DRN-3683414

The complaint

Mr M complains about the advice AFH Independent Financial Services Limited ('AFH') gave to transfer the benefits from his defined-benefit ('DB') occupational pension scheme, the British Steel Pension Scheme ('BSPS') to a self-invested personal pension ('SIPP'). He's concerned the advice may not have been suitable for him and might have caused a financial loss.

The firm which provided Mr M with the advice was operating under a different name to AFH. But as AFH is responsible for responding to the complaint, for ease of reading, I will only refer to AFH within this decision.

What happened

In March 2016, Mr M'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'). The PPF acts as a 'lifeboat' for insolvent DB pension schemes, paying compensation to members of eligible schemes for their lifetime. The compensation levels are, generally, around 90% of the level of the original scheme's benefits for deferred pensions. But the PPF's rules and benefits may differ from the original scheme. Alternatively, members of the BSPS were informed they could transfer their benefits to a private pension arrangement.

In May 2017, the PPF made the announcement that the terms of a Regulated Apportionment Arrangement (RAA) had been agreed. That announcement included that, if risk-related qualifying conditions relating to funding and size could be satisfied, a new pension scheme sponsored by Mr M's employer would be set up – the BSPS2. The RAA was signed and confirmed in August 2017 and the agreed steps were carried out shortly after.

The BSPS provided Mr M with a summary of the transfer value of his scheme benefits, following the RAA taking effect. These benefits had a cash equivalent transfer value ('CETV') of £383,377.

In October 2017, members of the BSPS were sent a "time to choose" letter which gave them the options to either stay in the BSPS and move with it to the PPF, move to the BSPS2 or transfer their BSPS benefits elsewhere.

Mr M's recollection is that he chose to opt into the BSPS2. As he remained concerned about what the recent announcements by his employer meant for the security of his pension. He contacted AFH for advice and met with it in December 2017.

AFH conducted a fact-find with Mr M and an assessment of his attitude to risk. At that time Mr M was 48 years old and separated from his wife. He had four children aged between 7 and 19. He owned his home, which was worth around £140,000 subject to a mortgage of around £101,000. He had no other debts. He earned a basic salary of £31,000 a year. He had savings of £1,000.

AFH obtained transfer value analysis reports ('TVAS') and income drawdown reports (cashflow models). In January 2018 it produced a "retirement options report" setting out its analysis and recommendations – such reports are generally referred to as suitability reports. I will use that term in this decision.

AFH recommended Mr M should transfer his DB scheme funds into a named SIPP. It noted that it was "highly unlikely" that transferring would allow Mr M to achieve the growth rates required to match the DB scheme benefits (the critical yields), from either the BSPS2 or the PPF. It said that if Mr M wanted a secure pension for his lifetime he should take the benefits directly from the BSPS2. However, while setting out the risks involved in making a transfer, it recommended he do so as that would:

- Allow him to retire at age 55 while using £40,000 of his tax free cash ('TFC') lump sum to pay off his remaining mortgage.
- Allow him to access his funds in a flexible manner including reducing his income when his state pension became payable at age 67.
- Let him leave whatever was remaining in his fund as a legacy for his children on his death.
- Avoid the risk of the BSPS2 moving to the PPF at some point in the future.

Mr M accepted AFH's recommendation and transferred his DB scheme funds into the named SIPP.

In 2022 Mr M complained, via the Financial Ombudsman Service, that AFH's advice might not have been suitable for him. We passed his complaint on to AFH. AFH replied in April 2022. It didn't uphold the complaint. Amongst other things it said its cashflow models showed that transferring allowed Mr M to retire early at age 55 while paying off his mortgage and living off a net income of £15,000 a year. He could also leave any residual pension to his children on his death. AFH added that he couldn't achieve those objectives while remaining in the DB scheme.

Mr M asked us to consider his complaint. One of our Investigators looked into it. He didn't think AFH's advice was suitable for Mr M. The Investigator recommended Mr M's complaint be upheld. In short the Investigator said he didn't think AFH's cashflow models were realistic. He also didn't think that AFH had done enough to challenge Mr M's objectives of retiring at age 55 with an income of £15,000. So he said AFH should establish if Mr M had suffered a financial loss as a result of its unsuitable advice and if so pay him compensation.

AFH didn't reply to the Investigator's assessment. So, because things couldn't be resolved informally, the complaint was referred to me to make 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 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'). And 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 AFH'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.

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

Having considered all of this and the evidence in this case, I've decided to uphold the complaint for broadly similar reasons to those our Investigator gave.

My findings

AFH obtained TVAS reports which showed the relevant critical yields to match the benefits from the BSPS2 and the PPF. It did so for several scenarios including if Mr M took early retirement at age 55. It also obtained a TVAS if Mr M were to buy an annuity on a single life basis (where no spouse's pension was required on his death) given that he was soon to be divorced. Having done so AFH concluded that transferring his DB funds to a SIPP would be unlikely to achieve the required critical yields to match the DB scheme benefits. It said if Mr M required a secure income he should take the benefits from the BSPS2.

In other words AFH recognised that transferring would most likely mean Mr M would be worse off in retirement by doing so. I agree with AFH's analysis here. But I don't think it did enough to make it clear to Mr M that he was, most likely, making himself poorer in retirement by transferring.

AFH said Mr M required a gross income in retirement of £15,000 a year. That sum was less than half the gross income Mr M was living on at the time of the advice. AFH said its cashflow models showed that an income at that level would be sustainable from his SIPP from early retirement at age 55 until he was 98 years old. But I don't find AFH's models reliable.

AFH's models assume the funds in Mr M's SIPP would produce returns of 5% each year every year. Such a return was not impossible for an investor with Mr M's attitude to risk. However, given the volatility of the investment markets consistent growth at a level of 5% seems unlikely.

To put this into context, prior to October 2017 the Financial Ombudsman Service published future 'discount rates' in loss assessments where a complaint about a past pension transfer was being upheld. I'll explain that a discount rate is a measure of what an investment is likely to grow at in the future. They provide a useful indication of what growth rates would have been considered reasonably achievable for a typical investor. In Mr M's' case the discount rate for retirement at age 55 was 3.3%, considerably less than AFH's cashflow models' rate of 5%. So the prospect of a 5% year on year return seems very slim.

Further if there was a sustained period of poor investment performance then there was a very real chance that Mr M's fund would grow at a much slower rate. Also AFH's models aren't "stress tested" to allow for the possibility of market crashes or consistent poor performance. So I don't think they paint a complete picture of the likely future scenarios that Mr M could be facing in retirement.

It's also worth noting that AFH's models show that applying a consistent 5% growth, by age 55 the fund in his SIPP would be worth around £480,000. That sum was AFH's starting point for Mr M taking regular income from it. In contrast the SIPP provider also produced models of what Mr M's fund could be worth at retirement. But the SIPP provider used a retirement age of 65, some ten years after the model AFH showed. The SIPP provider's model was adjusted to allow for the effects of inflation and also for all adviser and product charges. That model showed that, at age 65, Mr M's fund would be worth around £436,000, some £44,000 less than AFH's model. But given that it was based on ten years additional growth (to age 65), then it should have been considerably more. The fact that it wasn't indicates that AFH's model possibly didn't account for all the factors which could affect his probable returns. So it didn't show a clear picture.

It follows that I don't think AFH's cashflow models are likely to be representative of Mr M's actual circumstances in retirement.

Further, as I've said above, AFH itself recognised Mr M would be unlikely to match the benefits from his DB scheme by transferring, at any age. So I don't think a transfer out of the DB scheme was in his best interests.

Of course matching the DB scheme income isn't the only consideration when giving transfer advice. There might be other considerations which mean a transfer is suitable, despite providing overall lower benefits. I've considered this below. When doing so I've been mindful that AFH's role was to find out what Mr M's wants and needs were and why. Its role wasn't simply to do what he wanted without appropriate analysis and challenge of his motives for doing so.

AFH said that Mr M wouldn't be able to take early retirement from the DB scheme at age 55, and repay his mortgage. That's because his entitlement from the BSPS2 at age 55 was TFC of £63,071 and a yearly pension of £9,460. Considerably less than the £15,000 a year AFH said Mr M would need in retirement. That said, if Mr M insisted on retiring at age 55 then he would have had income from other sources. As well as any surplus TFC left over after paying his £40,000 mortgage, he was also paying into his employer's recently set up defined contribution ('DC') pension. At that time, Mr M said the contributions were around £240 a month or £2,880 a year. But, unless he or his employer increased their contributions to the DC scheme, that was unlikely to make up the income shortfall by the time Mr M reached 55. But I'm not convinced that Mr M's wish to retire at age 55 was set in stone.

Mr M said he worked a demanding shift pattern which was driving his desire for early retirement. I can fully understand Mr M's wish to retire early. I think most people would say that they would like to retire early if given the chance. I also think most people would understand that having the opportunity to retire early isn't worth compromising their income security for the remainder of their retirement for. It seems to me that this is something Mr M was likely to reassess once he approached 55. And, I think early retirement was something that was – most likely – nice to have rather than a genuine need for him. But, having considered the evidence, I don't think achieving this goal at the expense of the guaranteed benefits from a DB scheme was in his best interests.

I've noted that when he completed the fact-find Mr M's desired retirement age was given as "55/57". So it appears Mr M recognised himself that retiring at age 55 might not be practical and that he might wish to defer it. Mr M was still seven years away from age 55, nine away from 57 and 17 years away from the DB scheme's normal retirement age of 65. And he wouldn't receive his state pension until 67. A lot could happen within the intervening period. And if Mr M had joined the BSPS2 scheme, and he decided that he still wished to transfer nearer to his chosen retirement age, then the BSPS2 would have allowed him the flexibility to do that. So he had no need to transfer when he did.

As I've said above I can understand why Mr M would want to retire at age 55. But, for most people, early retirement means a significant drop in income. And that would dramatically reduce most individuals' spending power and lifestyle choices. So, when faced with that prospect at an early retirement age, most people choose not to retire. Instead they opt to continue working to support their current and future lifestyle options. And that's seems to be a more likely prospect for Mr M. But there's no evidence AFH seriously challenged his preference for early retirement at age 55. So I don't think it met its obligations to challenge his objectives in light of what he would be giving up.

AFH also said a benefit of Mr M transferring was that it would give him the flexibility to reduce his income when his state pension became payable at age 67. I'm struggling to understand how this would be of benefit to Mr M. Making oneself poorer is rarely a positive situation for most people. And while the higher amounts of income he would receive, if he received his state pension on top of his BSPS2 income would inevitably lead to him paying more tax, that would only be because his income had increased. In other words he would have more money to spend, save or enjoy as he chose.

In contrast reducing the amount he drew down from his SIPP at age 67, as AFH's cashflow models showed, might mean the SIPP funds last longer but it would only allow Mr M to tread-water in terms of income levels. So he wouldn't see any tangible benefit of his state pension once that became payable, despite having contributed to it for all of his working life. I don't see how reducing his income and making himself poorer by doing so was in his best interests.

That said it's true to say Mr M couldn't have had the same level of flexible access to his DB funds as he could from a SIPP. While he could have chosen to take those early, if he'd wanted to take TFC, then he would have had to take that at the same time as drawing a regular income from his pension. Whereas the SIPP would allow him to draw down funds as he saw fit. But while I can see why that might have been an attractive prospect for him, it's not the case that he wouldn't have had any flexible access to cash if he didn't transfer.

As I've said above Mr M and his employer had begun contributing to a recently set up DC pension scheme. The nature of a DC pension means this already provided Mr M with some flexibility – he wasn't committed to take its benefits in a set way. Mr M could have taken lump sums from it as and when required and adjusted the income he took from it according to his needs. So, I think if Mr M retained his DB pension, this combined with his new workplace pension, would have likely given him flexible access to pension funds if that was what he needed.

In addition, if AFH had advised Mr M to remain in the BSPS2 and he'd later decided he needed greater flexibility than the scheme provided, then he could have chosen to transfer from that scheme nearer to his retirement age. And I think this was something that he could have explored closer to his intended retirement age; it wasn't a decision he needed to make straightaway.

AFH also said a transfer was suitable because it would allow Mr M to leave any residual funds to his children on his death. I'm aware Mr M was separated and planning to divorce. So the spouse's pension the DB scheme would pay was unlikely to have been important to him. But that assumes that Mr M would never remarry and, given he was only 48, that wasn't certain.

Further, the DB scheme would pay a dependents' benefit for Mr M's children if he was unfortunate enough to die while they were still in education – up to age 23. So the death benefits the DB schemes offered could have been valuable to Mr M's family in the event of his premature death.

In addition while the CETV figure would, no doubt, have appeared an attractive sum to be able to leave as a legacy to Mr M's children that figure wasn't guaranteed unless he died immediately. But, in reality, the sum remaining on death following a transfer was always likely to be different. How much would remain in the fund on Mr M's death depended on a number of factors. And there may not have been much left in his SIPP if he lived a long life, the investments performed poorly, or if he took large sums from the fund early in his retirement.

Further, I'm aware Mr M had death in service cover from his employer. So that would have paid a lump sum in the event he died while still working for the same employer. But, if he wanted to leave a legacy for his family, which didn't depend on his employment, investment returns or how much of his pension fund remained on his death, I think AFH should have instead explored life insurance. I appreciate life insurance can be expensive. So, the starting point ought to have been for AFH to ask Mr M how much he would ideally like to leave to his family, and it could have explored cover on a whole of life or term assurance basis. But there's little evidence it suggested this.

Overall, I don't think different death benefits available through a transfer justified the likely decrease of retirement benefits for Mr M. Also I don't think AFH properly explored the option of life insurance as an alternative with him. And ultimately AFH should not have encouraged Mr M to prioritise the potential for alternative death benefits through a SIPP over his security in retirement.

AFH also said that transferring would avoid the risk of Mr M's pension moving to the PPF should that happen to the BSPS2 in the future. I understand Mr M may have legitimately held concerns about how his employer had handled his pension and the prospect of entering the PPF. But it was AFH's role to objectively address those concerns. The "time to choose" exercise had concluded and the BSPS2 was in the process of being established; so every indication was the BSPS2 would be viable. But even if not, the PPF would still provide Mr M with a guaranteed income, the possibility of early retirement and the option of accessing TFC. Mr M was unlikely to improve on these benefits by transferring. So, entering the PPF was most likely not as troubling as he might have thought, and I don't think any concerns he held about this meant that transferring was in his best interests.

Overall, I can't see persuasive reasons why it was clearly in Mr M's best interests to give up his DB benefits and transfer them to a personal pension. And I haven't seen anything to persuade me that Mr M would have insisted on transferring, against advice to remain in the DB scheme.

For the above reasons I think AFH's advice to Mr M to transfer out of the DB scheme and into a SIPP was unsuitable for him as it was not in his best interests. So, I think AFH should compensate him 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 M, as far as possible, into the position he/he/they would now be in but for the unsuitable advice. I consider Mr M would most likely have remained in the DB scheme and opted to join the BSPS2 if AFH had given suitable advice.

AFH must therefore undertake a redress calculation in line with the rules for calculating redress for non-compliant pension transfer advice, as detailed in policy statement PS22/13 and set out in the regulator's handbook in DISP App 4:
https://www.handbook.fca.org.uk/handbook/DISP/App/4/?view=chapter.

AFH should use the FCA's BSPS-specific redress calculator to calculate the redress. A copy of the BSPS calculator output should be sent to Mr M and the Financial Ombudsman Service upon completion of the calculation together with supporting evidence of what AFH based the inputs into the calculator on.

For clarity, Mr M has not yet retired, and as far as I'm aware has no plans to do so at present. So, compensation should be based on the scheme's normal retirement age, as per the usual assumptions in the FCA's guidance.

This calculation should be carried out using the most recent financial assumptions in line with DISP App 4. In accordance with the regulator's expectations, this should be undertaken or submitted to an appropriate provider promptly following receipt of notification of Mr M acceptance of my final decision.

If the redress calculation demonstrates a loss, as explained in policy statement PS22/13 and set out in DISP App 4, AFH should:

- calculate and offer Mr M redress as a cash lump sum payment,
- explain to Mr M before starting the redress calculation that:
    - his redress will be calculated on the basis that it will be invested prudently (in line with the cautious investment return assumption used in the calculation), and
    - a straightforward way to invest his redress prudently is to use it to augment his SIPP
- offer to calculate how much of any redress Mr M receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr M accepts AFH's offer to calculate how much of his redress could be augmented, request the necessary information and not charge Mr M for the calculation, even if he ultimately decides not to have any of his redress augmented, and
- take a prudent approach when calculating how much redress could be augmented, given the inherent uncertainty around Mr M's end of year tax position.

Redress paid to Mr M as a cash lump sum will be treated as income for tax purposes. So, in line with DISP App 4, AFH may make a notional deduction to cash lump sum payments to take account of tax that consumers would otherwise pay on income from their pension. Typically, 25% of the loss could have been taken as tax-free cash and 75% would have been taxed according to Mr M's likely income tax rate in retirement – presumed to be 20%. So making a notional deduction of 15% overall from the loss adequately reflects this.

Where I uphold a complaint, I can award fair compensation of up to £170,000, 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 £170,000, I may recommend that the business pays the balance.

My final decision

Determination and money award: I uphold this complaint and require AFH Independent Financial Services Limited to pay Mr M the compensation amount as set out in the steps above, up to a maximum of £170,000.

Recommendation: If the compensation amount exceeds £170,000, I also recommend that AFH Independent Financial Services Limited pays Mr M the balance.

If Mr M accepts this decision, the money award becomes binding on AFH Independent Financial Services Limited.

My recommendation would not be binding. Further, it's unlikely that Mr M can accept my decision and go to court to ask for the balance. Mr M 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 M to accept or reject my decision before 16 November 2023.

Joe Scott
Ombudsman