DRN-3031739

The complaint

Mr G complained that Fairstone Financial Management Limited (FFM) advised him to transfer out of an occupational pension scheme he held with his employer, to a type of personal pension called a flexible retirement plan.

The pension Mr G was transferred out of comprised of two elements: a defined benefit (DB) scheme, which formed the majority of his pension savings; and a smaller, defined contribution (DC) scheme.

Mr G's complaint is that he is worse off as a result of being advised to transfer out of these schemes.

What happened

Mr G met with a representative of FFM, initially in May 2016, to discuss his retirement needs. He was in the process of being made redundant after working for his company since the late 1970s and his main intention at that point was to retire more or less immediately (with a possibility of taking on some part-time work to stay active and earn a little).

The FFM adviser noted Mr G wanted to review the financial options available to him for his pension savings in the light of his redundancy and retirement. As a result of the discussions, the adviser recommended Mr G transfer out of both the DB and DC elements of his workplace pension as of September 2016. He was recommended to invest the money with a well-known fund provider and to then set up a drawdown facility. The intention at that point was to leave the transferred pension funds invested in a with profits fund for around a year, in line with his attitude to risk (ATR), which FFM had assessed as 'low medium'. The plan was to then access a drawdown facility later and begin taking cash and income. The FFM adviser said this would help Mr G achieve his overall objective of income 'flexibility' and access to ad-hoc lump sums.

In late 2017 Mr G was advised again by FFM. He did indeed go on to access a drawdown option and re-invest the rest of his money in other funds, again in accordance with his ATR profile.

One of our investigators comprehensively looked into the complaint and said that the DB element of Mr G's pension should not have been recommended for transfer to a personal pension. The investigator said the investments he had been advised to transfer into would have needed to grow substantially to have been able to match what he had previously. They said Mr G should be compensated in line with the regulator's DB transfer methodology for this failure.

However, in respect of the DC element of Mr G's pension savings, the investigator thought the recommendation to transfer out broadly met Mr G's objectives. Accordingly, they didn't think we should uphold this part of the complaint.

FFM responded by disagreeing with the investigator's view and I have considered all the points made with great care. Most I respond to within my findings below, however, in particular I note it's been implied that we are holding FFM to incorrect regulatory standards, that suitability of the advice was considered by our Service with the benefit of hindsight, and that Mr G knew about the risks. FFM also maintained that the recommendation to transfer the DB element was sound and in accordance with Mr G's objectives of having more flexibility to access his pension savings earlier in his retirement. FFM said its own analysis backed up the recommendation and said the investigator had focussed solely on the 'critical yield', a calculation used when comparing the DB scheme with what growth would be needed to buy an annuity. It said this wasn't relevant to Mr G's situation.

As the complaint couldn't be resolved informally, it was passed to me to make an ombudsman's 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'll begin by explaining that although I have only included a summary of the complaint, I have read and considered all the evidence and arguments available to me from the outset, in order to decide what is, in my opinion, fair and reasonable. When considering what is fair and reasonable, I am required to take into account relevant law and regulations; regulators' rules, guidance and standards; codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

The regulator, the Financial Conduct Authority ('FCA'), states in its Conduct of Business Sourcebook ('COBS') that the starting assumption for a transfer from a DB scheme is that it is unsuitable. So, FFM should have only considered a transfer if it could clearly demonstrate that the transfer was in Mr G's best interests (COBS 19.1.6).

I've taken a careful note of the records FFM has from the time, including its fact-find and recommendation report. And having considered everything, I am upholding Mr G's complaint about the DB pension element and directing FFM to put matters right. This is because I think the recommendation to transfer from the DB scheme was unsuitable.

For the DC pension element, I think the recommendation to transfer to a drawdown plan was reasonable. I am therefore not upholding this part of the complaint.

<u>Overview</u>

The Cash Equivalent Transfer Value (CETV) for Mr G's DB plan in 2016 was approximately £436,000 and this formed the larger part of his retirement savings. He had accrued deferred benefits having completed over 27 years of pensionable service and the estimated pension payable at the scheme retirement age of 65 was around £24,500 per year, and £12,500 upon early retirement at 57. These were valuable benefits at a low cost and also index-linked to keep pace with inflation.

In 2006, Mr G's company stopped the future accrual within the DB scheme and opened a DC scheme which he joined. So, as well as the DB element I've mentioned above, Mr G had then also accrued a sizable 'pot' of money in the DC scheme. And as part of Mr G's redundancy agreement a further substantial lump sum was added to the DC pension. By 2016, this meant the transfer value for Mr G's DC plan was approximately £188,000.

Mr G was 56 years old at the time he was first advised by FFM. He had been married for many years and owned his main home jointly with his wife. Only a moderate mortgage of around 10% was outstanding on their main property, which had a market value of £200,000.

He and Mrs G also owned a property abroad, with a loan outstanding of less than 10% of the £140,000 market value. The mortgage interest rate for both these loans was said to be 1%. Mr and Mrs G owned a further property outright. This had no mortgage and was valued at around £130,000, albeit it was jointly owned with a close family member. A car loan was outstanding and being paid down.

According to FFM's own records from the time, Mr and Mrs G had access to £131,000 in 'cash' savings, bolstered by redundancy payments for both Mr and Mrs G. Mr G was in good health in 2016. A summary of what FFM said that their assessment revealed and what Mr G wanted to achieve is as follows:

- a preference for a higher income in the earlier part of retirement whilst Mr and Mrs G were still relatively young; a joint income of around £500 per week was discussed with an expectation that this amount would reduce over the years as Mr and Mrs G both got older,

- A requirement for around £3,000 per year to spend on their family and £5,000 per year to help fund a new car every three years or so,

- A preference that any outstanding pension savings upon death could be inherited by Mr G's family.

The FFM report that eventually recommended the whole transfer of Mr G's pension savings (DB and DC elements) highlighted the following benefits to him and Mrs G:

- Higher tax-free cash

- Investment diversity

- Greater control

- Retirement flexibility

- Consolidation and easier administration

I've considered all this information and I'm going to deal with both the DB and DC elements of Mr G's pensions separately, as the issues involved differ slightly.

<u>*DB pension transfer*</u>

As our investigator explained, DB schemes typically have significant benefits and guarantees. Giving up benefits and guarantees available under a DB scheme and subjecting future pension income to the risks associated with unpredictable investment returns should only be done where it can be shown that it was clearly in the best interests of Mr G.

So, as I've set out above, the starting point here is that a transfer will *not* usually be suitable. In my view, having looked at Mr G's DB scheme and benefits, and all the evidence available, I'm not satisfied the DB transfer was in Mr G's best interests.

Financial viability

The advice was given during the period when the Financial Ombudsman Service was publishing 'discount rates' on our website for use in loss assessments where a complaint about a past pension transfer was being upheld. Whilst businesses weren't required to refer to these rates when giving advice on pension transfers, I consider they provide a useful indication of what growth rates would have been considered reasonably achievable when the advice was given in this case.

When Mr G was given advice, the recommendation report referred to the critical yield, which I explained about earlier. Our investigator referred to this in the view he sent out to both parties to help demonstrate a comparison between transferring out of Mr G's DB pension and the benefits he would have at his normal retirement age of 65 if he stayed in. The critical yield is a useful benchmark, which I explain more about later on, although I note in Mr G's case, he had indicated a desire to retire very soon, at around 57 years of age.

In his case, however, the critical yield required to match Mr G's scheme benefits at age 65 was 8.14% if he took a full pension, and 5.86% if he took a tax-free cash element and a reduced pension. And FFM said in order to purchase an annuity to provide benefits of equal value to the estimated benefits provided by the existing scheme assuming no spouse's pension, no increases in payment and no guarantee – the 'hurdle rate' – was 3.25%. The transfer value analysis also compared retirement at the age of 57. In this case the critical yield was 47.23%.

The relevant discount rate closest to when the advice was given which I can refer to was published by the Financial Ombudsman Service for the period before October 2017 and was 3.5% per year for eight years to retirement. For further comparison, the regulator's upper projection growth rate at the time was 8%, the middle projection rate 5%, and the lower projection rate 2% per year.

I've taken all this into account along with the composition of assets in the discount rate, Mr G's 'low medium' attitude to risk and also his retirement plans. There would be little point in him giving up the guarantees available to him through his DB scheme only to achieve, at best, the same level of benefits outside the scheme. But here, given the lowest critical yield was 5.86%, I think Mr G was likely to receive benefits of a substantially lower overall value than the DB scheme, as a result of investing in line with that attitude to risk.

FFM disagrees with the critical yield concept and implies this is a restrictive comparison applicable only to purchasing an annuity. It says this didn't apply to Mr G's situation and provided a number of alternative financial models which it implied show Mr G would have been able to meet his and Mrs G's needs in retirement.

Nevertheless, the critical yield is a telling indicator of the value of the benefits being relinquished. And the models provided by FFM included a wider assessment of Mr and Mrs G's assets to demonstrate their retirement plans were viable over a number of years - these were not direct comparisons with the benefits being given up. I also think Mr G would have found these models difficult to understand, and certainly, to draw 'like for like' comparisons from. Also, as FFM will know, past performance of invested funds is no guarantee for future performance and so there was no assurance that the funds recommended would have provided better benefits than the scheme Mr G was already in. I therefore consider the regulator's standard projections and discount rates to be more realistic in this regard in the long term. So, looking at financial viability in isolation, a transfer out of the DB scheme wasn't in Mr G's best interests.

However, I went on to assess whether there might be other considerations relevant to Mr G's situation which made the advice suitable.

Flexibility and income needs

I don't think Mr G required the degree of flexibility with his pension sums in early retirement in the way that was put forward by FFM. I say this because Mr and Mrs G already had access to a substantial amount of cash. In my view, the notes of discussion and recommendation that flowed from those discussions fail to sufficiently take Mr and Mrs G's large amount of savings into account. I also note he was able to invest the entire sum of the pension funds directly after the transfer took place, and he took well over a year before deciding what he wanted to do.

So, although the issue of 'flexibility' is recorded at numerous points, and that Mr G wanted to retire relatively early, the meaning of the actual 'flexibility' being sought is much less clear. I also think the recommendation report leans significantly towards the benefits of transferring and not so much on the advantages and the exploration of alternatives. I can't see evidence, for example, that Mr G had a strong need for a variable income in retirement. Rather, he was clear about needing £500 per week for general living expenses and lump sums to help with family gifts and funding a new car every three years. It also seems to me that whilst comments around him preferring a higher income at the beginning of retirement were no doubt genuinely held, I think these were aspirational comments and they took little account of other unforeseen or age-related outcomes such as Mr and Mrs G's ongoing health and needs beyond this initial early retirement period.

I'm satisfied that Mr G could have met his and Mrs G's income needs in retirement without transferring out of the DB scheme, which had valuable and guaranteed benefits, even at the age of 57. Given his circumstances and financial resources, retirement at 57 could have been met in a number of ways.

Our investigator said Mr G wanted an income of around £34,000 (net) per year in retirement comprising of the elements I've described above, according to the information gathered by FFM. However, I've taken account of FFMs representatives reply to this matter and I agree it is reasonable to say that the income required actually was around £26,000, with the other items being funded by lump sums drawn from other sources.

As our investigator considered, Mr G's could have used his substantial cash savings and also his DC pension without immediately accessing his DB scheme. These were substantial funds which, even without any growth, would have been enough to cover his expenditure requirements until the age of 65 and still allowed flexible access, without touching his DB pension at all. At 65, he would then have access to a higher amount from his DB scheme, around £24,500 per year. And as I've also said above, at 66 Mr G would have access to the state pension, currently equivalent to around £9,400 per year. This option would enable a total income of around the desired figure whilst also preserving the guarantees and benefits of the DB scheme. I don't think this was explored enough with Mr G.

Death benefits

Death benefits can be an emotive subject and of course when asked, most people would like their loved ones to be taken care of when they die. The lump sum death benefits on offer through a personal pension plan were most likely an attractive feature to Mr G. But whilst I appreciate death benefits were important to Mr G - and he might have thought it was a good idea to transfer his DB scheme to a personal pension because of this - the priority here was to advise him about what was best for his retirement provisions. A pension is primarily designed to provide income in retirement, rather than inheritable wealth. And I don't think FFM explored to what extent Mr G was prepared to accept a lower retirement income in exchange for higher death benefits.

I therefore think the existing death benefits attached to the DB scheme were underplayed. Mr G was married and so the spouse's pension provided by the DB scheme would have been useful and important to Mrs G if Mr G predeceased her, particularly as her own pension income was moderate. I don't think FFM made the value of this benefit clear enough to Mr G. This was guaranteed and was not dependent on investment performance, whereas the sum remaining on death in a personal pension was.

Summary

In my view, the recommendation Mr G was given in relation to transferring out of the DB element underplayed the risks of giving up a secure income with many guarantees. It failed to take enough account of the options above and the other opportunities they presented for retirement funding, whilst still preserving the important benefits from his existing scheme.

I am therefore upholding this part of the complaint and in doing so I'd like to emphasise that I have considered Mr G's circumstances, not with hindsight, but from the perspective I think was apparent at the time FFM gave the advice. I haven't seen persuasive reasons why Mr G needed to transfer out of his DB scheme or that it was in his best interest to give up the guaranteed DB benefits.

DC pension transfer

Our investigator issued his view and recommended that we should not uphold this element of the complaint. He thought about the reasons given for the advice to transfer the DC element and observed that Mr G had actually gone on to drawdown funds at a later date. The investigator also thought the funds the pension savings were placed into were generally right for Mr G, given his ATR rating.

I broadly agree with this and I make reference above to the part the transferred DC element plays in achieving Mr G's retirement aspirations and the support and flexibility it provides in allowing him to maintain the important benefits of the DB scheme.

It's fair to point out the costs were somewhat higher in the scheme he transferred the existing DC part into and also that his existing DC scheme was already invested in funds in accordance with his attitude to risk. However, his existing DC scheme did come with certain restrictions and rules about accessing the money. After transferring out, Mr G went on to utilise the drawdown features and the rules of his old DC scheme had made it clear that if he had wanted an income, he might need to transfer his plan to another provider.

So, this means that as far as the DC element of Mr G's pension is concerned, I'm satisfied transferring out of the scheme was suitable for the reasons given. I also think the funds he went on to invest in were suitable for him.

Putting things right

A fair and reasonable outcome would be for the business to put Mr G, as far as possible, into the position he would now be in but for FFM's unsuitable advice. I consider Mr G would have most likely remained in his DB scheme if suitable advice had been given.

FFM must therefore undertake a redress calculation in line with the regulator's pension review guidance as updated by the Financial Conduct Authority in its Finalised Guidance 17/9: Guidance for firms on how to calculate redress for unsuitable DB pension transfers.

Mr G accessed his transferred funds from age 57 However, as set out above, I think if he had remained in the DB scheme, he likely would have relied on his DC pension and cash savings to fund his early retirement. So FFM should assume for the calculations that Mr G would have taken benefits from the DB scheme at 65.

This calculation should be carried out as at the date of my final decision and using the most recent financial assumptions at the date of that decision. In accordance with the regulator's expectations, this should be undertaken or submitted to an appropriate provider promptly following receipt of notification of Mr G's acceptance of the decision.

FFM may wish to contact the Department for Work and Pensions (DWP) to obtain Mr G's contribution history to the State Earnings Related Pension Scheme (SERPS or S2P). These details should then be used to include a 'SERPS adjustment' in the calculation, which will take into account the impact of leaving the occupational scheme on Mr G's SERPS/S2P entitlement.

If the redress calculation demonstrates a loss, the compensation should if possible be paid into Mr G's pension plan. The payment should allow for the effect of charges and any available tax relief. The compensation shouldn't be paid into the pension plan if it would conflict with any existing protection or allowance.

If a payment into the pension isn't possible or has protection or allowance implications, it should be paid directly to Mr G as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid. Typically, 25% of the loss could have been taken as tax-free cash and 75% would have been taxed according to his likely income tax rate in retirement - presumed to be 20%. So making a notional deduction of 15% overall from the loss adequately reflects this.

The payment resulting from all the steps above is the 'compensation amount'. This amount must where possible be paid to Mr G within 90 days of the date FFM receives notification of his acceptance of my final decision. Further interest must be added to the compensation amount at the rate of 8% per year simple from the date of my final decision to the date of settlement for any time, in excess of 90 days, that it takes FFM to pay Mr G.

It's possible that data gathering for a SERPS adjustment may mean that the actual time taken to settle goes beyond the 90 day period allowed for settlement above - and so any period of time where the only outstanding item required to undertake the calculation is data from DWP may be added to the 90 day period in which interest won't apply.

Where I uphold a complaint, I can award fair compensation of up to £160,000, plus any interest and/or costs that I consider are appropriate. Where I consider that fair compensation requires payment of an amount that might exceed £160,000, I may recommend that the business pays the balance.

My final decision

<u>Determination and money award</u>: I uphold this complaint and require Fairstone Financial Management Limited to pay Mr G the compensation amount as set out in the steps above, up to a maximum of £160,000.

Where the compensation amount does not exceed £160,000, I would additionally require Fairstone Financial Management Limited to pay Mr G any interest on that amount in full, as set out above.

Where the compensation amount already exceeds £160,000, I would only require Fairstone Financial Management Limited to pay Mr G any interest as set out above on the sum of £160,000.

<u>Recommendation:</u> If the compensation amount exceeds £160,000, I also recommend that Fairstone Financial Management Limited pays Mr G the balance. I would additionally recommend any interest calculated as set out above on this balance to be paid to Mr G.

If Mr G accepts this decision, the money award becomes binding on Fairstone Financial Management Limited.

My recommendation would not be binding. Further, it's unlikely that Mr G can accept my decision and go to court to ask for the balance. Mr G may want to consider getting independent legal advice before deciding whether to accept any final decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr G to accept or reject my decision before 10 June 2022.

Michael Campbell
Ombudsman