of probabilities having weighed up the information provided by each party. Having reviewed the timeline, I'm satisfied that the parties have had reasonable time to provide all the information they wished me to consider. Where a finding is made that a business has done something wrong, redress will be calculated on a fair and reasonable basis.

I trust the parties will not take it as a discourtesy that I have not addressed every point raised, I'd like to give reassurance that I have read the information provided by both parties. This decision focuses on the core complaint as to the suitability of the recommendation of this particular investment to Mrs V, considering the point the recommendation was made, taking into account Mrs V's particular circumstances, her objectives, attitude to risk and capacity for loss.

I've considered Mrs V's circumstances. At the time the review was undertaken in August 2015, Mrs V was in good health with a sufficient income to cover her monthly outgoings. She held £390,124 in an offshore bond, £68,727 in an ISA and £624,483 in portfolio (unit trusts). Mrs V also owned her own home and was undertaking building works.

<u>Objective</u>
It is common ground that Mrs V was concerned generally about IHT and wished to protect her capital for her daughter to inherit. There's also no dispute that the recommendation to invest in an EIS offered inheritance tax efficiencies. Further, the EIS provided the opportunity to defer the capital gains tax liability that had been triggered by cashing in the unit trusts. This particular EIS was also said to target capital preservation, but to be clear the investment strategy of aiming not to lose capital invested, was separate to the inherent risks of investing in an EIS (addressed below).

Cathedral identified that Mrs V had a significant capital gain from her portfolio and recommended the EIS in order to defer that CGT liability, explaining that if the CGT liability wasn't deferred Mrs V would need to pay HMRC £120,476. The suitability letter highlighted that CGT could be deferred, but in my view it was not clear that this liability could crystalise when the EIS shares were sold. Instead, the suitability letter said that there *may be* an opportunity to phase the withdrawals so that tax would not need to be paid on the original plan and illustrations showed a zero liability. From what I have seen, no further assessment of this possibility was made.

<u>Risk</u>
Cathedral place weight on the suitability report, which I have considered. However, it wouldn't be fair and reasonable for me to view this in isolation given that there are differing accounts from the parties, so I have reviewed the information provided by both parties.

I've considered the information available to the adviser at the time. It is not disputed that Mrs V's attitude to risk was assessed as medium and that's expressly recorded in the suitability report, namely that her overall risk profile had remained the same and was medium. I note Mrs V describes herself as more of a cautious investor and I have seen a letter showing investment into a portfolio in 2011 said to be in a cautious fund, but I don't think undermines the general finding that as at the time advice was given Mrs V's general attitude to risk was medium, which was consistent with the investments she held.

In addition to the suitability report (addressed below), Cathedral have placed reliance upon two risk assessments, which say Mrs V selected different risk responses for the EIS (risk level 6 high) and general investment (risk level 4 medium) when answering a series of questions about risk appetite. I place limited weight on these assessments. It's now clear that they were completed by the adviser, in close succession (within five minutes of each other) very early in the morning. They were not completed by Mrs V but are said to reflect discussions held the day before. However, neither Mrs V nor her daughter recall having sight of these documents and there are no contemporaneous notes of the meeting to show that these specific questions were put to Mrs V.

Cathedral have said Mrs V had investment experience but I've balanced that against her account that she had limited experience save for having knowledge of investing in shares, which she inherited after her husband's death. There is nothing to show that Mrs V had experience with this type of investment, EISs being non-mainstream, complex, illiquid, specialised and speculative investments, where there is a real risk of losing the original, capital investment.

And whilst it's fair to say that Cathedral did ensure the recommendation was also discussed with Mrs V's daughter, I'm persuaded by her account that she relied upon the advice provided, I haven't seen anything that shows Mrs V's daughter had any particular experience with this type of complex investment either.

I think it's fair to conclude that Mrs V was willing to take some risk to gain inheritance tax relief, but I'm not persuaded that tax advantages were more important to her than the risk of losing all the capital sum.

The suitability letter refers to there being a discussion about the large increase in risk associated with potential "tax savings" and it was recorded that Mrs V was unhappy about paying her taxes if no action was taken. Cathedral say Mrs V agreed she would accept "a very high level of risk" where there was "a risk of losing some or all of [her] capital."

However, the highlighted key risks section also included in the suitability letter was less clear and said the EIS would invest in smaller companies, that have a higher failure rate, whereby capital would be at risk. The letter then went onto capture chunks of information taken from the EIS Information Memorandum (IM). Mrs V recalled there was a lot of "jargon" being used so she deferred to the adviser's expertise.

Cathedral also say that Mrs V was provided with a copy of the EIS IM, so ought to have been aware of the risks. But as Mrs V was seeking and relying upon professional advice, it wasn't enough for the adviser to expect Mrs V to have identified different factors from the IM or to point to sections of it. It was for the adviser to assess whether the level of risk was suitable for Mrs V.

I have also considered Mrs V and her daughter's consistent recollection that the risk of losing all capital was not made clear in the discussions with the adviser. Both describe being advised that for some extra risk, tax advantages could be secured not that all the capital investment was at risk. Given Mrs V's lack of experience with this type of investment, I don't think it would be unreasonable for her to rely upon what she was told. I've also noted that the illustrations produced at the time, were arguably misleading. They showed projections as to the possible tax savings that could be achieved by investment in the EIS, compared to not investing or investing part. However, the illustrations assumed that the capital sum remained the same over time, they did not reflect the high risk of the capital sum depleting significantly.

It's also relevant that there was a higher concentration of risk due to the lack of diversification. The IM stated investment may be in one or a small number of companies, with the investments being in one sector, "Therefore, there is likely to be limited diversification, which could increase the risk for investors." However, there's nothing to show that Mrs V was advised about the impact of a lack of diversification with this investment, which was a material risk factor, other than a generic reference to possible limited diversification. I agree with the investigator that investing funds in a single industry sector exposed Mrs V to significant risk if a downturn in that area materialised. I'm not persuaded by the argument that this course was reasonable because Mrs V wished to have less paperwork. Ultimately the responsibility for assessing the suitability of an investment lies with the professional adviser and failing to diversify the investment, especially one which was a substantial amount of overall assets, increased the risk exposure.

Cathedral also say the recommendation was suitable because other areas of investment were reduced to a cautious approach, but I don't think that's borne out by the evidence. Within the same recommendation another £120,476 was recommended for investment in a tax efficient Business Property Relief scheme, which again was higher risk. Further, the portfolio to which the balance of funds were moved to, was selected at Spectrum Growth 4, which appears to have been a balanced portfolio.

Taking everything into account, for similar reasons to those addressed by our investigator, it is my view that Mrs V was exposed to more risk than she wanted to take. By their own calculations, Cathedral state in their letter of March 2022 that Mrs V was advised to invest 40% of her assets into the EIS. That was a significant proportion. Considering Mrs V wanted to protect her capital to pass to her daughter, I'm not persuaded she would have invested into the EIS if she had understood that all the capital was at risk.

<u>Capacity for loss</u>
It is also relevant considering Mrs V s circumstances above that she had some capacity for loss, but I note that much of her assets were tied into property. Mrs V did not need access to the funds for day-to-day living but had referred to wanting to retain some access, which wasn't possible when the funds were tied into the EIS for several years.

Conclusion
In light of my findings, I am not satisfied that it is likely that Mrs V would have invested in the EIS if she'd understood the risks involved. Overall, for the reasons given, I'm not persuaded that the recommendation was suitable for her. I am therefore upholding this complaint.

Putting things right

In order to put things right, I've considered how to put Mrs V back into the position she'd have probably been in if she hadn't been given unsuitable advice, which isn't as straightforward as simply refunding the original investment.

I'm mindful that had it not been for the unsuitable advice, Mrs V wouldn't have had the EIS tax relief already availed of and she wouldn't have whatever value (if any) the EIS now has. This redress effectively unwinds the investment as if it wasn't made and a comparator investment was made instead. So, Mrs V may wish to take advice about the tax implications of accepting this decision.

Given the information Mrs V has provided, I think she'd have invested differently. It isn't possible for me to say precisely what she would have done, so I've considered what I think is fair and reasonable given her circumstances, objectives and attitude to risk when she invested.

To compensate Mrs V fairly, Cathedral must:

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

• Cathedral should also pay interest as set out below.

Investment name	Status	benchmark	from ("start date")	To ("end date")	Additional interest
Octopus EIS	Still exists	FTSE WMA Stock Market Income Total Return Index and then from 1 March 2017 the FTSE UK Private Investor Income Total Return Index	Date of investment	Date of my decision	8% simple per year from date of decision to date of settlement (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value

This means the actual amount payable from the investment at the end date. If at the end date the investment is illiquid (meaning it could not be surrendered or 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 Mrs V agrees to Cathedral taking ownership of the investment, if it wished to. If it is not possible for Cathedral to take ownership, then it can request an undertaking from Mrs V that she repays to Cathedral any amount she might receive from the investment in future.

Cathedral may also add to the actual value any available tax reliefs Mrs V has received by virtue of making the investment. It may ask her for evidence of this, or assume she has availed herself of all available relief at his marginal rate of tax.

For ease it can calculate the value of the available relief and add it to the actual value as one figure at the end.

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

Any withdrawal, income or other distribution 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 are a large number of regular payments, to keep calculations simpler, I'll accept if Cathedral 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.

The EIS only exists because of illiquid investments. In order for the EIS to be closed and any further fees that are charged to be prevented, those investments need to be removed. I've set out above how this might be achieved by Cathedral taking over the investment or this is something Mrs V can discuss with the provider directly. But I don't know how long that will take.

If third parties are involved, we don't have the power to them what to do. If Cathedral are unable to purchase the investment, to provide certainty to all parties I think it's fair that Cathedral pays Mrs V an upfront lump sum equivalent to five years' worth of wrapper fees (calculated using the fee 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 decided on this method of compensation because:

• Mrs V was willing to accept some investment risk, but I'm not persuaded she would have taken more risk to gain tax efficiencies.

• The WMA index and Private Investor index are made up of diversified indices representing different asset classes, mainly UK equities and government bonds. They would be a fair measure for someone who was prepared to take some risk to get a higher return.

• Although they are called income index, the mix and diversification provided within the index is close enough to allow me to use them as a reasonable measure of comparison given Mrs V's circumstances and risk attitude.

I have also taken into account that Mrs V has suffered distress at being unable to access her funds, whilst watching the value deplete overtime. I consider that it is more likely than not that she has suffered distress and upset as a result of the advice given and the subsequent locking into an investment, which was unsuitable for her needs. In my view it is fair and reasonable to make an award of compensation and I consider that £500 is a fair sum.

My final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £170,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £170,000, I may recommend that Cathedral Independent Financial Planning Ltd pays the balance.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My final decision is that Cathedral Independent Financial Planning Ltd should pay the amount produced by that calculation up to the maximum of £170,000 (including distress or inconvenience but excluding costs) plus any interest on the balance as set out above. Cathedral Independent Financial Planning Ltd should provide details of its calculations to Mrs V in a clear, simple format.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £170,000, I recommend that Cathedral Independent Financial Planning Ltd pays Mrs V the balance plus any interest on the balance as set out above.

If Cathedral Independent Financial Planning Ltd does not pay the recommended amount, then any investment currently illiquid should be retained by Mrs V. This is until any future benefit that she may receive from the investment together with the compensation paid by Cathedral Independent Financial Planning Ltd (excluding any interest) equates to the full fair compensation as set out above.

Cathedral Independent Financial Planning Ltd may request an undertaking from Mrs V that either she repays to Cathedral Independent Financial Planning Ltd any amount she may receive from the investment thereafter, or if possible transfers the investment to Cathedral Independent Financial Planning Ltd at that point.

This recommendation is not part of my determination or award. It does not bind Cathedral Independent Financial Planning Ltd. It is unlikely that Mrs V can accept my decision and go to court to ask for the balance. Mrs V may want to consider getting independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mrs V to accept or reject my decision before 27 July 2023.

Sarah Tozzi
Ombudsman