DRN-4104170

Financial Ombudsman Service

The complaint

Mrs M has complained about the advice she received from TenetConnect Services Limited ('TenetConnect') to invest into an Enterprise Investment Scheme ('EIS'). She says the investment was too high risk for her. The EIS has lost value and Mrs M has said she is also liable for tax. She would like financial compensation.

What happened

In January 2016 TenetConnect advised Mrs M to invest £35,000 into an EIS. She said she was nervous about investing into an EIS rather than her pension but was persuaded to do so because of the encouragement and reassurance she received from her adviser.

In August 2020 Mrs M complained to TenetConnect. She didn't think the EIS investment was appropriate for her needs. She said that at the time of the advice she had wanted to reduce her working hours and was looking for a tax efficient way to access the retained profits in her company in a stress free and low risk way such as a pension.

Mrs M said she had suffered a 10% loss on the capital invested and could end up losing more by the time the illiquid investment could be sold. She had no way of recovering her funds and had incurred a £15,000 tax bill. She was never advised of the high level of risk involved or that she wouldn't have access to her money after the investment period ended.

TenetConnect rejected Mrs M's complaint. It said;

- A pension contribution rather than an EIS investment had been discounted because Mrs M had wanted to mitigate her income tax which would only have been possible with this type of investment product.
- Mrs M's financial position at the time meant she could look to invest for the medium to longer term.
- Mrs M was given significant risk warnings and she had the capacity to question any recommendation that was made to her.
- She had been told that she may not be eligible for the EIS benefits or that they could be delayed.
- It couldn't be held responsible for any performance issues. The recommendation had been suitable for her needs and objectives.
- Mrs M had been warned that she could only start to withdraw money from her investment in years five, six and seven. And she was warned withdrawing funds might be delayed.

Unhappy with the outcome Mrs M brought her complaint to the Financial Ombudsman Service. Our investigator who considered the complaint thought that it should be upheld. He said;

- He would have expected for the risks of the investment to have been explained to Mrs M rather than just focus on the tax benefits. He thought the investment was too high risk for Mrs M. She considered herself to be a low risk investor and he thought this was likely to have been the case.

- It wasn't enough to refer to generic risks or point out that the risk of the investment had been set out in the Information Brochure.
- Mrs M wouldn't potentially have been able to withdraw funds until the age of 57, 58 and 59. He concluded the EIS was more illiquid than a pension which had been discounted for this reason. He wasn't satisfied the potential longer-term nature of the investment was appropriately highlighted.
- He concluded that TenetConnect should pay compensation to Mrs M by comparing the performance of the EIS with the average rate from fixed rate bonds as a benchmark. It should also pay £300 Mrs M for the distress and inconvenience she had been caused.

TenetConnect didn't agree with the investigator. It said;

- Mrs M was capable of understanding the risks associated with the investment.
- The suitability report provided risk warnings about the investment. The six-page overview brochure Mrs M had been given contained the risk factors and highlighted some of the key considerations for an investor.
- Mrs M had total assets over £1m and the amount invested represent 3.33% of her total assets or 20% of her cash holdings. It wasn't unreasonable for a client to take a high-risk approach with a small percentage of their overall assets.
- Mrs M had been made aware there could be a delay in the tax certificates being provided. The tax could be reclaimed when they were received.
- The medium to long term status of investing in the EIS had been explained to Mrs M.
- The pension didn't provide the tax reliefs required which was the chief objective at the time of the advice.
- It didn't agree Mrs M didn't want any risk to her capital as this would discount any type of investment.

The investigator responded to TenetConnect's objections and remained of the opinion that the complaint should be upheld. As the complaint couldn't be resolved, it has been passed 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.

After doing so, I have reached the same conclusion as the investigator and broadly for the same reasons. I will explain why.

<u>Mrs M's circumstances</u>

I've considered Mrs M's circumstances at the time the advice was given as recorded in TenetConnect's Financial Planning Questionnaire and Summary of Current Position.

At the time, Mrs M was 51 years of age, married with two children who were financially dependent upon their parents. She and her husband jointly had their own home valued at around £700,000 with a small mortgage outstanding and also owned a second property valued at around £140,000. Mrs M was self-employed and had two pensions from previous employment. She took an annual income of £60,000 as salary and dividends from her business.

Mrs M held £5,000 in a joint bank account with her husband and had cash of just over £93,000 and £58,000 in her business bank accounts. She also held a cash ISA of £8,000 and a stocks and shares ISA valued at £500 'but no other investments of significance'. Mrs M's total assets were recorded as just over £1m.

So, overall Mrs M's own investible assets were the £5,000 she jointly held with her husband, so £,2500, a cash ISA of £8,000 and £500 in a stocks and shares ISA. All other cash was held within her business accounts, but I note £58,000 of that was held within a business savings account for corporation tax and VAT purposes. I wouldn't consider property to be readily realisable and particularly as Mrs M had two dependent children living at home. Its recorded that Mrs M's 'primary objective at this time is to access the retained profits held within your business as tax efficiently as possible.'

<u>Mrs M's attitude to risk</u>

For this investment, Mrs M's attitude to risk was recorded by TenetConnect as being medium. I have considered how this came about and how TenetConnect made Mrs M aware of the varying levels of risk implicit in different investments, particularly bearing in mind I've seen nothing to suggest that she was anything more than a relatively novice investor as she only held cash at the time.

I'm satisfied that Mrs M was seeking advice because she didn't have the knowledge or experience to make such an investment decision unaided. So, TenetConnect needs to demonstrate that it gave suitable advice taking into account Mrs M's circumstances, understanding and knowledge after ascertaining her attitude to risk.

TenetConnect has provided us with the suitability report from January 2016. It says;

> **<u>'Part 4 – Attitude to Risk and Fund Selection</u>** [original emphasis]
>
> We discussed your attitude to investment risk and capacity for loss in conjunction with our standard approach to investments.
>
> We discussed the various different types of assets, for example cash, bonds, equities, property and alternative investments, and you are aware of the risks associated with each. We agreed that you are best described as having some previous experience of investing in into direct equities.'

Later on, in the same document it said;

> 'I consider this form of investment [the EIS] to be suitable for you for the following reasons:
>
> - Your attitude to risk is such that you are happy to place money in ventures that could expose you to potential capital loss but could give attractive investment returns;'

And in conclusion it said;

> 'Taking everything into account:

> You confirmed you are a Medium Risk investor on our risk spectrum. You want your capital to keep pace with inflation and are investing for at least five years. You are comfortable with most of your capital being invested in equities and property, some of it overseas. You realise that there may be significant falls in the value of your investments, and that accepting this risk gives you the potential to achieve better long-term returns.'

I'm not convinced that TenetConnect has been able to show us *how* it came to the conclusion that Mrs M was a medium risk investor, there is very limited evidence from the point of sale documents about what was discussed and agreed. And I don't have evidence about how the risk of investing was explained to Mrs M – TenetConnect's risk spectrum it referred to.

With reference to any previous investment experience Mrs M would have had I note that on the application form for the EIS it has a suitability section and Mrs M had to tick boxes about any investments she had held within the previous five years. And she ticked 'no' to all of difference investment types listed which were –

> 'tax efficient investments (including VCTs, EIA, EZT),
>
> Entities quoted on the main market of the London Stock Exchange,
>
> AIM-listed companies or companies that are not listed'.

So, while it is recorded elsewhere that Mrs M had some previous experience of direct equity investment the above would lead me to question this statement as to her investment experience and I think it should have led the adviser to seek more information about this.

And I'm not satisfied that Mrs M's previous employment history, her current self-employed status, and her recorded investment experience lends itself sufficiently in order for me to conclude that she fully understood the investment risk. And in particular, the risk associated with an EIS. Otherwise I think it's likely she would have questioned its suitability for her over and above any of the potential tax efficiencies the investment offered.

I explain this further on in my decision.

<u>The advice to invest</u>

The suitability report states that alternatives to the EIS were considered but not recommended;

- 'Pension – I considered the option of placing a lump sum into a pension. However, this option was discounted because you already have a significant pension and you would not benefit from income tax relief at the point of the investment which is the primary reason for making the investment at this time.
- ISA/UT/Bond – I considered the option of placing a lump sum into an ISA, Unit trust and Investment Bond however, these options were discounted as you would not receive income tax relief on the contribution….'

It was recommended that Mrs M invest £35,500 into an EIS which is categorised by TenetConnect in its suitability letter of 19 January 2016 as being 'Medium – High'. The income tax relief and other advantages of the EIS investment were detailed. And it stated the EIS was 'designed to be held for the medium to long term as investments into EIS qualifying companies have to be held for at least three years in order to benefit from the upfront tax relief'.

EIS' work by giving investors tax relief for income tax, capital gains tax and inheritance tax when they invest into smaller businesses. As they invest into smaller companies the risk is greater than with other investments. I don't think it is unreasonable to say they are high risk investments which can potentially fall in value and the investor might not get back their investment.

In the suitability letter it states that some of the reasons for recommending the particular investment manager for the EIS;

> '• Investee Companies will benefit from uncapped upside potential, while EIS tax reliefs and preferential recoupment terms will help reduce the downside risk.
>
> •The investment will be spread across a number of Investee Companies and thus also, a number of Entertainment Projects diversifying the specific risk investors are exposed to. The reason I feel that this opportunity is particularly suitable is that, while investments in unquoted companies can be generally considered as high risk, the strategy employed by the Manager allows for uncapped return potential free of capital gains tax, and target returns are commensurate with the risk profile of the Service.'

However, I think the latter part of this statement tries to mitigate the level of risk involved. While it states investment in unquoted companies is generally considered to be high risk, it then goes on to downplay that risk by referring to uncapped tax-free returns. This comment only highlights the potential upside of the tax benefits and, in my opinion, underplays the actual risk of the investment itself. It suggests to me that the tax advantages are leading the investment advice with lessor consideration to the risk involved.

TenetConnect has said that Mrs M had the capacity to understand what she was investing in. It said that Mrs M ran her own business and also cited her previous employment. However, I would say that just because Mrs M ran her own business it doesn't necessarily follow that she would be confident with making investments or understanding the complexities of an investment such as an EIS. I think Mrs M looked to, and was reliant upon TenetConnect for its investment expertise. And some of the subsequent queries Mrs M raised – such as her concerns about being able to access her capital – would suggest that she hadn't fully understood how the investment worked.

I think this is reiterated in Mrs M chasing for tax certificates in October 2016, not long after the investment. In her email she said;

> 'In hindsight I'm not sure I made the right choice here. I will have to take £15k out of the company as a dividend to pay the tax bill, which will incur dividend tax and then also increase my personal tax liability for this FY. Do you have a rosier view on it than that?'

I'm not convinced that by asking this question so soon after the investment was made shows that Mrs M fully understood how the investment worked.

And while it may be TenetConnect's opinion that Mrs M had the ability to question what she was being recommended I don't think this supersedes TenetConnect's responsibility to make a suitable recommendation in the first instance.

Based on what I have seen I am satisfied that Mrs M was looking to invest her capital in a tax efficient way and, at the instigation of TenetConnect, was interested in exploring the potential of EIS investments to achieve that. But I'm not persuaded she was made fully aware of or understood the extent of the risk she was taking when balanced against the tax benefits.

In my opinion, TenetConnect placed too much emphasis on the tax benefits of the investment which I don't think outweighed the requirement that it had to recommend a suitable investment for Mrs M or the potential disadvantages that recommendation exposed her to.

I don't think it's enough for TenetComment to refer to the risks as outlined in the Information Brochure and similar which are generic risks. The key risks would need to be highlighted to Mrs M to ensure she understood how the investment worked. I would have expected to see equal information given about the tax advantages of the investment alongside the risks involved when it was recommended to Mrs M. I don't think equal weight was given to the specific risks of the investment when compared to the potential tax benefits. The majority of the information about risk was given in generic statements or within longer documents provided about the EIS.

I note though that its clear from the file that TenetConnect did carry out additional checks for the suitability of the investment for Mrs M. The adviser submitted an internal 'Specialist Approval Process' request form which was used if the adviser wished to 'recommend a product to a retail client that **does not** [original emphasis] fall under the definition of a 'Non Mainstream Pooled Investment'. That request documents records basic details about Mrs M and states that her attitude to risk had been ascertained after 'discussion' and was recorded as being '4 out of 10'.

So it's clear at this point that Mrs M was a retail investor and the investment that had been recommended to her – which it already had been by this point – wasn't necessarily right for her because of its 'non-mainstream pooled investment' status as identified by Tenetconnect. The suitability section of the request says 'The client has built up a comfortable lifestyle and has minor debt with solid income. Significant profits have built up within the company and the client would now like to start accessing those funds. The client has a pension fund with various investments, but does not currently have any direct investments.'

In response various comments were made including;

> 'Based on the file at hand, a perception could be reached that this client has limited investment knowledge and experience. It would be useful to understand what elements gave comfort that this client had the necessary financial awareness over and above investment holdings.
>
> Based on my understanding of the file I have assumed a high risk specialist exposure of c11%....This feels relatively high for a 4/10, as noted in the approval request. I would be grateful for your view on how this blends with the wider portfolio. I think [there] should also be some consideration to the potential increase in overall exposure into high risk VCTs [this was later corrected to EISs] relative to the ATR [attitude to risk] as it could become difficult to support.'

In reply, it's pointed out that the cash position within the business had increased to £200,000 and amongst other comments it says;

> 'We have discussed the risks of EIS investment with the client….They have confirmed that they have held shares in the past within an ISA and direct…ATR at present reflects the fact that does not currently hold any direct shares. Hopefully the fact that she has in the past and is willing to accept a higher level of risk than she has in the past should help to get this case underway.'

I comment on Mrs M's willingness to accept a higher level of risk elsewhere as I'm not convinced that is a correct conclusion. And I would also question the lack of evidence about Mrs M's history of share ownership.

Part of the response to the above says;

> 'With regards to further supporting the suitability of the recommendation from an investment knowledge and experience basis. I note that the client has had some direct share experience. It would be useful to provide a wider summary of the softer facts in this case. For example, what type of direct shares did she hold, what value and how long did she hold them. Is the client fully dependent on the adviser in terms of understanding the recommendation or does she have enough knowledge to challenge assumptions, recommendations etc. Is there anything in her professional capacity of running a business which can be used to provide this wider picture.'

Again, part of the reply;

- 'The client runs this business [Mrs M's business] so is analytical and successful. This client is very happy to question and understand the detail and has done so as part of our discussions with them. The client would not be led into an investment without appreciating the potential risks and we would always present those risks from the outset.
- We do not have the historical information on the stocks and shares and she would need to spend time looking for the information.
- Is this information something that we can seek to arrange in the event that the level of EIS investment exceeds £36,000, rather than delay things further when we are comfortable that she understands the risks associated with this type of business as [the adviser] has been clear to outline the nature of the investment.'

The product was approved for Mrs M, but I note it was subject to approval conditions, some of which were;

- 'The client(s) must be provided with a full copy of any product literature relating to the investment.
- You providing the client with a full copy of the EIS Information Memorandum, and drawing to their attention, in writing, to the risk warnings.
- The additional summary supporting the client's overall financial sophistication should be included in the suitability report.
- The report should make clear that the level of exposure to this strategy is relatively high for a client with a risk profile of 4/10 and that this has been mitigated by the cash the client has in the remainder of the portfolio.'

However, I note that the approval for the investment – including the approval conditions – was given on 9 February 2016 and the recommendation to invest had already been given to Mrs M in TenetConnect's letter of January 2016. I'm not sure what further information was given to Mrs M and when, so can't see whether she was provided with the additional information as identified in the approval conditions.

But in any event, I've already concluded that I think too much weight was given to the potential tax benefits of the investment was given in the recommendation letter compared to the high-risk nature of the underlying investments.

So while additional information was sought about Mrs M's circumstances prior to the investment because of the high risk nature of the investment I'm not convinced that it was a useful exercise about the advice already given to Mrs M or that any further action was taken because of the concerns that were raised. Mrs M had around £104,000 of investible assets – at the time of the recommendation letter – and £35,000 represented just under 33% of that. So, Mrs M was being advised to invest a third of her available assets into a high-risk investment which needed to be held for the medium to long term before she would be able to access.

Mrs M was 52 years of age at the time of the investment. But on the time horizon of five, six and seven years of being able to access her capital that would have meant she would have been 57, 58 and 59 years of age, if not longer. I think this illiquidity could have posed a problem to Mrs M. She was looking to reduce her working hours which – I assume – could potentially have impacted on her income. So, I don't think it's unreasonable to assume that because of this, and Mrs M's age, that she may have wanted access to her capital at an earlier date.

And as part of Mrs M's complaint she said that she wouldn't have access to her money after the investment period ended The investigator highlighted the information given to Mrs M around the time horizon of the EIS investment and I agree with his conclusion that emphasis was given to it being sold after three years rather than the longer term. While the suitability report does refer to it being a medium to long term investment there are many additional comments about it being sold after three years. And it was included within a 'short term' section in the report of less than five years where the other options were medium term (five to 15 years) and longer term (more than 15 years).

And as I think it more likely than not that that Mrs M was a relatively inexperienced investor, I think she would have concluded from the information she was given that she would have access to her capital sooner than was actually the case. And by Mrs M making this one of her complaint points, I think this reiterates her lack of understanding.

Mrs M was looking at the potential to invest for tax efficiency, but I don't this should have been done at the expense of all other considerations – including risk and Mrs M being able to access her funds. I'd question whether it was the tax element of the investment that led to the conclusion to invest into and EIS in the first place rather than taking an overall view of Mrs M's circumstances, requirements and attitude.

Taking all of the above into account, I think Mrs M was exposed to a too high-risk investment when taking all of her circumstances into consideration. Mrs M's investible assets at the time of the advice were all held in cash. I think it was too much of a leap from a no risk investor to a high-risk investor, despite the potential tax advantages. That being said, I don't think it was the case that Mrs M only wanted to remain in cash. It's clear she was looking for some investment opportunity – preferably with tax efficiencies.

In its response to the investigator, Tenetconnect said that the assessment at the time suggested Mrs M was a medium risk investor and therefore the redress the investigator proposed wasn't right. Like the investigator I don't think Mrs M was a medium risk investor. There is no evidence of her previous investment experience and all her investible assets were in cash. While I can't comment on what alternative investment options may have been available to her or what different action she would have taken if she'd been different advice, I think it's reasonable to use a benchmark for redress purposes. And the average rate from fixed rate bonds doesn't seem an unreasonable taking in account her likely attitude to risk.

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put Mrs M as close to the position she would probably now be in if she had not been given unsuitable advice.

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

What must TenetConnect do?

To compensate Mrs M fairly, TenetConnect must:

- Compare the performance of Mrs M'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.

- TenetConnect should also add any interest set out below to the compensation payable.

- Pay to Mrs M £300 for distress and inconvenience caused.

Income tax may be payable on any interest awarded.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Ingenious Shelley Media EIS	Still exists but illiquid	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 end date.

If at the end date any asset 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 Mrs M agrees to TenetConnect taking ownership of the illiquid assets, if it wishes to. If it is not possible for it to take ownership, then it may request an undertaking from Mrs M that she repays to TenetConnect any amount she 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, TenetConnect 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 (including any tax relief the investor has already received on this investment) paid out of the investment 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 you total all those payments and deduct 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 decided on this method of compensation because:

- Mrs M wanted to achieve a reasonable return without risking any of her capital.

- The average rate for the fixed rate bonds would be a fair measure given Mrs M's circumstances and objectives. It does not mean that Mrs M would have invested only in a fixed rate bond. It is the sort of investment return a consumer could have obtained with little risk to their capital.
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My final decision

I uphold the complaint. My decision is that TenetConnect Services Limited should pay the amount calculated as set out above.

TenetConnect Services Limited should provide details of its calculation to Mrs M in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs M to accept or reject my decision before 11 August 2023.

Catherine Langley
Ombudsman