DRN-3996467

The complaint

Mr and Mrs W are complaining about financial advice given to them by Prosperity Independent Financial Advisors and Stockbrokers Limited trading as Prosperity Financial Advisors and Stockbrokers (Prosperity).

What happened

Mr and Mrs W met with their longstanding financial adviser from Prosperity in September 2020. They explained that they'd wound up their business and were entering retirement. They said they were looking for advice on how to fund their retirement including holidays. The Prosperity adviser introduced Mr and Mrs W to another company, A, who advised Mr W and his wife to release equity from their property using a lifetime mortgage arrangement.

The Prosperity adviser then suggested Mr and Mrs W try to mitigate inheritance tax (IHT) by investing the money released from the property into a loan trust through Prosperity. They recommended Mr W make a loan to a discretionary loan trust (DLT) which then invested in an offshore bond. This was split 50:50 between two different managed funds.

Mr and Mrs W complained to Prosperity (and company A) in September 2021 after a conversation with their children. They said the recommended products don't meet their requirements. They say the main objective at the time was to have the ability to pay for luxury holidays on an annual basis and they think neither of the recommended products meet this requirement or their wider objectives. Instead they could have made withdrawals from time to time from their existing investments rather than incurring large fees on both products. And they say their intended spending would have significantly reduced the IHT liability so negating the need for the DLT.

Prosperity replied to Mr and Mrs W's complaint. They said any complaint about the equity release mortgage needed to be made to company A – they were aware such a complaint had already been made and not upheld. They said they'd introduced Mr and Mrs W to company A because one of the ways of reducing IHT is to create a debt against the estate in the form of a lifetime mortgage. But, having done that, they needed to remove the cash from the estate otherwise it would still be subject to IHT.

In relation to the DLT, Prosperity felt it was suitable because it provided the potential for capital growth, allowed a regular income, and moved any growth in the investments outside Mr and Mrs W's estate, effectively capping any IHT liability.

Mr and Mrs W weren't persuaded by Prosperity's response and brought their complaint to our service. Our investigator upheld the complaint, saying he didn't think Prosperity had made suitable recommendations. He said Prosperity ought to pay to Mr and Mrs W the difference between the total redemption cost of the mortgage and the value of the DLT plus all withdrawals from it. He said Prosperity should also pay Mr and Mrs W all fees and charges they'd taken in respect of the advice.

Prosperity disagreed with our investigator. They said their client's objectives had been to increase tax efficient income and to mitigate IHT. They said they agreed that funding for the luxury holidays could have come from existing investments but wouldn't have had the desired effect of immediately and substantially reducing their current IHT liability – which, they said, was achieved by creating a debt against the estate with the lifetime mortgage.

Prosperity added that the roll-up interest in the lifetime mortgage would offset the likely increase in value of the property over time. They also said the investment bond and loan trust were an ideal structure for an individual looking to reduce their IHT while giving them access to large lump sums – but Mr and Mrs W didn't have sufficient existing assets (before taking out the lifetime mortgage) to achieve this. Finally, Prosperity said Mr and Mrs W were fully aware of the costs of the lifetime mortgage in terms of the roll up of interest but it was their adviser's opinion that the cost of this would be less than the IHT saving.

Our investigator and Prosperity couldn't reach an agreement so the matter came to me for a decision. I issued a provisional decision on 27 June 2023. In that provisional decision I said:

> *"Introduction to company A*
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> *There's no documentation from the time which explains why Prosperity referred Mr and Mrs W to company A. In response to my questions, Prosperity said they'd explained the benefits and drawbacks of a lifetime mortgage to Mr and Mrs W over a number of years. Mr and Mrs W had acknowledged they were asset rich but income poor and that they'd want to look at either moving or a lifetime mortgage to release equity from their property – but then in 2019 it was clear they didn't want to move house. So, Prosperity say, they made the referral in 2020 on this basis.*
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> *I don't think it was inappropriate for Prosperity to introduce Mr and Mrs W to company A – their testimony and Prosperity's indicates that Mr and Mrs W were looking to fund holidays in their retirement but didn't want to sell their house. Whilst they had other assets, principally in the form of an offshore bond, these were providing Mr and Mrs W with a monthly income. So I think it was reasonable for Prosperity to introduce their clients to company A to explore the possibility of a lifetime mortgage.*
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> *Suitability of the lifetime mortgage*
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> *I can't say Prosperity advised Mr and Mrs W to take out the mortgage – there's no documentation that suggests this was the case. And it's clear company A advised on the suitability of the mortgage. Our service has already considered Mr and Mrs W's complaint against company A.*
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> *Because I don't think Prosperity advised Mr and Mrs W on the suitability of the mortgage, I can't say they're responsible for the costs of it. It follows that I'm not inclined to say Prosperity need to pay Mr and Mrs W the cost of unwinding the mortgage.*
>
> *Suitability of the DLT*
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> *Prosperity were, however, responsible for recommending the DLT and offshore bond. I don't think these recommendations were suitable and I'll explain why.*
>
> *It's clear from the October 2020 fact find and from testimony from both parties that Mr and Mrs W were recently retired and looking to enjoy their retirement, travelling as much as possible. The fact find was completed on the assumption that £300,000 would be released from their property by the lifetime mortgage. It also documents that Mr and Mrs W were looking to generate a tax efficient income from their savings and that they were*

concerned about a growing IHT liability. The fact find also said that Mr and Mrs W wanted to retain access to their capital.

I've thought about all this and I'm not persuaded the DLT was suitable for Mr and Mrs W's needs. It created a debt from the DLT to Mr W – which is an asset in his estate for IHT purposes. So from that perspective it's no better than holding the cash initially. The value of the loan and therefore the estate is gradually reduced as withdrawals are made from the bond. But that reduction in the value of the estate would also be the case when the cash was spent. Capital growth would fall outside of the estate with the DLT – but my understanding is that this cash was released from the mortgage with the primary intention of funding Mr and Mrs W's lifestyle in retirement – not to be passed on when they died. And while the capital growth wouldn't be liable for IHT, it would have been classed as a chargeable event for any withdrawals greater than 5% per year.

As it happens, at the time Mr and Mrs W made additional withdrawals, the bond had made a loss rather than a gain. So the additional withdrawals didn't attract a tax liability. But when determining suitability, I think Prosperity should have anticipated there would be additional withdrawals and expected tax consequences of those.

Putting things right

Having reached a provisional conclusion that the DLT and bond weren't suitable for Mr and Mrs W, I have to think about what they'd have done if they'd been given a suitable recommendation. I recognise that Mr and Mrs W say they wouldn't have taken out the mortgage, but – as I've explained above – I can't hold Prosperity responsible for that. So I have to think about what they would have done with the £250,000 which was loaned to the DLT. It is not possible to say precisely what he would have done, but I am satisfied that what I have set out below is fair and reasonable given Mr W's circumstances and objectives when he invested.

Mr and Mrs W hadn't used any of their Individual Savings Account (ISA) allowances for the 20/21 tax year, and, as the DLT was set up in January, they'd shortly have had access to further ISA allowances. I'm inclined to say Prosperity should have recommend Mr and Mrs W fully utilise their ISA allowances for 20/21 and 21/22, investing in medium risk assets to reflect their attitudes to risk as documented by the fact find. This would account for £80,000 of the £250,000. I think Mr and Mrs W would have kept the remainder in cash or in low risk, instant access accounts, as they were planning to spend significant amounts in the near future.

What should Prosperity do?

To compensate Mr and Mrs W fairly, I'm inclined to say Prosperity must:

- *Compare the performance of Mr W's investment with that of the benchmarks 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.*
- *Prosperity should also add any interest set out below to the compensation payable.*
- *Pay Mr W £300 for distress caused by the unsuitable advice.*
- *Repay the advisor's fees paid directly from Mr and Mrs W to Prosperity together with simple interest at 8% a year, from the date the fees were paid to the date of settlement.*

If the above comparison shows that no compensation is payable, the difference between the actual value and the fair value can be offset against the fees with interest.

Income tax may be payable on any interest awarded.

Investment name	*Status*	*Benchmark*	*From ("start date")*	*To ("end date")*	*Additional interest*
£170,000 of the DLT	*Still exists and liquid*	*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)*
£80,000 of the DLT	*Still exists and liquid*	*FTSE UK Private Investors Income Total Return Index*	*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, Prosperity 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 Prosperity 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 chosen this method of compensation because:

- *Mr and Mrs W wanted income with some growth and were willing to accept some investment risk. Investing two tranches of £40,000 in ISAs, either side of the 2020/21 tax year end would have allowed them to achieve this in a tax efficient way. Whilst I'm aware this would in practice have meant holding £40,000 in cash for a couple of months before investing it in early April 2021, I'm satisfied treating all of the £80,000 as if it was invested in ISAs on the start date of the DLT is a reasonable and more pragmatic solution than splitting these tranches up.*
- *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.*
- *Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr W's circumstances and risk attitude.*
- *Mr and Mrs W wanted to achieve a reasonable return and have ready access to a significant proportion of their capital.*
- *The average rate for the fixed rate bonds would be a fair measure for the remaining £170,000 given Mr W's circumstances and objectives. It does not mean that Mr W would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with little risk and easy access to their capital.*

Both parties submitted comments on my provisional decision. I'll set these out and my responses below.

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 and Mrs W were very unhappy that I'd said Prosperity couldn't be held responsible for the advice given to them by Company A. They said they felt strongly that the Prosperity advisor was responsible for introducing them to Company A and they commented that he was at the meeting with Company A and put pressure on them to take out the equity release mortgage. They said they explained at the time that they weren't happy that the interest rate had gone up on the mortgage but were assured by advisors from both companies that it was in their best interests. Mr and Mrs W reiterated that they felt Prosperity should be held responsible for the cost to redeem the mortgage plus any early repayment penalties as they wouldn't have taken it out if the Prosperity advisor hadn't encouraged them to.

I can understand Mr and Mrs W's position but I remain of the view that I can't hold Prosperity responsible for the advice given to them by a different company. I realise Prosperity suggested the lifetime mortgage but Company A separately assessed the suitability of the product for Mr and Mrs W and ultimately made the recommendation.

Mr and Mrs W were also upset with the amount of £300 that I'd suggested – they said they both take medication for stress and the situation has caused them both increased anxiety. I've thought about this but their comments haven't changed my mind. This compensation is for the impact on Mr and Mrs W of the money being placed in trust rather than in the ISAs and instant access accounts that I said would be more suitable. I'm satisfied £300 is a fair amount for that.

Prosperity were also unhappy with my provisional decision. They said they'd discussed capital requirements at length and thought the £50,000 that was set aside as well as the £1,000 per month income from the trust would be enough for Mr and Mrs W's needs. They said Mr and Mrs W's main objective was to achieve an additional regular tax efficient income to support them in retirement. And Prosperity said Mr and Mrs W were keen to invest for growth rather than just savings. They also said it was reasonable to assume that the DLT would provide some IHT savings over the medium to long term.

I've considered Prosperity's comments but they haven't changed my mind. I've looked at the fact find again and this talks about travelling as much as possible over the next 10 years. Whilst it does mention looking for options to increase annual tax efficient income, this is followed by "*and accessibility in the future*". It talks about having sufficient rainy day funds in the event of an emergency and says £50,000 was available for emergencies. I can't see anywhere on the fact find documenting that this £50,000 was to cover holidays. I'm satisfied there were other ways of investing some of the capital for growth at a medium risk level which would avoid the significant tax penalties of taking money out of a DLT.

In summary, neither parties' comments have changed my mind and so my final decision is unchanged from my provisional decision.

My final decision

As I've explained above, I'm upholding Mr and Mrs W's complaint. My decision is that Prosperity Independent Financial Advisors and Stockbrokers Limited trading as Prosperity Financial Advisors and Stockbrokers should pay the amount calculated as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs W and Mr W to accept or reject my decision before 24 August 2023.

Clare King
Ombudsman