

The complaint

Mrs R, through her representative, complains that the advice she was given by The Prudential Assurance Company Limited to contract out of the State Earnings Related Pension Scheme (SERPS) was unsuitable.

What happened

I issued my provisional decision on this complaint on 28 February 2022. The background and circumstances to the complaint and the reasons why I wasn't provisionally minded to uphold it were set out in that decision. I've re-produced the relevant sections of it below, and it forms part of this final decision.

Mrs R was advised to contract out of SERPS sometime around the end of 1988. She was contracted out as from April 1987.

Prudential has said that it received two years' worth of rebates into the policy. And that Mrs R took the benefits from it in 2006, including tax-free cash. This was several years before she could have taken the benefits from SERPS.

In 2020 Mrs R complained, through her representative, about the suitability of the advice that she'd been given. It said, in summary, that the advice to contract out of SERPS was unsuitable. It said it exposed Mrs R to the risks of a significantly lower pension. The representative said that Mrs R wasn't properly informed of the inherent risks in the product recommended, or of all the costs associated with the policy. It said if Mrs R had been warned of the risks she wouldn't have accepted the advice to contract out.

Prudential didn't uphold Mrs R's complaint and it was referred to us. One of our investigators considered it. The investigator said that there were two key factors in deciding whether contracting out was favourable – the investor's age and their earnings. He said Mrs R was below the relevant age, and her earnings were above the minimum amount such that it was considered it would likely be beneficial for her to contract out. He said Mrs R had been invested in a with-profits fund which he noted was itself invested in a spread of asset classes. He thought the fund presented relatively lower risks, and overall he didn't think the advice to contract out was unsuitable.

The investigator said the personal pension member's scheme booklet highlighted the cost of running the scheme, and the charges that applied. He said the booklet went onto explain there was a policy fee, and provided a breakdown of that fee. The investigator wasn't persuaded that Mrs R wasn't made aware of the plan's costs.

Overall, the investigator thought the advice to contract out had been suitable, and he didn't think Prudential had treated Mrs R unfairly. Therefore he said he wouldn't be asking Prudential to do anything further.

Mrs R's representative said that Mrs R didn't accept the investigator's findings. It said it didn't think the applicable legal and regulatory standards or good industry practice had been taken into account.

The investigator responded to say that the government had encouraged workers to contract out. He said he had applied the rules and regulations that were applicable at the time, as well as good industry practice. In doing so, he said he hadn't identified that Prudential had done anything wrong.

Mrs R's representative said that it wasn't true that the government encouraged workers to contract out. And even if it were true, it wouldn't make it right. It said what the government may or may not have 'encouraged' anyone to do wasn't mentioned in the DISP Rules as a criteria for how the ombudsman made decisions.

The representative also said there was a difference between common industry practice and good industry practice. It said although it had been common practice to advise people to contract out of SERPS without properly warning them of the risks, this wasn't good practice. It said the LAUTRO requirements at the time provided:

"A company representative who, in the course of any relevant investment business, has dealings with an investor: shall give the investor all information relevant to those dealings and that information; shall use his best endeavours to enable the investor to understand the nature of any risks involved.

A company representative shall, in advising an investor as to the suitability for that investor of any investment contract, have regard, in particular, to the investor's financial position generally, to any rights he may have under an occupational pension scheme or the State earnings-related pension scheme, (if such rights are relevant in the particular case) and to all other relevant circumstances."

It said it was clear that these requirements weren't met. And the adviser hadn't acted with "reasonable skill and care" as required by law.

What I've provisionally 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.

To give some brief background, in the late 1980s the government decided to allow individuals to contract out of the SERPS. It wanted to give individuals more choice, and shift pension provision from the State to the private sector.

Where an individual contracted-out of SERPS using a personal pension, a proportion of their National Insurance contributions were re-directed into a personal pension plan. The idea was that these rebates, as they were known, would be invested, and build up a fund that could provide a higher pension than would otherwise have been provided by the SERPS.

One of the critical issues was to decide what level of rebate applied. If the rebates were set too low then the SERPS pension given up would likely be worth more than the investment within the personal pension. If the rebates were set too high, then 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 those who were older, as they had less time before retirement to benefit from investment growth on their rebates.

The government gave no advice as to 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 LAUTRO 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 determine whether an applicant's earnings would be enough to benefit from contracting out.

As the investigator said, at the time of contracting out Mrs R 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 that Mrs R would likely to be better off at retirement by contracting out of SERPS.

As explained above, Mrs R's representative has referred to the adviser's obligations under the LAUTRO rules. And also the adviser's obligations under the common law, to amongst other things, act with reasonable skill and care.

Given that Mrs R was exposed to the risk that the benefits from the personal pension could be lower than she would otherwise have obtained from SERPS, the adviser was obliged to take risk into account in deciding whether it was suitable for Mrs R to contract out. And he was also obliged to alert Mrs R to the risks presented by contracting out which could ultimately lead to a lower pension.

However the advice to contract out was given over 30 years ago. There were lesser regulatory requirements on the documentation that firms were obliged to complete at the time.

There is only limited documentation available recording the circumstances of the advice given. And this documentation doesn't record the level of risk that Mrs R had indicated that she was willing to take. It does record that Mrs R had an endowment mortgage policy. This might suggest that she was willing to take some risk. However, I accept the circumstances of the sale of that endowment aren't known, and it doesn't necessarily indicate that Mrs R was aware of the degree of risk it involved.

Clearly it's very difficult to say with any reasonable degree of certainty exactly what was and wasn't discussed at the time that Mrs R contracted out. So where, as here, the evidence is incomplete or inconclusive, I have to make my decision on the balance of probabilities; in other words, what I consider is most likely to have happened in light of the available evidence and the wider circumstances.

Although a copy of the illustration isn't available, it was normal practice to provide an illustration at that time. Given Mrs R'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 have been motivated not to provide Mrs R with a copy. So I think it's more likely than not that an illustration was given to Mrs R.

LAUTRO had specific requirements in connection with contracting-out of SERPS, and its members had to provide illustrations in a specified way. I think the illustration provided to Mrs R would have shown that the amount payable at retirement date was subject to the growth rates used in the illustrations being achieved.

Prudential has provided copies of other documentation that it says would have been given to Mrs R at the time that she contracted out. However in my view this literature didn't highlight the risk that the pension that Mrs R might get from contracting out could be lower than if she had stayed in SERPS.

For the reasons I've explained above, at the time that Mrs R contracted-out in 1988 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. And the written documentation doesn't show that Mrs R was clearly warned that there was a risk that she could get a lower pension by contracting out. So on the one hand, I think it's likely that the adviser would have presented contracting out in a favourable light.

However on the other, I think Mrs R ought to have been aware that the benefits at retirement depended on the performance of the investments and the growth rates shown in the illustration being achieved. This would, therefore, indicated to her that there were no guarantees.

In its final response letter Prudential said that Mrs R's circumstances were such that contracting out was likely to be beneficial; that is given her age and earnings. However it also said that she needed to be able to contract out for at least five years.

Mrs R was only a year below the pivotal age at the time that she contracted out. However the pivotal age wasn't a 'cliff edge' as such. There was a gap of several years between the pivotal age and the age where it was considered it would likely be more beneficial to contract back into SERPS. I'm satisfied that when Mrs R contracted out there was the potential for her to remain contracted out for the five-year period.

Taking all the above into account, given Mrs R's age and earnings, I think it would have been reasonably considered that she would likely improve on the benefits that she would otherwise have got from SERPS by contracting out. Mrs R wasn't guaranteed to be better off by contracting out of SERPS; there was some risk involved. But in my view contracting out wouldn't have appeared to have presented significant risks at the time.

The documentation that's now available doesn't clearly explain that risk. However I've seen no persuasive evidence that Mrs R wasn't willing to take any risk. And in my view, if the risks had been explained in the context of the degree of risk the transaction presented, I don't think, on balance, Mrs R would more likely than not have made a different decision.

Overall, for the reasons I've outlined above, I don't think that contracting out was unsuitable for Mrs R.

I said, therefore, that my provisional decision was not to uphold Mrs R's complaint.

I asked Mrs R and Prudential to let me have any further evidence or arguments that they wanted me to consider before I made my final decision.

Mrs R's representative said that it had nothing further to add.

Prudential didn't provide any further evidence or arguments.

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've seen no reason to depart from my provisional decision not to uphold Mrs R's complaint.

My final decision

For the reasons outlined above, my final decision is that I don't uphold Mrs R's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs R to accept or reject my decision before 21 April 2022.

David Ashley
Ombudsman