DRN-3458097

The complaint

Mr D complains that the advice given to him by Morgans Ltd about his Personal Pension arrangements was unsuitable. This complaint relates to two instances of advice where Mr D's pension was switched to a new provider and in the second instance tax-free cash taken and drawdown commenced.

What happened

Switch 1 – Zurich to Royal London.

Mr D held a Personal Pension with Zurich. In 2002 Mr D met with an adviser from Morgans, she advised Mr D to switch his pension to Royal London. The reasons given were that it would provide cheaper fund management and provide access to a wider range of investment choice. The value at the time was £25,264.24. Mr D had been invested wholly in With-Profits.

Within the reasons why letter Morgans said that the Zurich policy had exit charges and a bid/offer spread charge. However, we've since seen evidence that this wasn't correct – there was no exit penalty and no bid/offer spread charge.

Our original investigator looked into matters and from the information she was able to obtain, she found that the charging structure of Royal London's plan wasn't cheaper than the original plan and so she said this transfer was unsuitable.

However, a second investigator reviewed the case and after obtaining further information from the providers, he came to a different conclusion. He found that whilst the reasons Morgans had given at the time for justifying the transfer weren't accurate, there was a benefit to Mr D in transferring. After speaking to Royal London, he understood that at the advisers request the plan had a feature where the transfer value was enhanced on commencement, in this case 12%. To fund this enhancement an additional management charge was applied each year to clawback the enhancement over the life of the policy – which had a retirement age of 65. But the investigator concluded that the net enhancement of the transfer value was significant enough to mean that the transfer was suitable. He explained it gave Mr D a bigger pot to invest, which with good returns could provide higher benefits than the same returns from Zurich. The investigator also felt that the diversification achieved through the transfer was sensible and suitable for Mr D.

Both parties appear to have broadly agreed with the conclusions of the second investigator regarding Switch 1.

Switch 2 – Royal London to Phoenix Wealth

In 2006 Morgans says it wrote to all members to inform them that the rules around accessing protected rights pension funds had changed (allowing the funds to be converted into tax-free cash). Mr D's recollection is slightly different, he says he was approached by Morgans who told him his pension was doing well and tax-free cash was available.

Regardless of how it came about, Mr D met with Morgans and it was recorded that he wished to take his benefits so he could access the tax-free cash early but that he didn't require income. The adviser recommended a switch to income drawdown with Phoenix Wealth. She said there would be a small penalty applied due to the clawback arrangement due to the enhancement with Royal London of 7%.

It appears that directly before transfer the value of the plan was £33,157.94 and after tax-free cash of £8,269.74 was taken, a total of £24,809.24 was left. Morgans took commission of 6.5% from this balance – a total of £1,612.60. The plan also had other charges included, a Policy Service Charge of £125 deducted before the policy was placed into drawdown and then a Drawdown Service Charge of £125 after the tax-free cash had been paid. Meaning the amount left to be invested had reduced to £23,071.64.

Morgans said that Mr D had no safeguarded benefits but would lose the 50% spouses pension attached to the protected rights on transfer to drawdown.

Our original investigator didn't uphold the advice given to switch from Royal London to Zurich as Mr D had said that around the time of advice he'd wished to purchase a car and caravan. The investigator had also worked on Mr D's separate case looking at advice to go into drawdown in 2005 from a separate plan. She said this wasn't Mr D's main pension provision and it seemed to be a better route than using credit facilities. And whilst she didn't think the advice process was thorough enough to say Mr D was fully informed, she thought he'd have gone ahead anyway as he had a requirement for the tax-free cash.

However, our second investigator came to a different conclusion. He spoke to Mr D and ascertained that he'd only purchased a caravan and not a car. He said the crux of whether this advice was suitable was whether Mr D needed the tax-free cash. He explained Morgans should've recorded at the time why Mr D required the tax-free cash and it hadn't. And its defence that Mr D required it to purchase a caravan and a car had only come from something Mr D had told us subsequently (in relation to the other complaint). He'd now clarified with Mr D what he'd actually used the money for – and he'd purchased a caravan for £12,000 from the proceeds of the earlier advice to take tax-free cash from the other, larger, pension. The investigator pointed out this made sense considering the values and timescales involved.

So he concluded that there didn't appear to be any justification for drawing down the pension and taking tax free cash. He concluded the main function of a pension was to provide income in retirement – to take benefits earlier than that for other reasons would require a compelling reason to be suitable – and there wasn't one here. The investigator also said the further transfer in 2013 recommended by the same adviser wasn't Morgans' responsibility as she had since moved to another firm.

Morgans in response said that in today's environment it agreed significant supporting evidence would be needed to recommend taking pension benefits to access tax free cash, but it was not so sure that this was the case in 2006.

It also said it was the client's money and if he wished to access his tax-free cash then what position was it to stand in his way. Morgans feel the investigator is applying the stricter rules of today to 2006.

Before issuing this decision I contacted both parties to say I intended to issue a decision along the same lines as the second investigator's view but I would be making an amendment to the redress. I explained that the investigator had awarded 8% interest to be applied to any loss calculated at the date of the switch in 2013. However, Mr D's fund had remained invested, and typically 8% is awarded due to loss of use of money. Whereas, any losses Mr D suffered were actually a loss of investment opportunity. And therefore an index in line with his attitude to risk was a fairer solution.

Morgans responded to say that it didn't understand why if we agreed the loss should be capped at 2013, why it needed an award to bring it up to the date of calculation. It also said its records show the adviser left in 2011, so that is the date that should be used to calculate the loss.

The investigator explained that if a loss was found in 2013, the 'missing' funds needed to be brought up to date, as Mr D would've had more money then to invest.

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.

What is it I have to decide?

The investigators' view that switch 1 was suitable hasn't been disputed and I am in agreement with his findings. So I don't think it necessary to discuss this in any more detail.

However, the advice given in relation to switch 2 is still in dispute. I therefore have to decide whether this advice was unsuitable. And if so, whether Mr D would've done something different if given suitable advice.

The rules and guidance applicable at the time

As Morgans have pointed out legislation has strengthened over time but there were still rules and guidance in place at the time of the advice in 2006. I've set out below the relevant rules and guidance from the time:

COB 5.3.5(1) said:

(1) A firm must take reasonable steps to ensure that, if in the course of designated investment business:

(a) it makes any personal recommendation to a private customer to:

(i) buy, sell, subscribe for or underwrite a designated investment (or to exercise any right conferred by such an investment to do so); or

(ii) elect to make income withdrawals; or

(iii) enter into a pension transfer or pension opt-out from an occupational pension scheme; …

the advice on investments or transaction is suitable for the client.

… (3) In making the recommendation or effecting the transaction in (1), the firm must have regard to:

(a) the facts disclosed by the client; and

(b) other relevant facts about the client of which the firm is, or reasonably should be, aware.'

Suitability wasn't defined but it is generally understood that this was built on the concept introduced by LAUTRO and FIMBRA – that suitability meant ensuring the advice met the customer's demands and needs based on an analysis of their circumstances at the time.

'COB 7.2 Churning and switching

COB 7.2.2 G 01/12/2001

Principle 6 (Customers' interests) requires a firm to pay due regard to the interests of its customers and treat them fairly. A firm should therefore not "churn" a customer's account, that is, enter into transactions with unnecessary frequency having regard to the customer's agreed investment strategy. A firm should also not switch a private customer within or between packaged products unnecessarily, having regard to what is suitable for that customer. Firms are reminded that a customer's interests are paramount.

COB 7.2.3 R 01/12/2001

A firm must not:
(1) deal, or arrange a deal, in the exercise of discretion for any customer; or

(2) make a personal recommendation to a private customer to deal, or arrange a deal that gives effect to such a recommendation; or

(3) make or arrange a switch within a packaged product or between packaged products, in the exercise of discretion for a private customer; or

(4) make a personal recommendation to a private customer to switch within a packaged product or between packaged products, or make or arrange a switch that gives effect to such a recommendation;

unless the firm has taken reasonable steps to ensure that the deal or switch is in the customer's best interests, both when viewed in isolation and when viewed in the context of earlier transactions.'

In December 2008 the Financial Services Authority (now the FCA) published a thematic review summarising the good and bad practices it found from its research. It assessed pension advice from April 2006 to see what was happening in the market.

The report set out four main areas where customers had lost out due to poor advice:

- *'the switch involved extra product costs without good reason (79% of unsuitable cases);*

- *the fund(s) recommended were not suitable for the customer's attitude to risk and personal circumstances (40% of unsuitable cases);*

- *the adviser failed to explain the need for, or put in place, ongoing reviews when these are necessary (26% of unsuitable cases); and*

- *the switch involved loss of benefits from the ceding scheme without good reason (14% of unsuitable cases).'*

With regards to costs, it also said:

'*Unnecessary additional costs*

3.4 This was by far the most common reason for unsuitable advice, accounting for 79% of unsuitable cases. The main problems found were:

• extra product costs were incurred without good reason (65% of unsuitable cases);

• a switch to consolidate different pension schemes where the cost was not explained or justified to the customer (35% of unsuitable cases); and

• the new pension was more expensive than a stakeholder pension, but a stakeholder pension would have met the customer's needs (21% of unsuitable cases).'

My findings

Mr D was given advice to transfer his benefits into drawdown to access his tax-free cash. But in doing so early redemption penalties and extra costs were suffered and he also lost his entitlement to a 50% spouse's pension.

The adviser said in the suitability letter that there would be a small penalty applied to the fund on transfer. I disagree that the penalty was small, it was 7% of the fund, he also paid 6.5% commission to Morgans and another £250 of provider charges. So Mr D suffered significant costs to access his tax-free cash. In considering whether Mr D was treated fairly alongside the rules and guidance at the time, I think its reasonable to say there would need to be a very good reason to incur these penalties.

Did Mr D require the tax-free cash?

Morgans in its suitability letter said it was recommending drawdown as Mr D required tax-free cash, but it didn't record why he required it. Which is a failing in itself. Firms were required to detail why they were making a recommendation with reference to a customers circumstances and needs. Not recording why Mr D required the tax-free cash raises questions, if it was discussed I'd expect it to have been recorded as it was the key reason for recommending the switch and Mr D incurring additional costs.

As part of our investigations into this case and the separate case, Mr D told us that the only reason taking tax-free cash appealed was that he was considering buying a new caravan and car. He'd also told us, he'd already paid off his mortgage, was on good money for the time and had no dependant children, so he could've financed large purchases in other ways.

Mr D clarified about the above, that in the end he only bought the caravan which cost him around £12,000. And he used the tax-free cash that he'd received from the proceeds of his former employer's plan in 2005, which Morgans had also advised him to transfer to access tax free-cash.

So given there was no documented need (in either transfer) for tax-free cash. And Mr D's recollections from the time which I've no reason to believe aren't honest, it doesn't appear that there was any great need for Mr D to take more tax-free cash in 2006.

Was the advice suitable?

In switching the pension, as I've already set out Mr D incurred significant costs and also gave up a 50% spouses pension to access the tax-free cash that it doesn't appear he needed. I think this is a clear failure to meet the standard of advice required at the time (as set out earlier) under COB.

Morgans should've reasonably been aware of the reasons why Mr D wanted to take tax-free cash and it should've balanced this against his needs in retirement. As ultimately, the purpose of a pension is to provide income in retirement. It didn't do so.

It should also have had regard for Mr D's circumstances, such as his other pension provision and the fact it had already advised him to transfer his main pension provision to access tax-free cash just a year earlier (and in doing so losing Mr D a significant amount of protected tax-free cash). It also needed to consider this switch in isolation but also in relation to other transactions it had advised on. And only four years prior, Morgans had recommended Mr D a plan and actively selected a feature where exit penalties would be applied on a sliding scale if the pension was switched or taken early. The benefit of which was to give Mr D a higher starting figure to invest with the idea of outperforming the additional charges applied. In advising Mr D to switch his plan so soon after, he then incurred a 7% penalty due to selecting this feature which most likely undid any good the enhancement would've offered. I don't think Mr D's interests were held as paramount as COB 7.2.2 required.

Looking at the findings of the thematic review, the advice given here meets many of the markers of poor advice identified by the regulator at the time. Mr D suffered unnecessary costs without good reason and also lost benefits.

What would Mr D have done if given suitable advice?

Morgans have argued that Mr D approached them wanting to take tax-free cash and it wasn't for them to stand in his way as it was his money. But I think this is a fundamental misunderstanding of its responsibilities when giving advice. Mr D wasn't paying them simply to administer a switch for him, he was paying for expert advice. And he didn't come to Morgans with a specific destination in mind, there's no evidence to say Mr D was insistent. So Morgans needed to give suitable advice considering Mr D's circumstances and needs, and provide him with all the facts so he was fully informed. I don't think it did.

Mr D also disputes that it was him who approached Morgans, regardless I think Mr D was fully reliant on Morgans for advice. Had Morgans advised Mr D that there would be significant penalties on taking his benefits early which likely wouldn't be recovered and discussed properly whether there was a pressing need for tax-free cash, I don't think Mr D would've wished to go ahead with the switch to drawdown. Had he understood he would likely be better off leaving his funds invested until he needs them in retirement, I think Mr D would've listened to this advice.

Conclusions

The advice given to Mr D in 2006 was wholly unsuitable for his circumstances and needs. And it didn't meet the required standards of the time.

If Mr D had been given suitable advice, I don't think he would've wished to take the tax-free cash and would've left his benefits invested with Royal London until he required income in retirement.

Putting things right

It is not possible to put Mr D back into the position he would've been had he not switched his pension in 2006. And I understand he has also made a further switch in 2013. The adviser was no longer connected to Morgans Ltd when the further switch in 2013 occurred, which means Morgans could no longer advise Mr D on his investment/retirement plans. And therefore I think the date of the 2013 switch is a fair point to calculate the loss at.

Morgans in response has argued it should be an earlier date as the adviser ceased to work for Morgans in November 2011, so this is the date that should be used. I've considered this carefully but having done so I think the date of the switch in 2013 is a fairer date to select. I say this because the adviser's way of working appears to have only to involved switching providers rather than considering the investments within an existing provider. So the result of the advice in 2006, would likely always have been the same regardless of whether she was working for Morgans or her new firm.

We've contacted Phoenix Wealth to ask if any fund switches were made between 2011 and 2013 and they've informed none were, bar a mandatory and automatic switch that happened due to a fund being no longer offered. So I think any losses up to the switch in 2013 were as a result of the advice given in 2006. I recognise Morgans couldn't have changed the portfolio after 2011 but had the adviser stayed with Morgans the evidence strongly suggests she wouldn't have made any changes then in any event. It should be noted that I don't know the performance of the funds in question, so it could be that 2013 or 2011 could increase or decrease the loss in question. This is not about choosing a date that benefits one party or the other but what seems fair and reasonable in the circumstances.

Morgans also questioned why if the loss was calculated in the past, i.e at the date of switch , why does it need to be brought up to date – it said this didn't seem fair. The reason for this is, let's say the loss Mr D suffered in 2013 was calculated as £5,000, had it not been for Morgans unsuitable advice he would've had £5,000 more to invest – to the present day. So that £5,000 needs to be brought up to date, as if Mr D had invested it.

The investigator had said to use 8% simple interest to bring the award up to date – but this is commonly used in situations where a customer has lost the use of that money where it would otherwise would've been in their pocket to spend. But I understand that Mr D is only looking to draw benefits from his pension plans now and they remain invested. An alternative to using the actual investments a customer has been invested in (the switch in 2013 brought about new investments – so it wouldn't be fair to use these) is an index which can be used to mirror the likely investment performance an investor with a similar risk rating could've received. In the circumstances here I think this is the fairest solution.

Fair Compensation

In assessing what would be fair compensation, my aim is to put Mr D as close as possible to the position he would probably now be in if he had been given suitable advice.

I think Mr D would have remained within his Royal London plan. I am satisfied what I have set out below is fair and reasonable, taking this into account and given Mr D's circumstances and objectives when he invested.

What should Morgans do?

To compensate Mr D fairly Morgans should:

- Compare the performance of Mr D's investment up until 2013, with the notional value if it had remained with Royal London from 2002 through to 2013. If the actual value is greater than the notional value, no compensation is payable. If the notional value is greater than the actual value, there is a loss and compensation is payable.

- If there is a loss, Morgans should pay into Mr D's current pension plan, to increase its value by the amount of the compensation calculated – this should include a payment to reflect the loss being brought up to date using the index specified. The payment should allow for the effect of charges and any available tax relief. Morgans shouldn’t pay the compensation into the pension plan if it would conflict with any existing protection or allowance.

- If Morgans are unable to pay the compensation into Mr D's pension plan, it should pay that amount direct to him. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore the compensation should be reduced to *notionally* allow for any income tax that would otherwise have been paid. This is an adjustment to ensure the compensation is a fair amount – it isn’t a payment of tax to HMRC, so Mr D won’t be able to reclaim any of the reduction after compensation is paid.

- The *notional* allowance should be calculated using Mr D's actual or expected marginal rate of tax at his selected retirement age.

- It’s reasonable to assume that Mr D is likely to be a basic rate taxpayer at the selected retirement age, so the reduction would equal 20%. However, if Mr D would have been able to take a tax free lump sum, the reduction should be applied to 75% of the compensation, resulting in an overall reduction of 15%.

- Provide the details of the calculation to Mr D in a clear, simple format.

- Income tax may be payable on any interest paid. If Morgans consider that it is required by HM Revenue & Customs to deduct income tax from that interest, Morgans should tell Mr D how much it has taken off. Morgans should also give Mr D a tax deduction certificate in respect of interest if Mr D asks for one, so he can reclaim the tax on interest from HM Revenue & Customs if appropriate.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional calculation to bring loss up to date
Phoenix Wealth Pension Plan	No longer in force as switched in 2013	Notional value from Royal London	2002 – date of switch to Royal London	August 2013 the date of the switch out to a new provider.	If a loss is found at the end date – this needs to be brought up to the date of calculation (present date) using the rate of return of the FTSE UK Private Investors Income total return index

Actual value

This means the actual amount of the Phoenix Wealth policy at date of switch.

Notional Value

This is the value of Mr D's investment had it remained with Royal London until the end date. Morgans should request that the Royal London calculates this value.

Any additional sum paid into the Phoenix Wealth Pension Plan should be added to the *notional value* calculation from the point in time when it was actually paid in.

Any withdrawal from the Phoenix Wealth Pension Plan should be deducted from the notional value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simpler, I'll accept if Morgans total all those payments and deduct that figure at the end to determine the notional value instead of deducting periodically.

If the Royal London is unable to calculate a notional value, Morgans will need to determine a fair value for Mr D's investment instead, using this benchmark: FTSE UK Private Investors Income Total Return Index. The adjustments above also apply to the calculation of a fair value using the benchmark, which is then used instead of the notional value in the calculation of compensation.

Why is this remedy suitable?

I've chosen this method of compensation because:

- Mr D wanted Capital growth and was willing to accept some investment risk.
- If the Royal London is unable to calculate a notional value, then I consider the measure below is appropriate. If the provider is able to calculate a notional value then the index below should be used to bring any loss up to date.
- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It's a fair measure for someone who was prepared to take some risk to get a higher return.
- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr D's circumstances and risk attitude.

There is guidance on how to carry out calculations available on our website, which can be found by following this link: https://www.financial-ombudsman.org.uk/businesses/resolving-complaint/understanding-compensation/compensation-investment-complaints. Alternatively, just type 'compensation for investment complaints' into the search bar on our website: www.financial-ombudsman.org.uk.

My final decision

I uphold the complaint. My decision is that Morgans Ltd should pay any loss calculated as set out above.

Morgans Ltd should provide details of its calculation to Mr D in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr D to accept or reject my decision before 28 October 2022.

Simon Hollingshead
Ombudsman