complaint

Mr K has a number of complaints about Towergate Financial (Scotland) Limited (formerly Albannach Financial Management). And the complaints are made for him by his daughter Ms E.

This complaint is about advice Towergate gave to Mr K in 2007.

Ms E has complained on behalf of her father, Mr K, the advice was unsuitable for him and has caused losses.

In December 2007, Towergate advised Mr K to cancel the two bonds it had arranged in 2006 and invest in:

(i) an offshore bond and its underlying funds; and
(ii) an enterprise investment scheme (EIS) investment through a limited company they advised him to set up to make the investment.

Ms E complains the advice was unsuitable for Mr K and Towergate's poor service led to additional losses through delays in acting on instructions.

For the EIS, Ms E complains Mr K was misled over the level of risk involved, and the complexities and costs of setting up and managing a company were not explained.

background

Ms E complained to Towergate and to us in 2011. She made a number of points and there has been a dispute about whether that amounted to one complaint or more than one. I have decided that there is more than one complaint but I will need to refer to aspects of the other complaints when they are relevant.

Our adjudicator considered the information Ms E sent on behalf of Mr K and thought there were four complaints – including two for the 2007 advice. She issued her findings on each of those complaints. Towergate didn't agree with the adjudicator's findings.

I issued provisional decisions where I said I was proposing to uphold the complaints and explained the awards I thinking of making.

In summary, I thought the bond and EIS weren't suitable. Although they were recommended as replacements for other investments that were themselves unsuitable, the bond and EIS weren't properly explained and the investments were higher risk than was suitable. And as the EIS arrangement was unsuitable for Mr K and the investment was also unsuitable for the limited company holding it. With suitable advice, Mr K wouldn't have established the company - it has no purpose other than to make the unsuitable investment.
For the bond, I thought Towergate should compensate Mr K for the losses he incurred and the potential IHT liability that would arise as a result of this compensation payment, and pay him £200 for the distress and inconvenience caused to him.

For the EIS I thought that as it isn't readily realisable, it should be treated as having nil value in the loss calculation. I also proposed to compensate for the expense in winding up Mr K's company. But later (when things did not go smoothly) costs incurred and inconvenience

suffered by Mr K in running the company and filing accounts weren't directly attributable to Towergate's advice.

Towergate didn't accept my findings. Its solicitors made a number of points on my views about the merits of the complaints. It was also concerned the 'complaint' had been separated and said:

- Mr K made a single complaint about the advice Towergate gave in 2006 and on a number of occasions afterwards for IHT planning. It didn't consider these four issues to be separate complaints. The complaint should be considered as one.
- All of the investments made arose from the same advice. Towergate had been asked to advise on how best to minimise Mr K's estate's exposure to IHT.
- The investments lose context if they are considered in isolation. For example the advice to invest in the offshore bond was intended to complement the EIS investment.
- The EIS advice was given to Mr K before his limited company was set up, so that company cannot complain about the advice.
- The proposed redress could result in Mr K being compensated a number of times for the same loss. At the very least, one redress calculation should be provided across all four complaints. Mr K's estate's IHT liability has significantly reduced as a result of the advice – that cannot be appreciated if the complaint is separated.

Ms E said:

- The offshore bond provider has said that it can't be surrendered, and Mr K can only take withdrawals of 10% of the premium value per year. Mr K's beneficiaries will be unable to access the funds. The 'suppression clause' was described as a 'discount' and not explained properly. Mr K wasn't told there would be no access at all – if his wishes in respect of his Estate can't be carried out, the protection is pointless.
- Mr K didn't receive the December 2007 recommendations letter – he didn't understand the nature of the offshore bond. The investment has failed to achieve Mr K's objective of protecting his capital, and 'balanced' risk had no meaning to Mr K.
- The losses are almost the same as the IHT would have been, so it has provided no benefit. The IHT saving in respect of the bond was only required for two years until the EIS achieved its IHT protected status.
- She questioned whether the EIS was illiquid, and felt surrendering might not be the best thing to do as it could lead to a large potential IHT liability.

I issued a jurisdiction decision. I concluded there were three complaints – the advice given in 2007 was one financial service and so one complaint, not two. I also set out the redress I proposed to award and asked the parties for their comments on that.

Ms E said:

- Redress for either of the two investments calculated individually would exceed the maximum compensation the service could award. Lumping the two matters together has deprived Mr K of the fair compensation that would put him back in the position he should have been in, had he received suitable advice.

Towergate's solicitors didn't want to add anything further.

We then heard from Towergate who said that it was no longer using solicitors. It said:

- It does not consider my view to be very clear. It considers that the IHT objectives have been achieved. And disposing of the assets now will lead to a significant IHT bill.
- And in any event it is unreasonable to award compensation before any detriment has been suffered.

my findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

It remains my view that the 2007 advice was one financial service, and therefore one complaint – even though the advice led to two rather than only one investment. This is the second in a series of complaints. And it must be treated as one complaint even if the amount of fair compensation is greater than the amount I can award in a single complaint.

There is a third and separate complaint about later fund switches in the off shore bond and that forms a boundary, in a sense, in respect of some of the issues in this complaint. In particular it has to be taken into account in order not the duplicate part of the redress between complaints two and three.

In the summer of 2006 Mr K had invested in a discounted gift trust arrangement. In November, after a medical underwriting process, the product provider said HMRC was unlikely to allow the discount. This meant the investment was unlikely to be as IHT effective as was hoped when it was recommended. So Towergate started to think about alternatives.

In early November it suggested an EIS arrangement. It described the scheme as very low risk with the underlying investment being a bank account. Soon after that it also suggested what it described as a 'nil surrender policy' – an offshore capital investment bond.

These suggestions were discussed with Ms E and emails went backwards and forwards. Markets were falling and Mr K and Ms E were getting concerned.

Towergate says it set out its recommendations in a letter in December 2007. Ms E says they did not receive that letter. Whether they did or didn't it's clear that both investments were recommended as part of one advice process that concluded with both investments being made.

the EIS investment

The EIS scheme is a system for giving tax relief and other tax benefits for certain types of investments. The clear implication is that the tax incentives are set up to encourage investments that would not be made without those incentives. The EIS scheme has a number of conditions. One is that the company the investment is in is not a listed company. And investment in unlisted companies is generally regarded as higher risk.

This was an unusual arrangement in that Mr K was advised to set up his own EIS qualifying company to use to invest. The idea was that the company qualified for tax benefits while investing in what were described as low risk investments. The investments were in a media company. The arrangement involved the distribution agreements for TV programmes and the resulting income streams which were guaranteed by a bank. The returns were said to be

similar to bank deposits, with the tax features being the main reason for choosing the investment.

The idea was that the shares in Mr K's company would qualify for Inheritance Tax Business Property Relief after two years.

The investment was in my view complex. It involved setting up and running a company which added a further layer of expense and complexity. And in the event that administration was very problematic for Mr K, returns were not filed on time and penalties had to be paid. The company was set up for the sole purpose of investing in the media company which was an unregulated collective investment scheme (UCIS) in the form of a Limited Liability Partnership. UCIS investments are subject to restrictions. They cannot be promoted to all investors, only certain classes of investors. This is because they tend to be higher risk, be more complex, and less liquid. They do not have the same regulatory supervision as regulated investments and they do not have the protection of the Financial Services Compensation Scheme if the investment goes bust.

The scheme itself was to create a portfolio of TV programmes and secure distribution licences providing a fixed twenty year income backed by a bank guarantee. This is a non-standard form of investment and not very easy to understand. And it is held in a non-liquid investment structure – the LLP/UCIS. And then the investment is held by the investor company.

Despite all these factors the investment was described by Towergate as low risk. In my view that was not a reasonable reflection of the way the investment was described in it its prospectus which included the warnings:

> *"Investing in a Company, which will participate in the partnership, may expose the investor to significant risk of losing all of the monies so invested."*

The investment also involved an initial charge of 7% which was a significant charge for an investment that targeted relatively low returns (despite its complexity) at a time when there was uncertainty about Mr K's health (as he had recently been refused the discount in a discounted gift trust arrangement).

In all the circumstances it is my view that this was unsuitable advice to Mr K. And that he has suffered considerable foreseeable inconvenience as a result. I do not say that all of the problems he encountered in running his company were foreseeable – but much of the increased administrative burden was.

Towergate says the arrangement is suitable as it has been effective from an IHT point of view. I do not agree. Mr K wanted to take reasonable steps to preserve the value of his estate for the benefit of his family. That is why he wanted to manage his affairs IHT efficiently. He did not want to avoid IHT at any price. The investments still need to be reasonable and suitable for Mr K. Setting up a company to invest in a UCIS was not, in my view, suitable.

Mr K was advised to set up a company to make the investment and the advice was given to him, rather than the company, before the company was set up. Mr K owns the company which in turn owns the investment in dispute. I think for most purposes they can reasonably be regarded as in effect one and the same. Any redress should be paid to Mr K, while the

value of the company's investment will need to be taken into account (as described below) in calculating any compensation due to him.

Also, any tax incentive the company and/or Mr K have been paid for investing in the EIS scheme that:

- would not have been received if the EIS investment had not been made; and
- is not repayable to HMRC

should be brought into account in calculating any redress due.

Mr K was interested in trying to mitigate his IHT liability as well as bringing some order to his investments which had previously been quite widely spread over many accounts with different providers and an ad hoc basis before he consulted Towergate. The problem is that his tax planning was disrupted by unexpected – and disputed – news about his medical condition. This did create some uncertainty and made IHT planning more problematic. It did not however take it off the agenda. But on the other hand I cannot see that saving IHT was Mr K's overriding objective – it was something he wanted to do when managing his affairs in so far as he reasonably could.

It is however the case that Mr K's estate will now be increased by any compensation. This is money that is supposed to put him in the position he would have been in but for the wrong which is being put right. If Mr K had had that money throughout he could have tried to make arrangements to make it IHT efficient. I cannot say for certain what those steps would have been. But I do consider that some form of IHT management is likely to have been used which may have been one or more of the usual methods such as outright gifts, or gifts to trusts. And/or Mr K may have tried again to get relevant life cover when things became clearer in relation to his health. However I do not consider that Mr K would have pursued IHT saving aggressively since some such methods involve higher levels of investment risk. Nor do I think that Mr K would necessarily have completely eliminated all IHT liability – some may have remained. So he may have reduced rather than eliminated the overall impact of IHT.

So there is some uncertainty about exactly what would reasonably have happened. There is also the added uncertainty about whether there will in the event be any IHT liability on this additional money. That depends on what steps Mr K now takes and, to be regrettably blunt, when he dies. Although Mr K could potentially reduce this loss by making a gift now, it would produce no benefit in IHT terms for three years in any case, and take seven years for the total gift to fall outside of his estate.

In view of all of this uncertainty I think the fair and reasonable outcome is a compromise. I consider that the compensation should be increased to take into account half the present full IHT rate ie 20% rather than the full 40%. This is not the same as paying an additional 20%. If Mr K is due, say, £10,000 (before any adjustment) and that is taxed at 40% there would remain only £6,000. I consider a reasonable compromise to be to halve the impact of that taxation as some of the tax could reasonably have been avoided. So in the example the target is a 'net' figure of £8,000. This is a reasonable compromise between completely effective IHT management and no relevant effective IHT management. But if the compensation is increased by 20% to £12,000 which is then taxed at 40% the outcome is only £7,200 ie less than the target compromise outcome. The uplift paid must be enough to leave the correct figure (£8,000 in the example) after a 40% tax deduction. Compensation of £13,334 is needed so that after deduction of 40% the target of £8,000 is achieved.

the offshore bond

As well as the EIS investment, Towergate recommended a bond investment. On the one hand this seems a relatively straight forward arrangement. £250,000 was invested in the bond and that money was invested in a spread of funds within that bond wrapper.

At the time Mr K's attitude to investment risk was recorded as balanced. But the adviser also recorded that Mr K

> *"Would like to invest in funds that will give the potential for higher than bank deposit returns but avoiding the most extreme volatilities."*

This is more in line with Towergate's definition of low risk than its definition of balanced risk, both of which were:

> *"Low Risk …You are prepared for some of your investments to be in funds where there will be a limited degree of fluctuation in values in return for prospects of modest long-term growth although this is not guaranteed.*
>
> *Balanced Risk … You would like to see a reasonable proportion of your investments in largely equity-backed investments. In this risk area there is potential for loss, but you are prepared to see your investments fluctuate in return for a higher level of growth."*

I consider that Mr K wanted to largely preserve his capital for the benefit of his children. And a lower rather than higher level of risk was suitable for him to try to achieve that objective. But the overall balance of the investments in the bond was higher than low risk. And there were a number of complicating features with the bond which made the arrangement unsuitable:

- Not all the funds are simple traditional investment funds – some are more involved
- The fund is an offshore bond and so it is subject to a different tax regime to an onshore bond
- The bond had non-typical terms in order to qualify for different treatment for IHT than would normally apply to a bond investment.

The non-typical structure was described by Towergate as a 'nil surrender policy'. And it was described in the (disputed) recommendation letter as having a structure that was backed by a leading tax QC and as having to be subject to the following terms:

- The policy is written on three or four lives. In this case it was Mr K and his children.
- The policy has no surrender option
- And partial withdrawals are limited to
  - 10% per year of the original premium while Mr K is living
  - 1% per year of the original premium after Mr K's death

After Mr K's death the life assurance bond continues for the lives of the other lives assured. The new owner(s) will be the person(s) entitled under Mr K's will.

Because access to the money/investment is restricted the value of the bond is reduced for IHT purposes. The exact value would be worked out by a firm of actuaries.

I consider this to be a complex higher risk arrangement that was not suitable for Mr K's attitude to risk and objectives.

Towergate says the arrangement is suitable as it has been effective from an IHT point of view. I do not agree. As I said above, Mr K wanted to take reasonable steps to preserve the value of his estate for the benefit of his family. That is why he wanted to manage his affairs IHT efficiently. He did not want to avoid IHT at any price. The investments still need to be reasonable and suitable for Mr K. This is a complex higher risk arrangement and was not suitable for Mr K.

In relation to the bond, any losses should be calculated up to the point of disputed fund switching in September 2008 which is separate matter and dealt with in the third complaint. So any losses caused by that further event should be calculated and paid in respect of that complaint.

If there is a loss at that switch point this should be paid to Mr K with interest from that time to the date of payment.

I also consider that the unsuitable advice to invest in this higher risk illiquid offshore bond has caused Mr K much concern. This distress and inconvenience (which is additional to the problems he has experienced with the EIS investment) should also be compensated.

My comments about possibly having to pay IHT on the financial loss made above apply to the bond investment also.

fair compensation

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

This case is made more complicated because part of it is about an investment which is also complained about (but in relation to a different matter) in complaint three. What that means in this case is that the present actual position is made up of the combined effect of things that are dealt with in this complaint and complaint three. So it is important to make sure that things are put right fairly between each complaint and that there are no gaps and no duplication. The compensation relating to the bond should therefore only deal with the period up to the start of the period covered by complaint three.

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

what should Towergate do?

To compensate Mr K fairly, Towergate must:

- Compare the performance of Mr K's investments 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.

A separate calculation should be carried out for each investment.

I will call this part of my award A. Towergate should also pay interest as set out below.

- Pay to Mr K £1,200 for the considerable distress and inconvenience caused to him. I will call this part of my award B. This should be paid within 28 days of our telling Towergate that Mr K has accepted this decision. If it is not paid in that time, simple interest is to be paid on this amount at the rate of 8% per year from the date of this decision to the date of payment.

Income tax may be payable on any interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
EIS	still exists	for half the investment: FTSE WMA Stock Market Income Total Return Index; for the other half: average rate from fixed rate bonds	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 Towergate being notified of acceptance)
Offshore Bond	still exists	for half the investment: FTSE WMA Stock Market Income Total Return Index; for the other half: average rate from fixed rate bonds	date of investment	the date of the switch in September 2008	8% simple interest from the end date to the date of payment of the compensation.

for each investment:

actual value

This means the actual amount paid or payable from the investments at the end dates. For the bond this should be the value immediately before the switch/switch instruction in September 2008.

If at the end date the EIS investment 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 Mr K agrees to Towergate taking ownership of the investment from his company, if it wishes to. If it is not possible for Towergate to take ownership, then it may request an undertaking from Mr K (and/or his

company) that he (or his estate or his company as appropriate) repays to Towergate any amount he (or it) 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, Towergate should use the monthly average rate for the fixed rate bonds with 12 to 17 months maturity 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 payment out of the investment should be deducted from the *fair value* at the point it was actually paid so it ceases to accrue any return in the calculation from that point on.

Any tax incentive paid to Mr K and/or to his company for investing in the EIS that

- would not have been received if the EIS investment had not been made; and
- which is not repayable to HMRC

should also be deducted.

If there are a large number of regular payments, to keep calculations simpler, I will accept if Towergate totals all those payments and deducts that figure at the end instead of deducting periodically.

why is this remedy suitable?

I have decided on this method of compensation because:

- Mr K wanted capital growth with a small risk to his capital.

- 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 WMA 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 K's risk profile was in between, in the sense that he was prepared to take a small level of risk to attain his investment objectives. So, the 50/50 combination would reasonably put Mr K into that position. It does not mean that Mr K 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 K could have obtained from investments suited to his objective and risk attitude.

Mr K may also suffer IHT on the above compensation (not including the compensation for distress and inconvenience) and the interest on it, which would not have been payable if appropriate arrangements were made in 2007. So it is fair and reasonable that Towergate should now cover this loss also – but on a basis that takes into account the uncertainties I

have mentioned. This should be done by applying 20% (ie half the present IHT rate) on A in the way I have described above. I will call this part of my award C. This should be paid within 28 days of our telling Towergate that Mr K has accepted this decision. If it is not paid in that time, simple interest is to be paid on the amount at the rate of 8% per year from the date of this decision to the date of payment.

The money award of A, B and C are subject to the maximum award limit mentioned below. The interest I award is additional to the money award limit. But I can only award that additional interest on the maximum money award (£100,000).

my final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £100,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £100,000, I may recommend the business to pay the balance.

determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Towergate Financial (Scotland) Limited should pay Mr K the amount produced by that calculation – up to a maximum of £100,000 plus any interest set out above.

If Towergate Financial (Scotland) Limited does not pay the full fair compensation, then any investment currently illiquid should be retained by Mr K. This is until any future benefit that he may receive from the investment together with the compensation paid by Towergate Financial (Scotland) Limited (excluding any interest) equates to the full fair compensation as set out above.

Towergate Financial (Scotland) Limited may request an undertaking from Mr K (and/or his company) that either he (or it) repays to Towergate Financial (Scotland) Limited any amount Mr K (or it) may receive from the investment thereafter or if possible, transfers the investment at that point.

Towergate Financial (Scotland) Limited should provide details of its calculation to Mr K in a clear, simple format.

recommendation: If the amount produced by the calculation of fair compensation exceeds £100,000, I recommend that Towergate Financial (Scotland) Limited pays Mr K the balance plus any interest on the balance as set out above.

This recommendation is not part of my determination or award. It does not bind Towergate Financial (Scotland) Limited. It is unlikely that Mr K can accept my decision and go to court to ask for the balance. Mr K may want to consider getting independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr K either to accept or reject my decision before 12 December 2016.

Philip Roberts
ombudsman