

The complaint

Mr M complains that the Prudential Assurance Company Limited gave him unsuitable advice to contract out of the State Earnings Related Pension Scheme ("SERPS").

What happened

In 1989 Mr M was advised by Prudential to contract out of SERPS. He was 32 years old at the time and had little experience or knowledge of pensions and investments.

Once he was contracted-out, a proportion of Mr M's National Insurance Contributions was taken and invested in Prudential's With-Profits Fund instead of going into SERPS.

Mr M is now retired and receives £43.64 per month from the Prudential annuity. He says

- this is less than he would have received if he had not opted out of SERPS, and he shouldn't have been exposed to the risk of a significantly lower retirement income as a result of contracting out;
- if he'd been warned of this risk, he wouldn't have accepted the advice;
- his contributions were invested in a single with-profits fund, which was unsuitable as there was a lack of diversification and a concentration of risk.

Our investigator didn't think the complaint should be upheld. She said the advice given was suitable based on the information known at the time, taking into Mr M's income, his age and the length of time until his retirement.

Mr M doesn't agree and has requested an ombudsman's decision. He's assisted in bringing the complaint by a representative, who has made a number of points, including:

- Mr M should not have been exposed to the risk of a much lower retirement income as a result of giving up inflation-protected benefits;
- even if it was suitable to contract out, the funds should have been spread across a range of investments to reduce the risk, rather than being invested in a with-profits fund;
- Prudential originally upheld the complaint but then said it would not uphold it based on the fact Mr M lost his job after the advice was given;
- it wasn't known at the time that this would happen, so it's not relevant to the advice given at the time.

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.

Where someone contracted-out of SERPS using a personal pension, some of their National Insurance contributions (referred to as rebates) were re-directed into a personal pension plan. These rebates would be invested and build up a fund that could be used to buy benefits that would otherwise have been provided by SERPS.

One of the critical issues was to decide the level of rebate to be applied. 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. So it was more attractive for younger individuals to contract-out than older people, who had less time before retirement to benefit from investment growth on their rebates.

The actuaries at various pension providers carried out comparisons of the projected benefits from SERPS against the personal pension arrangement (based on the regulator's set assumptions of likely future investment returns) to decide who would likely benefit. The ages where the providers' advice as to whether to contract out or not would likely be beneficial were called pivotal ages. And there was a lower earnings limit, which was used to decide whether an applicant's earnings would be enough to benefit from contracting out.

An adviser was required to exercise '*due skill, care and diligence*', "*give the investor all information relevant to those dealings ...*" and "*use his best endeavours to enable the investor to understand the nature of any risks involved.*" The regulator also had specific requirements in relation to contracting-out of SERPS, and its members had to provide illustrations in a certain way. This included using a premium for illustration purposes of the minimum rebate payable for that year, with projections set at specified rates.

Mr M's representative has also referred to general legal duties including the duty to use reasonable care and skill, and to disclose the risks to ensure "informed consent". As the regulator's rules largely reflect those duties I have focused on those rules.

At the time of the advice, the pivotal age at which Prudential considered it likely men would benefit from contracting-out of SERPS was below 45, and the minimum salary was over £5,000 per year.

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

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

Prudential has provided a copy of the Member's Booklet, which would likely have been sent to Mr M at the time. This explains the plan's charges, where the funds would be invested, and that at retirement date it would be the value of the units in the plan that would be used to provide pension benefits. The terms and conditions would likely have been sent to Mr M after he'd taken out the plan. It was normal practice to provide an illustration at that time. Given Mr M's age, an illustration would likely have shown he would get higher benefits from contracting out of SERPS, and I can't think of a reason why the adviser would not have provided a copy. So I think it's more likely than not that an illustration was given to Mr M.

Mr M was aged 32. Prudential doesn't have details of his salary at the time, but has carried out a calculation based on the 1989 rebate received, which shows his salary would have been around £7,700. So he was below the pivotal age and earned more than the minimum amount of £5,000 regarded by Prudential's actuaries as enough to accumulate funds in the plan after covering the charges.

I'd also expect advice to have been given on Mr M's occupational scheme benefits. Prudential hasn't been able to provide a copy of the application form Mr M would have

completed. But it has provided a copy of a specimen form. This asks for details of employment, including *"In respect of service to which DSS contributions relate, are you a member of an occupational pension scheme (other than a scheme which provides benefits only on death)?"*

Mr M would have had to complete the application form in order to contract out of SERPS, so I consider it likely he would have been advised on his occupational scheme benefits.

Mr M's representative has said it wasn't suitable to put Mr M's funds in a with-profits fund, due to the lack of diversification and higher level of risk. I appreciate diversification is a well-known risk management tool, but the risks have to be considered in the context of the type of plan arranged. Prudential says the funds were invested in a spread of asset classes, which would generally be the case with these types of funds, and the Members' Booklet confirms this. Mr M had around 30 years to retirement date, and that would generally be enough time to take some risk. In the circumstances, I'm not persuaded that the fund was unsuitable.

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

For the reasons I've set out above, at the time that Mr M contracted-out in 1989 it was thought – using conservative assumptions – that given his age and level of earnings he would likely be better off at retirement by contracting out of SERPS. I think it's likely Mr M was told the benefits at retirement date depended on the performance of the investments and there were no guarantees. He had a long time until retirement, so was able to take a higher amount of risk. Given Mr M's age and earnings, I think it would have been considered likely he would improve on the benefits that would otherwise have been obtained from SERPS by contracting out.

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

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

As things turned out, Mr M may have ended up worse off as a result of contracting out. But I have to consider the advice in the context of what was known at the time, not with the benefit of hindsight.

Mr M is also unhappy that Prudential initially upheld his complaint, and then changed the outcome of this once it had received some additional information. Prudential did initially say it would uphold the complaint. After receiving further information, it began calculations which led to further enquiries about his circumstances at the time of the advice. After considering all the information, Prudential said it believed the advice was suitable. I've explained why I think the advice given in 1989 was suitable at the time. So I don't think the complaint should be upheld. But I can understand it would have been upsetting for Mr M to think his complaint was being upheld only to find out that wasn't the case.

Prudential offered Mr M £250 compensation for this and sent a cheque to him for that amount. I've considered the circumstances and think that's a fair sum for the disappointment caused by thinking the complaint would be upheld and then being told it would not. It's not clear if the cheque was cashed. If Mr M did receive the money there's no need for Prudential to do anything further. But if he hasn't had the money then Prudential should now make the payment to him.

My final decision

The Prudential Assurance Company Limited has already made an offer to pay £250 to settle the complaint and I think this offer is fair in all the circumstances.

So my decision is that if it hasn't already paid Mr M, the Prudential Assurance Company Limited should pay him £250.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 12 September 2022.

Peter Whiteley
Ombudsman