

The complaint

Ms S complains that Openwork Limited trading as The Openwork Partnership (Openwork) gave unsuitable advice to invest into an Enterprise Investment Scheme (EIS).

What happened

Ms S was advised to make the following investments into the same EIS: £320,000 in May 2018, £100,000 in November 2018 and £100,000 in February 2019. Ms S says the recommendations were unsuitable as the risk exposure was too high. Ms S was not a sophisticated investor and had a medium risk appetite. She sustained significant capital losses for which she seeks compensation.

Openwork maintain that the recommendations met Ms S's objective of tax mitigation and she was prepared to take more risk to achieve her objectives. Openwork highlight Ms S's pattern of investment into EISs since 2013 and her ongoing investment into other EIS products at the time with a different adviser. The investments into the EIS represented a small portion of Ms S's assets. Overall, Openwork concluded that Ms S was not exposed to more risk than she wanted to take and she did receive the benefit of significant income tax relief in line with her objectives. Further, Openwork submitted that it was more likely than not that each suitability letter had been sent and received. Given Ms S had received suitability letters in the past for a range of investments, Openwork thought Ms S would have raised concern if they had not been received and there was nothing to show that she did. Openwork highlight that the adviser was not responsible for the management of the investment and if Ms S had any such concerns they needed to be directed to the fund manager.

Our investigator considered the complaint. She considered Ms S's financial circumstances at the time of each recommendation and concluded that she had capacity to bear losses and the investment was affordable for her. The recommendations met Ms S's objective of tax mitigation, allowing her to reduce her income tax liabilities, defer her capital gains tax liabilities and become eligible for inheritance tax relief. Further the adviser had considered and discounted other products, giving reasons. Our investigator took into account that Ms S had experience of investing in high-risk investments such as EIS and loan notes. She was said to have a good understanding of the complex nature of EIS and the higher risks of capital losses. Overall, our investigator was persuaded that Ms S was willing to accept higher risks to gain tax advantages on this portion of her investable wealth. Whilst Ms S's disappointment in the performance of the EIS was noted, our investigator highlighted that no guarantees had been made and the tax benefits had been achieved.

Those acting on Ms S's behalf disagree with the view. They maintain that Ms S was unaware of the level of risk she was exposed to and say consideration should be given to the other investments she held.

As the parties do not agree the matter has come to me for a final 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.

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 recommendations of investing into an EIS, considering the point the recommendations were made, taking into account Ms S' s particular circumstances, her objectives, attitude to risk and capacity for loss. I note that Ms S has received a separate response in respect of a different product.

I've considered Ms S's circumstances at the time each recommendation was made, about which there appears to be little dispute. The fact find from March 2018, recorded Ms S owning her home and having six buy-to-let properties worth over £2 million. Total liabilities were recorded as being just over £650,000. Further investments of over £1 million were held in a general investment account, around £175,000 in ISAs and £940,000 in a savings account. £20,000 was also kept as an emergency fund. Ms S had received an annual income from 2017/2018 of £197,000 from her rental properties and had a tax liability of £74,488. Her main objective was income tax mitigation. At this time, Ms S also held around £2 million in other EIS products which she had invested in since 2013 and in other higher risk products.

In May 2018, Ms S was advised to invest £320,000 into an Earthworm EIS, which gave 30% income tax relief and enabled a portion to be carried back to the tax owed in 2017/2018. It was recorded that Ms S had also chosen to invest further funds in different EISs with another adviser to add diversification.

At a meeting in November 2018 a further fact find was completed, which showed an increased projected income of £264,847 with a tax liability of £101,973 which Ms S was again looking to mitigate through an EIS. Broadly her circumstances and objectives had not changed. A further £100,000 was invested into the EIS.

A slightly higher income was recorded in a fact find in January 2019 of £275,314 from income with a tax liability of £109,423, which Ms S was looking to mitigate. Broadly her circumstances and objectives had not changed. Ms S was advised invest a further £100,000 into the EIS.

Whilst Ms S says she was advised to re-mortgage her rental properties to invest in the EIS I haven't seen anything to support this. Meeting notes from April 2018 record that funding of the EIS investment would be from savings, accumulated via excess income. The November 2018 notes record that funds being invested were from a recently matured investment. The third EIS was funded from Ms S's general investment account. I also note Ms S claimed not be unsure whether she had received suitability letters, but accepted that her poor recollection didn't mean she hadn't received them.

Objectives

It's plain that Ms S's core objective was income tax mitigation. I note that she had used EISs to mitigate tax liability in the past (regularly since 2013), so this was not a new product to her. The initial suitability letter confirmed that discussions had taken place with Ms S's accountant and Ms S was looking to also carry back a portion of tax relief to mitigate her liability for 2017/2018. Further, the EIS gave Ms S the option to also defer any capital gains tax liability triggered by income derived from a general investment account. The suitability letters also highlighted the inheritance tax relief was another objective, which could met by holding the investment for over two years.

It isn't disputed that the EIS met the tax objectives and Ms S availed of the income tax and capital gains tax relief available. It's also clear that the aim of the EIS was to provide some capital growth, with a targeted return of £1.20 per £1 invested and whilst this strategy was to be pursued, no guarantees were made as to performance.

It was also further recorded that Ms S was attracted to the environmental benefits this particular EIS provided, whereby investment would be into waste, recycling or other sustainable projects. It's not disputed that funds were invested in line with this mandate.

Risk and experience

Ms S had been advised by the adviser for years and I have seen copies of fact-finding meetings notes and suitability letters following each meeting. On balance, I find it is more likely than not that the letters were sent and received. I think it is likely that Ms S would have queried things at the time if no correspondence was received.

Ms S says she had a medium risk appetite. That's consistent with a risk assessment undertaken in April 2018 and I've noted it was recorded in each suitability letter that Ms S' attitude to risk was balanced. However, it was also recorded that Ms S was prepared to take a higher level of investment risk with these particular investments to achieve her objectives. There's nothing to show that Ms S disagreed with this approach at the time of the meetings or after receiving the clear suitability letters. So, I'm persuaded it is more likely than not that this is something she wished to pursue.

The nature of the risks with this type of investment were then expressly set out within each suitability letter, highlighting that EIS have a higher risk exposure and stating that the investment could result in, *“total and permanent capital loss”*. Consistent with this, the suitability assessment section of the application form stated that, *“The Fund will be comprised of equity investments in higher-risk, early-stage unquoted companies.”* Ms S was described as an experienced investor who was willing to pursue tax efficiencies by exposure outside her “balanced” approach, also highlighting the small percentage of investable wealth being invested at each point. The same risk appetite was recorded in suitability letters of November 2018 and February 2019. It’s also fair to say that each suitability letter explained that the investment would be illiquid and its value would likely fluctuate. I’ve also taken into account that the adviser placed each recommendation within the context of Ms S’s overall portfolio.

It is relevant that Ms S had several years of investment in EISs behind her and investment in other high-risk products. Meeting notes from April 2018 recorded that Mrs S was an experienced investor *“acutely aware of the volatile nature of these investments.”* Further, fact find notes from April 2018 stated Ms S *“has a keen understanding of how these solutions operate and the benefits they add to her wider portfolio.”* The application form from March 2018 recorded that Ms S had invested in five EIS funds in the past and held £2.3 million in unquoted companies. At the time of initial risk assessment in 2018, the adviser recorded that Mrs S was an experienced investor, who had been receiving advice for some time and had experience with specialist investments such as EISs and VCTs. I note that at the time of the initial recommendation Ms S was investing further funds into other EIS products with other providers through a different adviser, in order to diversify her EIS holdings. Fact find meetings notes for November 2018 record that whilst Ms S was not considered an experienced investor more broadly, she had invested “heavily in EIS in the past” and understood the risk nature of these investments.

On balance, I find that it is more likely than not that Ms S understood that EIS products were high on the risk spectrum. Considering Ms S pattern of investing in this product over the years and having placed weight upon the contemporaneous fact finds, I find it is likely that Ms S understood that she was placing all her capital at risk to gain tax advantages, that’s further supported by her response to questions from the business in or around June 2021, in which she said:

I do remember Mike telling me about some risk investments I invested in 3 EIS for £37,500 each and he said to me I could make a lot of money or I could lose it all.

I find that it is more likely than not that Ms S was provided with copies of the product brochure and prospectus, which further detailed the risks of the investment, consistent with the information in the suitability letters, the following being highlighted:

“An investment in the Fund is a high-risk investment and any capital invested may be entirely lost.”

EISs are non-mainstream, complex, illiquid, specialised and speculative investments, where there is a real risk of losing the original, capital investment. Given Mrs S’s experience I think it is more likely than not that she would have raised concerns if she had any at the time. On balance, I think it is likely that Ms S was very much invested in the decisions that were being made, I’m not persuaded from the information provided that it’s likely Ms S didn’t understand what she was doing.

It is unfortunate that the EIS did not perform as well as anticipated but it did provide the income tax relief sought and capital gains tax deferral. That risks materialised resulting in large capital losses was an inherent risk and does not mean the recommendations were unsuitable for Ms S.

Capacity for loss

Considering Ms S's circumstances at the time of each recommendation, I'm persuaded it is more likely than not that she had capacity to withstand significant losses. As set out above, Mrs S held substantial assets and her income was significantly in excess of her needs. In line with this, I've noted that Ms S did not require access to the funds she invested and had no future plans for them. Those acting for Ms S have since confirmed that there were outstanding mortgages on at least three buy-to-let investment properties. But looking at the overall assets held by Ms S I don't think that makes a material difference to her capacity for loss and I've noted that the adviser did have regard to outstanding liabilities in the first fact-find.

It's also relevant that each investment represented only a small portion of her overall investable wealth with the total investment of £520,000 equating to around 12.28% of Ms S's investable wealth. I'm persuaded it is likely that this was a further factor considered by the adviser when assessing Ms S's capacity for losing the capital investment either in whole or in part.

Conclusion

Balancing Ms S objectives, knowledge, risk appetite and capacity for loss in the context of her pattern of investing and engagement in decision-making, I'm not persuaded that she was exposed to more risk than she wanted to take with these particular investments. Considering all these factors in the round, I find that the recommendations were not unsuitable for Ms S and it follows that I'm not upholding the complaint.

My final decision

I am sorry to disappoint Ms S but for the reasons given I am not upholding this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms S to accept or reject my decision before 18 August 2023.

Sarah Tozzi
Ombudsman