Financial Ombudsman Service

The complaint

Mr R complained that he was given unsuitable advice to transfer his defined benefit (DB) British Steel Pension Scheme (BSPS), to a personal pension plan.

DC Financial Limited is responsible for answering this complaint and so to keep things consistent, I'll refer mainly to "DCFL".

What happened

In March 2016, Mr R's employer announced that it would be examining options to restructure its business, including decoupling the BSPS from the company. The consultation with members referred to possible outcomes regarding their preserved benefits, which included transferring the scheme to the Pension Protection Fund (PPF), or a new defined benefit scheme (BSPS2). Alternatively, members were informed they could transfer their benefits to a personal pension arrangement.

In May 2017, the Pension Protection Fund (PPF) made the announcement that the terms of a Regulated Apportionment Arrangement (RAA) had been agreed. That announcement said that, if risk-related qualifying conditions relating to funding and size could be satisfied, a new pension scheme sponsored by Mr R's employer would be set up – the BSPS2.

Mr R was concerned about what the announcement by his employer meant for the security of his preserved benefits in the BSPS. He was unsure what to do and was referred to DCFL which is responsible for providing the pension advice. Information gathered about his circumstances and objectives at the time were broadly as follows:

- Mr R was 48 years old, married and at the time had no-one financially dependent on him. He was in good health and at that point he had accrued around 25 years of pension benefits with the BSPS.

- Mr R earned around £36,000 per year and lived in a home valued at approximately £80,000, which had an outstanding mortgage of around £36,000 with 9 years 11 months left to run. Mr R had disposable income each month of over £800 and no recorded savings.

- The cash equivalent transfer value (CETV) of Mr R's BSPS was recorded on the transfer analysis as £343,915 (the amount transferred was ultimately £355,129) and the normal retirement age (NRA) was 65. DCFL's transfer analysis also said Mr R's desired retirement age was 55.

DCFL set out its advice in a suitability letter and report on 29 August 2017. Mr R signed to say he'd read the letter on 5 September 2017. It advised him to transfer out of the BSPS and invest the funds in a personal pension plan. DCFL said this would allow Mr R to achieve his objectives. Mr R accepted this advice and so transferred to a personal pension in October 2017. In 2021 Mr R complained to DCFL about its advice, saying he shouldn't have been advised to transfer out to a personal pension.

Mr R referred his complaint to our Service. One of our investigators looked into the complaint and said it should be upheld. In response, DCFL said it hadn't done anything wrong and was acting on the financial objectives Mr R had at the time.

As the complaint couldn't be resolved informally, it's 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've also taken into account relevant law and regulations, regulator's rules, guidance and standards and codes of practice, and what I consider to have been good industry practice at the time. This includes the Principles for Business ('PRIN') and the Conduct of Business Sourcebook ('COBS'). Where the evidence is incomplete, inconclusive or contradictory, I reach my conclusions on the balance of probabilities – that is, what I think is more likely than not to have happened based on the available evidence and the wider surrounding circumstances.

The applicable rules, regulations and requirements

The below is not a comprehensive list of the rules and regulations which applied at the time of the advice, but provides useful context for my assessment of DCFL's actions here.

- PRIN 6: *A firm must pay due regard to the interests of its customers and treat them fairly.*
- PRIN 7: *A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.*
- COBS 2.1.1R: *A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).*
- The provisions in COBS 9 which deal with the obligations when giving a personal recommendation and assessing suitability and the provisions in COBS 19 which specifically relate to a DB pension transfer.

I have further considered that the regulator, the Financial Conduct Authority ('FCA'), states in COBS 19.1.6 that the starting assumption for a transfer from a DB scheme is that it is unsuitable. So, DCFL should have only considered a transfer if it could clearly demonstrate that the transfer was in Mr R's best interests.

I've used all the information we have to consider whether transferring away from the BSPS to a personal pension was in Mr R's best interests.

I don't think it was, so I'm upholding his complaint.

Financial viability

DCFL referred in its transfer analysis and suitability report to 'critical yield' rates. The critical yield is essentially the average annual investment return that would be required on the transfer value - from the time of advice until retirement - to provide the same annuity benefits as the DB scheme. In this case, DCFL used the existing scheme (BSPS) for the critical yield comparisons, rather than the 'new' BSPS2, details of which were emerging at the time.

However, I think it's fair to say that despite some uncertainty at the time, the BSPS2 critical yields were likely to be between the BSPS and PPF yields, but most likely much closer to the existing scheme (BSPS).

I also think it's important to point out that DCFL itself acknowledged, during its advice, that the critical yields required to match the benefits of Mr R's existing scheme were high. It said in its suitability report, *"the critical yield required is high and it would be very unlikely that an investment could provide a return to match the benefits you are giving up".* It explained the critical yield required to match his existing benefits at the age of 65 was 6.33%; and it was 11.71% compared against retirement at the age of 55.

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.

The relevant discount rate was 4.3% per year for 16 years to retirement (age 65), which is well below the critical yield figures I've referred to above. For a retirement at 55, the discount rate was only 3.3%.

This infers that reaching the critical yields above would be unlikely. And there would be little point in transferring if Mr R was likely to receive lower pension benefits in the longer term.

However, I've also considered some other issues. I've also kept in mind, for instance, that the regulator's upper projection rate at the time of the advice was 8%, the middle projection rate was 5%, and the lower projection rate was 2%. DCFL said Mr R's attitude to risk (ATR) was "cautious", so I think a growth assumption near to the regulator's lower projection was appropriate here, and so even lower than the discount rate. At just 2%, this was substantially below the critical yields I've set out above.

Of course, all this could be said to be of limited relevance since DCFL itself said at the time the critical yields were very unlikely to be achieved. And so, having said this back in 2017, it would be hard for DCFL to argue now that these types of growth figures *were* viewed as achievable at the time.

Elsewhere in its transfer analysis, DCFL showed some figures to Mr R that implied he'd be able to have an income from his transferred funds well into his old age. But these weren't making like-for-like comparisons with the scheme he could join (BSPS2) as the benefits and guarantees associated with a DB pension were being lost.

DCFL also made mention of the PPF, which it described as a compensation scheme providing a *"safety net"* for pension schemes when the sponsoring employer becomes insolvent. DCFL said the critical yield to match the benefits available through the PPF at age 65 was 3.75% per year if Mr R took a pension under the reduced terms of the PPF and 3.32% if he took the same PPF option together with a tax-free lump sum.

But these yields related to the *reduced* benefits available with the PPF and DCFL itself says Mr R wouldn't have wanted to transfer to this scheme. It's also important to remember here that the effect of charges and fees associated with a personal pension would have further reduced the likely growth.

As a further comparison, I can also see that DCFL's transfer analysis showed that in order to purchase an annuity to provide benefits of equal value to the existing scheme at retirement at age 65, the funds required would be around £805,051 – far in excess of Mr R's 'current' CETV. Even in order to purchase an annuity to provide benefits of equal value to the estimated benefits of the existing scheme, assuming *no* spouse's pension, *no* increases in payment and *no* guarantee at retirement, the estimated fund required was still £485,650. In my view, these costs provide a revealing window into the real value Mr R would lose if he transferred out to a personal pension plan.

However, to be clear, DCFL's recommendation that he should transfer out to a personal pension was not predicated on the financial comparisons with his current scheme alone. Rather, DCFL said Mr R had different reasons to transfer away, so I've thought about all the other considerations which might have meant a transfer *was* suitable for him, despite providing the overall lower benefits mentioned above.

I've considered these below.

Flexibility and other needs

DCFL recommended a transfer to a personal pension based on what it said were Mr R's wider objectives. I've used the suitability report, 'fact-find' and other documents from the time of the advice to summarise the following themes as supporting the recommendation to transfer away:

- Mention was made several times throughout the advice of Mr R retiring early if possible, at 55. DCFL said he could pay off his mortgage due to the flexibility of a personal pension arrangement.
- Mr R wanted personal control over his pension.
- There would be better and more flexible access to death benefits in a personal pension plan.
- The future of the BSPS was a concern and he'd lost trust in the company. Mr R didn't want to enter the PPF.

So, it seems the supporting reasons that DCFL recommended the transfer out to a personal pension was for the flexibility and control it offered to Mr R. I have therefore considered all these issues in turn.

- *Retiring early / paying off his mortgage*

DCFL mentioned that Mr R had said he wanted to retire early but I think this was no more than a 'stock' objective used to help add legitimacy to the recommendation to transfer away. I don't doubt that Mr R might have genuinely hoped to retire as early as 55, but it was also made clear that he may well work longer. So, I've seen nothing that shows this was anything more than what he aspired to do at that stage, as opposed to being part of a formulated plan. I say this because Mr R was only 48 years old at the time and he didn't have any concrete plans for retirement at that point.

DCFL also promoted to Mr R that he could access more tax-free cash if he transferred to a personal pension plan and he could also do this without starting to draw his pension. It said he'd be able to access 25% of his pension as a lump-sum and then use the remaining funds more flexibly. It's usually the case that more tax-free cash can be accessed from a personal pension when compared against a DB scheme; this is because the values and benefits of the two schemes are calculated differently. But extra tax-free lump sums being removed from a personal pension, potentially from the age of 55 in his case, also came with consequences in that the amount left for his later retirement years would obviously decrease.

Even if I were to consider the unlikely scenario that Mr R's retirement plans were more fixed than the mere aspirations set out by DCFL - and he really did want to retire early - I think DCFL should have assessed the possibility of achieving this goal whilst being a member of the BSPS2, for example. Early retirement under the BSPS2, or indeed the PPF, would still have been an option for Mr R, although this would have meant Mr R's pension benefits would have been somewhat different due to him accessing the pension earlier and for longer. I think it's likely there were discussions about this, but I think this was discounted by DCFL and portrayed very negatively. The advice simply focussed on him transferring away completely.

So, whilst I accept the notion of retiring early and / or accessing tax-free cash might have been appealing, this needed to be considered against the other options Mr R faced, including opting for the BSPS2. I can't see that Mr R required flexibility in retirement in the way DCFL suggested, which in any case, was poorly defined.

In fact, it seems DCFL and Mr R himself could only estimate the amount he'd need to live on in retirement, because it was still a while away yet. So, in my view this was most likely no more than an 'educated guess' at that point in time as up to 16 more years could elapse before his NRA. Nevertheless, his income needs in retirement were recorded as being around £1,200 per month (although no analysis or information backs this up in any way).

On the other hand, DCFL only referred to his estimated BSPS annual pension (rather than the BSPS2). It said that upon reaching the NRA this was likely to be £21,838 per year (or £11,874 at the age of 55). So, it seems to me that if Mr R wanted around £1,200 (net) per month, these values were not demonstrably outside his needs especially as DCFL doesn't seem to have considered either Mrs R's financial situation, such as her earnings or a pension, or their other sources of income, which I come on to below. As I've said above, I think these pension values would have been broadly comparable if transferring to the BSPS2 (although DCFL didn't take the opportunity to wait what would have only been a few weeks to find out the full details about BSPS2). And as a DB pension this would be guaranteed and index linked.

Put another way, I certainly haven't seen anything to persuade me that Mr R *wouldn't* have been able to meet his likely retirement income needs by accessing his DB pension instead of transferring out to a personal pension plan.

Mr R would have also already almost finished his mortgage repayments when he reached 55. So, DCFL heavily basing its rationale for the transfer on him using the money to help pay off his mortgage was very poor advice indeed, in my view. Our investigator summed this up well: what would be the point in irreversibly transferring away from a DB scheme to pay down a very small mortgage – in a very low interest rate environment – which had only two years left to run? If they'd really wanted to, Mr and Mrs R could have also used some of their disposable monthly income they currently enjoyed to pay this mortgage off completely before Mr R retired, and I think the cost of this would have been modest. No other debt was recorded on the 'fact-find'.

As well as retirement potentially still being some time away, we know Mr R had already joined his employer's new defined contribution ('DC') scheme and would have been making contributions to it for up to 16 years more, until he retired. Mr R's contributions to this 'second' pension were being added to by his employer and I think there's every reason to say that by retirement – whenever it came – there would have been a substantial amount in this DC pension to complement his deferred DB scheme (in BSPS2).

I think therefore, that by retirement, Mr R could have been in a good position if he'd transferred to the BSPS2. On one hand he'd have had a long-standing DB pension, but one with all the guarantees and benefits this type of scheme brought. And on the other hand, he'd have built up a DC pension over several more years, which, if he later found he did require flexibility, this pension could have provided it.

I have therefore considered what DCFL said about retiring early and the potential flexibility brought about by transferring to a personal plan: it implied this would include how funds were invested, the level of income he could withdraw from it and a greater ability to flexibly use the tax-free lump sum element.

However, I don't think recommending a transfer-out based on these reasons was suitable because he was still quite young in pension terms, and little was known about what his retirement would look like. DCFL also implied that Mr R would be able to have complete control over the pension if he transferred out. But I've seen nothing which shows Mr R had either the desire or capacity to exercise personal control over his pension. Mr R's previous exposure to investing was not really known and he had no such investments at the time of his own.

So, I think Mr R's circumstances were much more aligned to him transferring to BSPS2 and retiring from that when he felt he was ready to do so, and then drawing a DB pension. Because he also had a 'second', DC pension, this supported that strategy, in my view.

I therefore think the much more suitable option was for Mr R to access his DB pension in the way it was originally intended. Using this, together with his other assets put him in a good retirement position, when it eventually came.

- *Death benefits*

DCFL implies that death benefits were discussed at the time and the personal pension would better enable the retention of the value of the funds if Mr R died.

Death benefits are 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 was probably made to look like an attractive feature to Mr R. But whilst I appreciate death benefits are important to consumers, and Mr R might have thought it was a good idea to transfer the BSPS 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. And I don't think DCFL explored to what extent Mr R was prepared to accept a lower retirement income in exchange for higher death benefits.

Mr R was only 48 and was married. So, I think the likely death benefits attached to the DB scheme were substantially underplayed. The spouse's pension provided by the BSPS2 would have been very useful to Mrs R if Mr R predeceased her. I don't think DCFL made the value of this benefit clear enough. This was guaranteed and it escalated – it was not dependent on investment performance, whereas the sum remaining on death in a personal pension was.

I also can't see whether, or the extent to which, life insurance was discussed in this case. But at 48 years old and in good health, a modest 'term' life insurance policy may have still been a reasonably affordable product if Mr R really did want to leave a legacy for Mrs R or someone else such as a close relative over a shorter period. But more so, it doesn't appear that DCFL took into account the fact that Mr R could have nominated a beneficiary of any funds remaining in his other DC scheme. So, to this end, Mr R already had plenty of options ensuring part of his pension wouldn't 'die with him'.

However, a more obvious drawback with a personal plan death benefits is that the amount left to pass on – to anyone – may be substantially reduced as the pensioner starts to withdraw his or her retirement income. To this end, if Mr R had lived a long life there could be nothing left at all in his personal pension plan.

I don't think different death benefits available through a transfer to a personal pension justified the likely decrease of retirement benefits for Mr R. I think this objective was no more than a generic comment and not meaningful to Mr R's situation.

- *Concerns over financial stability of the DB scheme*

It's clear that Mr R, like many employees of his company, was concerned about his pension. His employer had recently made the announcement about its plans for the scheme and DCFL said he lacked trust in the company. He'd heard negative things about the PPF and DCFL said he could have more control over his pension fund.

So, it's quite possible that Mr R was also leaning towards the decision to transfer because of the concerns he had about his employer and a negative perception of the PPF. However, it was DCFL's obligation to give Mr R an objective picture and recommend what was in his best interests.

By the point of the advice being delivered details of BSPS2 were emerging and it seemed likely it was going ahead. So, I think this should have alleviated Mr R's concerns about the scheme moving to the PPF.

However, even if there was a chance the BSPS2 wouldn't go ahead, I think that DCFL should have reassured Mr R that the scheme moving to the PPF wasn't as concerning as he thought. The income available to Mr R through the PPF would still have probably provided a significant portion of the income he would have needed at retirement, and he was still unlikely to be able to exceed this by transferring out, given his ATR and the effect of pension charges and fees. And although the increases in payment in the PPF were lower, the income was still guaranteed and was not subject to any investment risk. So, I don't think that these concerns should have led to DCFL's recommendation to Mr R to transfer out of a DB scheme altogether.

Summary

I don't doubt that the flexibility, control and potential for higher death benefits on offer through a personal pension would have sounded like attractive features to Mr R. But DCFL wasn't there to just transact what Mr R might have thought he wanted. The adviser's role was to really understand what Mr R needed and recommend what was in his best interests.

Ultimately, I don't think the advice given to Mr R was suitable. He was giving up a guaranteed, risk-free and increasing income within the BSPS2. By transferring to a personal pension, the evidence shows Mr R was likely to obtain lower retirement benefits. And I don't think there were any other particular reasons which would justify the transfer and outweigh this. I think DCFL ought to have advised him against transferring out of his DB scheme for this reason, particularly as it meant he'd be worse off in retirement.

So, I don't think it was in Mr R's best interests for him to transfer his DB scheme to a personal pension when he had the opportunity of opting into the BSPS2.

I think it was clear to all parties that BSPS2 was likely to be going ahead. Mr R still had a few years before he could retire. So, I don't think that it would have been in his interests to accept the reduction in benefits he would have faced by the scheme entering the PPF, as it wouldn't necessarily have been offset by the more favourable reduction for very early retirement. By opting into the BSPS2, Mr R would have retained the ability to transfer out of the scheme nearer to his retirement age if he needed to. Also, Mr R was married and there were valuable death benefits to remaining a member of a DB scheme, such as the BSPS2.

On this basis, I think DCFL should have advised Mr R to opt into the BSPS2.

I have considered, given the circumstances of the time, whether Mr R would have transferred to a personal pension in any event. I accept that DCFL disclosed some of the risks of transferring to Mr R, and provided him with a certain amount of information. But ultimately it advised Mr R to transfer out, and I think Mr R relied on that advice.

I'm not persuaded that Mr R would have insisted on transferring out of the DB scheme, against DCFL's advice. I say this because Mr R was an inexperienced investor and this pension accounted for most of his retirement provision at the time. So, if DCFL had provided him with clear advice against transferring out of the DB scheme, explaining why it wasn't in his best interests, I think he would have accepted that advice.

I'm also not persuaded that Mr R's concerns about the PPF were so great that he would have insisted on transferring his pension, knowing that a professional adviser, whose expertise he had sought out and was paying a substantial amount for, didn't think it was suitable for him or in his best interests. So if DCFL had explained Mr R was also unlikely to exceed the benefits available to him through the PPF if he transferred out, and that he could meet his income needs in retirement without risking his guaranteed pension, I think that would have carried significant weight.

In light of the above, I am upholding this complaint. I think DCFL should compensate Mr R for the unsuitable advice, using the regulator's defined benefits pension transfer redress methodology.

Putting things right

A fair and reasonable outcome would be for the business to put Mr R, as far as possible, into the position he would now be in but for DCFL's unsuitable advice. I consider Mr R would have most likely opted to join the BSPS2, rather than transfer to the personal pension if he'd been given suitable advice and compensation should be based on his normal retirement age of 65, as per the usual assumptions in the FCA's guidance. DCFL should use the benefits offered by BSPS2 for comparison purposes.

On 2 August 2022, the FCA launched a consultation on new DB transfer redress guidance and has set out its proposals in a consultation document - CP22/15-calculating redress for non-compliant pension transfer advice**.**

In this consultation, the FCA has said that it considers that the current redress methodology in Finalised Guidance (FG) 17/9 (Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers) remains appropriate and fundamental changes are not necessary. However, its review has identified some areas where the FCA considers it could improve or clarify the methodology to ensure it continues to provide appropriate redress.

A policy statement was published on 28 November 2022 which set out the new rules and guidance-https://www.fca.org.uk/publication/policy/ps22-13.pdf. The new rules will come into effect on 1 April 2023.

The FCA has said that it expects firms to continue to calculate and offer compensation to their customers using the existing guidance in FG 17/9 for the time being. But until changes take effect firms should give customers the option of waiting for their compensation to be calculated in line with the new rules and guidance.

We've previously asked Mr R whether he preferred any redress to be calculated now in line with current guidance or wait for the new guidance/rules to come into effect. He would like the complaint to be settled in line with new guidance / rules. I consider it's fair that DCFL calculates Mr R's redress in line with new guidance and rules when they come into effect.

DCFL must undertake a redress calculation in line with the updated methodology as soon as any new rules and/or guidance come into effect (rather than to calculate and pay any due compensation now in line with FG17/9).

In accordance with the regulator's expectations, this should be undertaken or submitted to an appropriate provider promptly once any new guidance/rules come into effect.

If the redress calculation demonstrates a loss, the compensation should if possible be paid into Mr R'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 R 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 compensation amount must where possible be paid to Mr R within 90 days of the date any changes to DB transfer redress guidance or new rules come into effect and DCFL has received notification of Mr R's acceptance of my decision. Further interest must be added to the compensation amount at the rate of 8% per year simple from the date any changes to DB transfer redress guidance or new rules come into effect to the date of settlement for any time, in excess of 90 days, that it takes DCFL to pay Mr R.

Income tax may be payable on any interest paid. If DCFL deducts income tax from the interest, it should tell Mr R how much has been taken off. DCFL should give Mr R a tax deduction certificate in respect of interest if Mr R asks for one, so he can reclaim the tax on interest from HM Revenue & Customs if appropriate.

I have also considered the impact on Mr R of the unsuitable advice and transfer. Our investigator recommended that a sum of £300 should be paid to Mr R by DCFL for what he referred to as the trouble and upset caused by this unsuitable transfer. I've taken into consideration Mr R's age and circumstances and also that by retirement this DB pension would still have been a significant part of his overall pension entitlement, So I think the thought of losing benefits would have negatively impacted Mr R. I therefore agree that DCFL should also pay Mr R £300 for the distress and inconvenience caused by the unsuitable advice which has likely had an impact on his retirement planning

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

Determination and money award: I've decided to uphold this complaint and I now direct DC Financial Limited to pay Mr R 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 DC Financial Limited to pay Mr R any interest on that amount in full, as set out above.

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

Recommendation: If the compensation amount exceeds £160,000, I also recommend that DC Financial Limited pays Mr R the balance. I would additionally recommend any interest calculated as set out above on this balance to be paid to Mr R.

If Mr R accepts my final decision, the money award becomes binding on DC Financial Limited.

My recommendation would not be binding. Further, it's unlikely that Mr R can accept my decision and go to court to ask for the balance. Mr R 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 R to accept or reject my decision before 7 March 2023.

Michael Campbell
Ombudsman