

The complaint

Miss C complains that she was wrongly advised by The Prudential Assurance Company Limited to contract out of the State Earnings Related Pension Scheme (“SERPS”). She now believes this advice was unsuitable.

What happened

In 1999 Miss C met an adviser from Prudential and was advised to take out a personal pension and contract-out of SERPS. Prudential’s records show that at the time Miss C’s annual income was over £5,000 and she was 30 years old.

Prudential’s representative referred to its in-house checks and said Miss C met the criteria where contracting-out could be beneficial for her. Prudential says standard practice meant an illustration was prepared for Miss C and she then agreed to take out the personal pension and contract-out of SERPS.

Once she was contracted-out, a proportion of Miss C’s National Insurance Contributions was taken and invested in Prudential’s With-Profits Fund instead of going into SERPS.

In June 2020, Miss C complained to Prudential, with the help of a representative. Her representative said the advice to contract-out of SERPS was unsuitable for a number of reasons, including:

- Miss C shouldn’t have been exposed to the risk of significantly lower retirement income;
- she wasn’t informed of, and shouldn’t have been exposed to, unnecessary fund costs;
- she was exposed to a pension linked to the stock market instead of valuable guarantees within SERPS including inflation protected benefits; and
- the advice was in breach of the regulator’s rules at the time and the common law duty to act with reasonable care and skill, and to disclose material information regarding risks, costs and available alternatives in order to allow informed consent.

Prudential didn’t accept that it had done anything wrong. It said Miss C met its criteria for establishing whether contracting-out was likely to be beneficial, and it would have explained there was no guarantee she would be better off.

When Miss C referred the complaint to this service our investigator didn’t think it should be upheld. He said:

- Prudential’s criteria were fair and reasonable and met the required standards at the time;
- Miss C met the criteria and it was reasonable at that time to think she would be better off if she contracted out of SERPS;
- there wasn’t anything to show Prudential did something wrong – it told Miss C about the risks and the information it provided was in line with what was required.

Miss C didn’t accept the investigator’s view and requested an ombudsman’s decision. Her representative said the most important consideration wasn’t Miss C’s age or income, but risk

– she wasn't informed about the risk and, if she had been, she would not have been willing to accept it.

The investigator considered this but didn't change his view. So the complaint has been referred to me to decide.

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.

In the late 1980s the government decided to allow individuals to contract out of SERPS. It wanted to allow more choice and move pension provision from the State to the private sector. Where someone contracted-out of SERPS using a personal pension, some of their National Insurance contributions (referred to as rebates) were re-directed into a personal pension plan. The idea was that these rebates would be invested and build up a fund that could be used to buy benefits that would otherwise have been provided by SERPS.

One of the critical issues was to decide the level of rebate to be applied. If they were set too low, the SERPS pension given up would likely be worth more than the investment within the personal pension. If they were set too high, the government would be paying more than it needed to, to offset the cost of its SERPS liabilities.

The level of rebate for contracted-out individuals was set by the government after taking advice from the Government Actuary's Department (GAD). In addition to the rebate level suggested by GAD, the government added an additional 2% annual incentive payment that would apply until 1993. The rebate percentage level was set as standard for all. This meant it was more attractive for younger individuals to contract-out than older people, who had less time before retirement to benefit from investment growth on their rebates.

The government didn't give advice about who should be advised to remain in SERPS and those for whom it was expected that contracting out would be beneficial. So the actuaries at various pension providers carried out comparisons of the projected benefits from SERPS against the personal pension arrangement (based on the regulator's set assumptions of likely future investment returns) to decide who would likely benefit. The ages where the providers' advice as to whether to contract out or not would likely be beneficial were called pivotal ages. There was also a lower earnings limit, which was used to decide whether an applicant's earnings would be enough to benefit from contracting out.

At the time of contracting out Miss C was below the relevant pivotal age, and her earnings were above the lower earnings limit. So on the face of it, against these criteria, it would have appeared likely she would be better off at retirement by contracting out of SERPS.

The regulator set out a code of conduct for advisers to follow. They were required to exercise *'due skill, care and diligence'* and *'deal fairly with investors'* and to *"give the investor all information relevant to those dealings and..."* and to use *"best endeavours to enable the investor to understand the nature of any risks involved..."*

The regulator also had specific requirements in relation to contracting-out of SERPS, and its members had to provide illustrations in a certain way. This included using a premium for illustration purposes of the minimum rebate payable for that year. The projections were set at two specified rates. The rates used were referred to as real rates of return (taking into account the effects of inflation). The rates of return were set as 0.5% and 2.5% above the National Average Earnings index and the projections were to include charges. If real rates of

return weren't used, the corresponding nominal rate of return could be used of 8.5% and 13% inclusive of charges. These rates of return were referred to as being conservative.

Miss C's representative has also referred to general legal duties to use reasonable care and skill, and not to make negligent mis-statements. As the regulator's rules largely reflect those duties I have focused on those rules.

At the time of the advice, the pivotal age at which Prudential considered it likely women would benefit from contracting-out of SERPS was below 35, and the minimum salary was over £5,000 per year. Prudential's calculations took into account the charges that would be applied to that particular product. Its assumed rate of return in carrying out these calculations was 8.5%. This is in-line with the lower rate of return set for projections on illustrations and demonstrated what was thought likely to be achievable at the time.

Many of the pivotal ages for women at the time were higher than Prudential's and many minimum salaries were lower. In the context of the economic climate and the rules of the day, I'm satisfied Prudential met what I would consider good practice at the time.

I think the illustration provided to Miss C would have shown that the amount payable at retirement date was subject to the growth rates used in the illustrations being achieved.

There's an issue here that the advice was given to Miss C over 30 years ago, and she took her benefits in 2018. So there's very little documentation from the time the advice was given. It's very difficult to say exactly what was and wasn't discussed about the risks of contracting out. Where the evidence is incomplete or inconclusive, I have to make my decision on the balance of probabilities – in other words, what I think is most likely to have happened.

Prudential has provided a copy of the Member's Booklet, which would likely have been sent to Miss C at the time. This does explain the plan's charges, and that at retirement date it would be the value of the units in the plan that would be used to provide pension benefits. The terms and conditions would likely have been sent to Miss C after she'd taken the plan out. And there's no clear warning about the risks that her pension could be lower than if she remained in SERPS. However, although a copy of the illustration isn't available, it was normal practice to provide an illustration at that time. Given Miss C's age, an illustration would likely have shown she would get higher benefits from contracting out of SERPS, and I can't think of a reason why the adviser would not have provided a copy. So I think it's more likely than not that an illustration was given to Miss C.

At the time, Miss C was aged 30 and earning more than £5,000 per year. So she was below the pivotal age and earned more than the minimum amount regarded by Prudential's actuaries as enough to accumulate funds in the plan after covering the charges.

Miss C's representative has said the key point isn't Miss C's age, or her income, but the risk involved - Miss C was giving up a valuable guaranteed pension in exchange for a pension that could be lower. He says she wasn't informed of the risk in the product recommended or the costs associated with it. And he says even if the advice was suitable, there's no evidence her contributions were diversified across different funds, so she was exposed to too much risk.

I agree there was a risk associated with contracting out. So when deciding whether it was suitable for Miss C to contract out, the adviser had to take risk into account and to alert her to the risks involved, which could ultimately lead to her receiving a lower pension.

There is no record of what level of risk Miss C was prepared to take. But there weren't the same requirements as there are today to complete a documented risk analysis. Prudential

say the adviser would have discussed the risks and carried out a risk assessment. At the time there wasn't a requirement to complete a fact-find document.

Miss C would have been given a personal quotation which was designed in line with what the regulator required. This could be used to compare the likely benefits from the personal pension with SERPS. It would have explained that the two pension figures estimated at retirement were based on growth of 2.5% per year in excess of the national average earnings yearly increase and 0.5% in excess of the same measure. The pension at retirement included 3% escalation and a 50% spouses' pension as required.

Miss C was made aware that she was giving up the SERPS benefit in favour of an investment linked to returns and she was provided with the specified figures to see whether it was likely she would be better off.

I appreciate diversification is a well-known risk management tool, but the risks have to be considered in the context of the type of plan arranged. We don't have information showing the make-up of the fund. But Prudential says the funds were invested in a spread of asset classes, and that would generally be the case with these types of funds. Miss C had over 20 years to retirement date, and that would generally be enough time to take some risk. I haven't seen any evidence to suggest she wasn't willing to take some risks at the time. In the circumstances, I'm not persuaded that the fund was unsuitable.

Miss C's representative has also argued that the costs within the fund and the impact of inflation represented an unnecessary risk. The regulator had specified that in providing figures for comparison, firms had to provide the potential benefits from the personal pension in a form it felt comparable to the benefits from SERPS. And the charges were included within the projections and in Prudential's actuarial calculations with regard to who would likely benefit from contracting-out with its personal pension.

For the reasons I've set out above, at the time that Miss C contracted-out in 1989 it was thought – using conservative assumptions – that given her age and level of earnings she would likely be better off at retirement by contracting out of SERPS. The documentation doesn't show that she was clearly warned there was a risk she could get a lower pension by contracting out. So it's likely the adviser would have presented contracting out in a favourable light. On the other hand, I think Miss C was likely to have been alerted to the fact that the benefits at retirement date depended on the performance of the investments and the growth rates shown in the illustration being achieved. This would have indicated to her that there were no guarantees. Given Miss C's age and earnings, I think it would have been considered likely she would improve on the benefits that would otherwise have been obtained from SERPS by contracting out.

There was no guarantee Miss C would be better off by contracting out of SERPS; there was some risk involved. But in my view contracting out would have appeared a relatively low risk at that time. I've seen no evidence to persuade me Miss C wasn't willing to take any risk. I think it's unlikely someone of her age and circumstances would have thought the risk was unacceptable.

Taking all the above onto account, and if the risks had been explained in the appropriate context, I don't think, on balance, it's more likely than not that Miss C would have made a different decision about contracting out. Overall I don't think that contracting out was unsuitable for Miss C.

My final decision

My final decision is that I don't uphold the complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Miss C to accept or reject my decision before 6 June 2022.

Peter Whiteley
Ombudsman