The complaint

Mr and Mrs R complain that they were given unsuitable advice to invest in an Enterprise Investment Scheme (EIS) by KD Wright Financial Services Limited (KDW). They've said had they known it was a high-risk investment, they wouldn't have put their capital at risk.

What happened

Mr and Mrs R received investment advice from KDW in 2015. They had recently sold an investment property and had made a gain of c.£90,000 which was subject to Capital Gains Tax (CGT). KDW recommended that they invest a total of £190,000 of their available capital of which £90,000 should be invested in an EIS with Octopus.

In 2021 KDW made them aware that the EIS relief in deferring the CGT liability was coming back into charge. They were then told by Octopus that the investment had also lost the majority of its value.

Mr and Mrs R then complained to KDW and said, in summary, that the EIS investment hadn't been appropriately explained to them. They thought that the investment wasn't suitable for their circumstances as it had been recorded that they weren't comfortable with any large losses in value.

KDW looked into the concerns that had been raised but didn't uphold the complaint. They thought that they'd made Mr and Mrs R aware of the inherent risks with the EIS investment and Mr and Mrs R had accepted these risks.

Mr and Mrs R didn't accept KDW's findings and asked us to help. The complaint was considered by one of our investigators who thought it should be upheld. He was of the opinion that the risks had been properly detailed to Mr and Mrs R, but noted they'd said that while they didn't mind short term small fluctuations in value, they didn't want large losses over a longer period. He thought that if they'd been made aware that their capital sum could significantly reduce and they would still have to pay the CGT bill, they would have preferred to pay the tax and not risk losing all their capital.

KDW didn't agree and said, in summary:

- The recommendation to invest into the EIS was suitable as it met Mr and Mrs R's main aim to offset their CGT. On death of the either Mr and Mrs R the CGT would fall away, and the asset would then be transferred to the surviving spouse free of CGT.

- Products of this type often didn't match an investor's attitude to risk (ATR), but it was an appropriate solution for what Mr and Mrs R had asked them to achieve. Mr and Mrs R were aware of the risks as detailed and agreed in the meetings and documented in the suitability report. They were holding cash and other balanced investments which were suitable to them. However, the EIS was the appropriate investment that met the need to defer CGT.

- Mr and Mrs R were fully informed at the 2015 meeting and again in the suitability report and they didn't know what more they could have done to explain the risk. Everything was discussed in the meeting and confirmed in writing.

The investigator wasn't persuaded to change his opinion so the complaint has been passed to me to make 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.

Having done so, I think this complaint should be upheld and I will now explain why. I've considered Mr and Mrs R's circumstances at the time of the recommendation. It was noted that they were both aged 66, retired, had no dependants and were in good health. They had experience of mainstream investments but hadn't ever invested in an EIS.

Mr R was receiving an income of c.£11,000 p.a. from his private and state pensions and £26,000 in rental income. Mrs R was receiving £8,000 per year from her state pension. They owned their own residential property which was valued at £475,000 and also investment properties valued at c.£650,000. They had stocks and shares ISA worth c.£115,000, an offshore bond worth c.£250,000, a GIA worth c.£39,000 and had c.£300,000 in cash.

Their ATR was recorded as Balanced which was defined as '*an investor who is somewhat concerned with short-term losses and may shift to a more stable option in the event of significant losses. The safeties of investment and return are typically of equal importance to the Balanced Investor*'.

There was a discussion around their capacity for loss and crucially, it was recorded that Mr and Mrs R wouldn't be bothered by short term losses, but they wouldn't be comfortable if their investment frequently experienced large losses in value. They had sold one of their investment properties and were subject to CGT of c.£90,000 and wanted to invest £190,000 in order to provide a return and also to mitigate income tax and defer CGT.

Mr and Mrs R have said, in summary, that they have always been risk averse, would never make any high-risk investments and were shocked to learn that they'd lost most of the money they'd invested in the EIS. KDW have disputed this and have pointed to the documentation from the time of the sale, which in their opinion clearly highlighted the risks of the investment.

Given that Mr and Mrs R had no experience of EIS', I would have expected KDW to have ensured that they fully understood the implications of the proposed investment. KDW met with Mr and Mrs R on 27 October 2015 and sent them an investment report on 5 November 2015.

I've considered the contemporaneous notes from the meeting. I think it is important to do so as the application for the EIS investment was made on 28 October 2015, which was only one day after the meeting and before the investment report was sent to Mr and Mrs R. The notes say:

"We discussed an EIS investment, and the fact that they could reclaim 30% income tax in the present and preceding tax years. This type of investment also allows deferment of CGT on gains made in the last three years and benefits from Inheritance Tax Business Property Relief - if you remain invested for 2 years and the investment is still being held on death.

We have discussed the fact that an EIS cannot be categorised among the normal range of *investments as the investment risk associated with EIS are difficult/impossible to quantify. This is because they involve holding shares in small limited companies which may be difficult/impossible to market. Hence the credibility of exit proposals by the investment managers is of great importance. They are however generally regarded as higher risk investments."*

The notes from the meeting don't appear to show that there was much emphasis put on the risk of losing their capital. An EIS is a non-mainstream, complex, illiquid and speculative investment where there is a real risk of losing the original capital sum. Mr and Mrs R's experience was limited to mainstream investments and as such it was down to KDW to ensure that the EIS was suitable for their circumstances and Mr and Mrs R were in an informed position about the level of risk they were being advised to take.

I've also considered the investment report that was sent to Mr and Mrs R, it said:

"*We have discussed the fact that an EIS cannot be categorised among the normal range of investments as the investment risk associated with EIS are difficult/impossible to quantify. This is because they involve holding shares in small limited companies which may be difficult/impossible to market. Hence the credibility of exit proposals by the investment managers is of great importance. They are however generally regarded as higher risk investments. They indicated that they were prepared to accept these risks in return for the tax advantages for a relatively small proportion of their overall wealth.*"

Despite the warnings, the report also noted '*The Octopus EIS targets capital preservation. Capital preservation is a strategy designed for investors who aim to preserve the value of their investment rather than achieve high returns. Above all else, the goal is to return the original amount (the capital) to investors when the investments are sold'.*

The report also said '*The Octopus EIS is a discretionary portfolio service that invests in UK smaller companies across a range of industry sectors - but with a particular emphasis on energy - where they believe there is potential for capital preservation. This strategy is aimed at investors looking to preserve the value of their investment rather than achieve high returns.'*

I think these summaries of the investment strategy contradicts the other warnings within the report and downplays the level of risk they were being advised to take.

I think it is also important to take into account Mr and Mrs R's recorded concerns about their investment not experiencing large losses in value. With this in mind, I think it was important for KDW to ensure their recommendation balanced the potential CGT mitigation against the high risk of capital loss and was suitable for Mr and Mrs R's circumstances.

I think it's fair to say that Mr and Mrs R would have been willing to take some risk in order to mitigate any tax that would be due. But I'm not persuaded that they fully understood the level of risk they were being advised to take and how it differed from their recorded ATR of medium. They weren't also told about the risks involved with investing in a single industry sector which exposed them to further risk in the event of a downturn in that particular sector.

This further increased the level of risk of the EIS that was recommended to Mr and Mrs R and I'm not satisfied that if they'd been made aware of all these risks before they made the investment, particularly that there was a strong chance they could potentially lose all their capital and still have to pay the outstanding tax, they would have gone ahead with the EIS investment.

KDW had a responsibility to ensure their recommendation was suitable for Mr and Mrs R's circumstances. Having considered everything, I don’t think the CGT deferral or other potential tax benefits were more important to Mr and Mrs R than preventing large losses to their capital.

Taking their circumstances, experience and ATR into account, I think the risks associated with the EIS were disproportionate compared to its potential benefits. When we also consider that Mr and Mrs R had no experience of EIS’s or any high-risk investments and had over 80% of their liquid assets exposed to risk, I’m not satisfied that the recommendation to invest in such a high-risk product was suitable for their circumstances. I am therefore upholding their complaint.

Putting things right

Fair compensation

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

I’m mindful that had it not been for the unsuitable advice, Mr and Mrs R wouldn’t have had the EIS tax relief already claimed and they 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, Mr and Mrs R may wish to take advice about the tax implications of accepting this decision.

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

What must KDW do?

To compensate Mr and Mrs R fairly, KDW must:

- Compare the performance of each of Mr and Mrs R's investments with that of the benchmark shown below.
- A separate calculation should be carried out for each investment.
- KDW should also add any interest set out below to the compensation payable.

Income tax may be payable on any interest awarded.

Investment name	Status	Benchmark	From (“start date”)	To (“end date”)	Additional interest
Octopus EIS - Mr R	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)
Octopus EIS - Mrs R	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)

For each investment:

Actual value

This means the actual amount paid or 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 Mr and Mrs R agree to KDW taking ownership of the investment, if it wished to. If it is not possible for KDW to take ownership, then it can request an undertaking from Mr and Mrs R that they repay to KDW any amount they might receive from the investment in future.

KDW may also add to the actual value any available tax relief Mr and Mrs R have received by virtue of making the investments. It may ask them for evidence of this, or assume they have availed themselves of all available relief at their 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 additional sum paid into the investment should be added to the *fair value* calculation from the point in time when it was actually paid in.

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 KDW 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 decided on this method of compensation because:

- Mr and Mrs R wanted Capital growth and were willing to accept some investment risk.

- 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 and Mrs R's circumstances and risk attitude.

My final decision

For the reasons I've given above, I uphold this complaint and my decision is that KD Wright Financial Services Limited should pay the amount calculated as set out above.

KD Wright Financial Services Limited should provide details of its calculation to Mr and Mrs R in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr R and Mrs R to accept or reject my decision before 18 April 2024.

Marc Purnell
Ombudsman