DRN-3690125

The complaint

Mrs M complains about the suitability of the advice provided by Sovereign Private Clients Limited ("Sovereign") in 2017 to transfer the value of her three personal pension plans ("PPPs") and safeguarded benefits in two defined benefits pension schemes ("DB schemes") to a new PPP.

Mrs M is represented in this complaint by a law firm ("Representative").

What happened

The events leading up to this complaint were set out in detail by our investigator in her assessment which she provided to both the Representative and Sovereign. I don't intend to repeat here what our investigator stated but will instead provide a summary.

During her working life, Mrs M had built up benefits in five different pension arrangements. In January 2017, she met a representative of Sovereign to discuss her pension planning. A fact find document was completed which recorded details about Mrs M's personal and financial circumstances, summarised as follows:

- She was 47, in good health, married and had three financially dependent children aged between 3 and 9. She hoped to retire at her State pension age of 67;
- She was a homemaker in receipt of State benefits of £230 per month;
- Other than her five existing pension arrangements at the centre of this complaint, her only other asset was a 50% share of the marital home valued at £130,000;
- She and her husband had an outstanding repayment mortgage of £47,000 on the marital home. She didn't have any other liabilities;
- Her risk profile was recorded as 4 out of 10, where 1 was low risk and 10 high risk;
- She had limited investment experience which had been gained from investing in the three PPPs at the centre of this complaint; and
- In terms of her pension planning objectives, she wanted to consolidate her five existing pension arrangements into a single plan to reduce administration, to maximise the death benefits for her family in the event of her early death and to generate improved investment returns.

Sovereign recommended that Mrs M transfer the value of her five existing pension arrangements into a new PPP. She accepted the recommendation. This resulted in a total amount of about £106,820 being transferred to the new PPP, as follows:

Scheme type	Approximate transfer value paid into new PPP
DB scheme	£42,946
DB scheme	£15,464

PPP	£23,303
PPP	£21,208
PPP	£3,899

Based on the terms and conditions signed by Mrs M, the costs and charges associated with Sovereign's recommendation were as follows:

Initial charge

- £5,270 – initial advice fee

Ongoing annual charges based on the new PPP fund value

- 1% – ongoing advice charge
- 0.65% – PPP investment fee
- 0.4% – PPP annual management charge

This complaint

In March 2021, on behalf of Mrs M, the Representative complained to Sovereign about the suitability of the advice it provided to her in 2017. In the Representative's view, Sovereign had failed to act in Mrs M's best interests when it recommended the transfer which had resulted in her suffering a financial loss. To put things right, it requested that Sovereign pay compensation to Mrs M.

Sovereign didn't uphold Mrs M's complaint.

Our investigator requested information from Sovereign regarding the recommendation it had provided to Mrs M in 2017. While Sovereign provided a copy of the completed fact find document, risk profiler and some other documents, it failed, despite multiple chasers, to provide a copy of its suitability report setting out the reasons for its recommendation or details of any transfer analysis it had carried out. Based on the limited evidence available, our investigator recommended that this complaint should be upheld. This was because it couldn't be shown that relinquishing benefits in the two DB schemes or switching the value of three existing PPPs into a new PPP was in Mrs M's best interests. To put things right, our investigator recommended that Sovereign carry out a redress calculation and pay any redress due to Mrs M on the basis that she would be a basic rate income taxpayer in retirement. Our investigator explained to Sovereign that it should calculate redress in two steps:

- Step 1 – for the two DB schemes, carry out a loss assessment in line with the FCA's *'Finalised Guidance 17/9: Guidance for firms on how to calculate redress for unsuitable DB pension transfers'*; and

- Step 2 – for the three PPPs, carry out a fund value comparison between the performance of the new PPP and a benchmark (50% FTSE UK Private Investors Income Total Return Index and 50% average rate from fixed rate bonds).

The Representative accepted our investigator's assessment and recommended remedy. It subsequently confirmed that Mrs M preferred to wait for the outcome of the FCA's consultation announced on 2 August 2022 before redress is calculated and settled by Sovereign. The consultation closed on 27 September 2022 with any changes expected to be implemented in early 2023.

Sovereign told our investigator that it didn't agree with her assessment and requested the matter be referred to an ombudsman for review. Sovereign didn't explain why it disagreed or provide any additional evidence for the ombudsman to consider.

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.

When considering what's fair and reasonable, and in accordance with the Financial Services and Markets Act 2000 and the Dispute Resolution section in the FCA's handbook, I need to take into account relevant: law and regulations; regulators' rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

I'd like to clarify that the purpose of this final decision isn't to repeat or address every single point raised by the Representative and Sovereign. If I haven't commented on any specific point, it's because I don't believe it's affected what I think is the right outcome.

The FCA's suitability rules and guidance

Sovereign was authorised and regulated by the FCA at the time it provided the recommendation to Mrs M. This meant that when it advised her it was required to adhere to the suitability rules and guidance in the Conduct of Business Sourcebook ("COBS") section in the FCA's Handbook. In assessing the suitability of Sovereign's recommendation, it's necessary for me to have due regard to these rules and guidance.

Primarily, Sovereign was required under COBS 2.1.1R to *"act honestly, fairly and professionally in accordance with the best interests of its client"* in its dealings with Mrs M.

The suitability rules and guidance that applied when Sovereign provided its recommendation to Mrs M were set out in COBS 9. The purpose of the rules and guidance are to ensure that businesses take reasonable steps to provide advice that is suitable for their clients' needs and to ensure they're not inappropriately exposed to a level of risk beyond their investment objectives and risk profile. To ensure that this is the case, and in line with the requirements in COBS 9.2.2R, the business must gather the necessary information for it to be confident its advice is suitable. Broadly speaking, this section of COBS 9 sets out the requirement for a regulated advisory business to undertake a "fact find" process.

There were also specific requirements and guidance relating to pension transfers involving safeguarded benefits, as was applicable to Mrs M's case – these were contained in COBS 19.

COBS 19.1.2R required the following:

> *"A firm must:*
>
> *(1) compare the benefits likely (on reasonable assumptions) to be paid under a defined benefits pension scheme or other pension scheme with safeguarded benefits with the benefits afforded by a personal pension scheme, stakeholder pension scheme or other pension scheme with flexible benefits, before it advises a retail client to transfer out of a defined benefits pension scheme or other pension scheme with safeguarded benefits;*

(2) ensure that that comparison includes enough information for the client to be able to make an informed decision;

(3) give the client a copy of the comparison, drawing the client's attention to the factors that do and do not support the firm's advice, in good time, and in any case no later than when the key features document is provided; and

(4) take reasonable steps to ensure that the client understands the firm's comparison and its advice."

Under the heading "Suitability", COBS 19.1.6G set out the following:

"When advising a retail client who is, or is eligible to be, a member of a defined benefits occupational pension scheme or other scheme with safeguarded benefits whether to transfer, convert or opt-out, a firm should start by assuming that a transfer, conversion or opt-out will not be suitable. A firm should only then consider a transfer, conversion or opt-out to be suitable if it can ***clearly*** *demonstrate, on* ***contemporary evidence****, that the transfer, conversion or opt-out is in the client's best interests." [my emphasis added]*

COBS 19.1.7G also stated:

"When a firm advises a retail client on a pension transfer, pension conversion or pension opt-out, it should consider the client's attitude to risk including, where relevant, in relation to the rate of investment growth that would have to be achieved to replicate the benefits being given up."

And COBS 19.1.8G stated that:

"When a firm prepares a suitability report it should include:

(1) a summary of the advantages and disadvantages of its personal recommendation;
(2) an analysis of the financial implications (if the recommendation is to opt-out); and
(3) a summary of any other material information."

Businesses are required to adhere to these rules and guidance because the FCA considers safeguarded benefits to be valuable. Based on the above regulatory rules and guidance, businesses advising on pension transfers should start by assuming that the existing DB scheme is suitable and only to recommend a transfer, which converts safeguarded benefits into flexible benefits, if it can clearly demonstrate it's in their client's best interests.

In addition to the requirements set out in COBS 9 and COBS 19, the regulator issued a report in December 2008 titled *"Quality of advice on pension switching".* The report summarised the findings of the regulator's thematic review on the quality of advice given to customers since pensions A-day on 6 April 2006 to switch the value of their pensions into a new PPP. The regulator stated:

"We assessed advice as unsuitable when the outcome was the customer switching into one of the following:

- *A pension incurring extra product costs without good reason (this outcome involved assessing cases where, for example, the reason for the switch was for investment flexibility, but this was not likely to be used; the reason was fund performance, but there was no evidence the new scheme was likely to be better; or the reason was* *flexibility of a drawdown option, but there was no evidence that this option was needed).*

- *A pension that was more expensive than a stakeholder pension, but a stakeholder pension would have met the customer's needs.*

- *A more expensive pension in order to consolidate different pension schemes, but where the extra cost was not explained or justified to the customer.*

- *A new pension and the customer had lost benefits from their ceding pension (for example, guaranteed annuity rates) without these being explained or justified.*

- *A pension that did not match the customer's attitude to risk and personal circumstances.*

- *A pension where there was the need for ongoing advice, but this had not been explained, or offered, or put in place."*

<u>*Was Sovereign's recommendation suitable?*</u>

Sovereign recorded that Mrs M's had three main objectives:

- **Consolidation:** to consolidate her five existing pension arrangements into a single plan to reduce administration;

- **Death benefits:** to maximise the death benefits for her family in the event of her early death; and

- **Investment returns:** to generate improved investment returns.

Sovereign recommended that Mrs M transfer the value of her five existing pension arrangements into a new PPP to achieve these objectives.

Mrs M was then 47, in good health, married and had three financially dependent children aged between 3 and 9. She hoped to retire at her State pension age of 67. She was a homemaker in receipt of State benefits of £230 per month. Given her employment status and the age of her children, I think it's fair to say she had limited scope to build up additional pension provision in the foreseeable future and so she'd be heavily reliant on the value of these benefits in addition to her State pension to support her standard of living in retirement. Other than her pension arrangements at the centre of this complaint, she didn't have any other investments or savings. She had limited investment experience. She had a low/medium risk profile and limited capacity for loss. All these factors strongly suggest to me that Mrs M should've been advised to retain her safeguarded benefits in the two DB schemes and to leave the three existing PPPs where they were.

In response to this service's information request, Sovereign provided limited documents. Despite multiple chasers, it failed to provide a copy of its suitability report setting out the reasons for its recommendation or details of any transfer analysis it had carried out. It was a regulatory requirement for Sovereign to prepare a suitability report and to carry out appropriate transfer analysis. The failure to provide these key documents was explicitly mentioned by our investigator in her assessment when she recommended that this complaint should be upheld. So Sovereign was made aware how important these documents were in helping this service carry out an independent investigation into the suitability of its recommendation. When Sovereign told our investigator that he disagreed with her assessment it didn't explain why. And it didn't provide any additional evidence or explain why it was unable to do so.

I'm satisfied that this service has given Sovereign adequate time and opportunity to provide additional documentary evidence including a copy of its suitability report and details of any transfer analysis it carried out. Under COBS 9.5.2R, Sovereign had a regulatory duty to retain its records relating to suitability indefinitely for the part of its recommendation for the two DB schemes and for at least five years for the part relating to the three PPPs. So it should still have these records. It's unclear to me why it hasn't been able to provide the information requested by this service – it hasn't provided any explanation. Because of this, I think it's fair to say that Sovereign has failed to cooperate fully with this service.

Our investigator asked Mrs M if she had retained any documents such as a suitability report or transfer analysis report, but she hasn't been able to provide any documents either.

This means that I'm required to reach on a final decision on this case based on the limited available evidence. I've set out my findings below under separate headings.

Consolidation

Just because Mrs M may have been attracted to the idea of consolidating her five existing pension arrangements into a single plan to reduce her administration, it didn't mean she needed to do so or that Sovereign should've recommended it. It was for Sovereign to demonstrate that it was suitable and in Mrs M's best interests to do this.

It's not in dispute that the consolidation into a new PPP led to Mrs M relinquishing valuable guarantees under the two DB schemes. I haven't seen any evidence that Sovereign complied with the FCA's requirements under COBS 19.1.2R in connection with this. And it may have been the case that switching the three PPPs to a new PPP led to additional costs or the loss of valuable features without good reason – but since Sovereign hasn't provided details of any transfer analysis it carried out, it's impossible to say. Based on what I've seen, I'm not satisfied it was suitable for Mrs M to consolidate her five existing pension arrangements into a new PPP or that it was in her best interests to do so to achieve her objective of reduced administration.

Death benefits

Like most individuals, I can understand that Mrs M may have wanted to maximise death benefits for her family in the event of her early death.

The recommended PPP offered flexible death benefits – nominated beneficiaries could choose to convert the fund value to secure a lifetime annuity, death lump sum or income drawdown or any combination of these. Based on the applicable tax rules, if death occurred under 75 the benefits are paid free of income tax – after 75 the benefits are taxed at the beneficiary's marginal rate of income tax. It's fair to say that immediately following the transfer to the PPP and for the period until Mrs M could draw any benefits from 55 onwards, the death benefits available would be significant (subject to investment performance) due to the simple fact she couldn't access and deplete the fund value for at least eight years.

But Mrs M was recorded as being in good health. So she could expect normal life expectancy into her 80s. As noted above, it's my view that she'd be heavily reliant on the value of her pension benefits at the centre of this complaint to support her standard of living in retirement. So it was likely that withdrawing money from these benefits from 67 onwards in line with her preferred retirement age would mean that the size of the fund remaining in later years – when death is more likely – could be much smaller than expected.

It's my view that Mrs M had no health issues at the time Sovereign advised her which might reasonably have prompted her to relinquish the guarantees under the two DB schemes for the sake of an enhanced safety net for her family. And as for the three existing PPPs, on death they likely would've paid a lump sum equivalent to the fund value – the same as the recommended PPP. So there wasn't any difference in the format of death benefits across the PPPs.

So, taking all of the above into account, I'm not convinced there was any real merit in Mrs M transferring to a new PPP at that time to provide improved death benefits. There's simply no evidence that this was required for Mrs M's family at the time.

Investment returns

It appears that the transfer to the new PPP led to Mrs M incurring an initial advice fee of about £5,270 and total ongoing annual charges of 2.05%, the cost of which would be deduced from her PPP. Given that Mrs M was meant to invest in the new PPP on a low/medium risk basis in line with her recorded risk profile, I think, in the absence of any transfer analysis information, the initial and ongoing annual charges would've likely materially impacted the opportunity for improved investment returns over and above the five existing pension arrangements.

Had Mrs M retained her safeguarded benefits in the two DB schemes she wouldn't have had to worry about investment performance or incurred any ongoing costs. As for the three existing PPPs, it's unclear what the ongoing charges were for these plans since Sovereign hasn't provided to this service details of any transfer analysis it carried out at the time. Therefore, I haven't seen any evidence to show that the investment returns were likely to be better under the recommended PPP compared to the existing pension arrangements.

If properly informed, would Mrs M have transferred anyway?

I haven't seen any evidence that persuades me Sovereign complied with the FCA's rules under COBS 2.1.1R, COBS 9.2.2R and COBS 19.1.2R, or followed its suggested guidance under COBS 19.1.6G, COBS 19.1.7G and COBS 19.1.8G. As a result, it's my view that suitability cannot be demonstrated and so it's fair and reasonable to uphold this complaint.

In potential mitigation of Sovereign's advice, I've also thought about whether Mrs M, if placed in a fully informed position, would nevertheless have decided to transfer the value of her five existing pension arrangements to the new PPP. This was a complex transaction involving many factors which Mrs M, as a layperson, wouldn't have been familiar. It's my view that she was heavily reliant on Sovereign, as the professional party in the transaction, to take those factors into account and provide suitable, balanced advice. Given Mrs M's reliance on Sovereign to provide expert advice, I think it's unlikely, on balance, she would've transferred against its advice had it advised her to retain her benefits in the two DB schemes and leave her three existing PPPs where they were, as I think it ought to have done based on the available evidence.

Putting things right

Since Sovereign's recommendation involved advice on safeguarded benefits in two DB schemes and defined contributions in three PPPs, redress will need to be calculated in two steps, as previously mentioned by our investigator.

Step 1 – assessing redress for the relinquished benefits under the two DB schemes

On 2 August 2022, the FCA launched a consultation on new DB pension transfer redress guidance and set out its proposals in a consultation document - CP22/15-calculating redress for non-compliant pension transfer advice**.** The consultation closed on 27 September 2022 with any changes expected to be implemented in early 2023.

In this consultation, the FCA stated that it considers the current redress methodology in Finalised Guidance (FG) 17/19 (Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers) remains appropriate and fundamental changes aren't necessary. However, its review has identified some areas where it considers it could improve or clarify the methodology to ensure it continues to provide appropriate redress.

The FCA stated that it expects firms to continue to calculate and offer compensation to their customers using the existing guidance in FG 17/9 while the consultation takes place. But until changes take effect firms should give customers the option of waiting for their compensation to be calculated in line with any new rules and guidance that may come into force after the consultation has concluded.

Our investigator previously asked Mrs M whether she preferred any redress to be calculated now in line with current guidance or wait for the any new guidance and rules to be published. She confirmed, via her Representative, that she would like to wait for the outcome of the consultation before redress is calculated and settled. I consider it's fair that Sovereign waits for the outcome of the consultation to settle this complaint.

A fair and reasonable outcome would be for Sovereign to put Mrs M, as far as possible, into the position she would now be in but for its unsuitable advice. I consider she would've retained her safeguarded benefits in the two DB schemes.

The basic objective of the proposed amendments to the redress methodology still aims to put a consumer, as far as possible, into the position they would be in if the business had advised them to remain in the DB scheme. Having reviewed the FCA's consultation and its proposed updates to the DB transfer redress methodology, I'm satisfied that the proposed changes will, if ultimately implemented, still reflect a fair way to compensate Mrs M.

I therefore don't consider it necessary for me to wait for any new guidance or rules to come into effect to determine this complaint.

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

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

Step 2 – assessing redress for the three PPPs

My aim is that Mrs M should be put as closely as possible into the position she would probably now be in if she'd been given suitable advice. I take the view that Mrs M would've invested differently under the three PPPs. It's not possible to say precisely what she would've done differently. But I'm satisfied that what I've set out below is fair and reasonable given Mrs M's circumstances and objectives when she invested.

To compensate Mrs M fairly, Sovereign must compare the performance of Mrs M's PPP that it recommended with that of the benchmark shown below. If the actual value is greater than the fair value, no compensation is payable. If the fair value is greater than the actual value there's a loss and compensation is payable. Sovereign should add interest as set out below.

Investment name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
New PPP	Still exists and liquid	*For half the investment:* FTSE UK Private Investors Income Total Return Index; *for the other half:* average rate from fixed rate bonds	Date of investment	Date of my final decision	8% simple per year from final decision to settlement (if not settled within 28 days of Sovereign receiving Mrs M's acceptance)

Actual value

This means the actual amount payable from Mrs M's PPP at the end date.

Fair value

This is what the PPP would've been worth at the end date had it produced a return using the benchmark.

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Sovereign should use the monthly average rate for one-year fixed-rate bonds as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any additional sum paid into the PPP should be added to the *fair value* calculation from the point in time when it was actually paid in.

Why is this remedy suitable?

I've decided on this method of compensation because:

- Mrs M wanted capital growth with a small risk to her capital.

- The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to her capital.

- 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.

- I consider that Mrs M's risk profile was in between, in the sense that she was prepared to take a small level of risk to attain her investment objectives. So, the 50/50 combination would reasonably put Mrs M into that position. It doesn't mean that Mrs M would've invested 50% of her money in a fixed rate bond and 50% in some kind of index tracker investment. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mrs M could've obtained from investments suited to her objective and risk attitude.

If the redress calculation in Steps 1 and 2 above demonstrates a loss, the compensation should, if possible, be paid into Mrs M's PPP. The payment should allow for the effect of charges and any available tax relief. The compensation shouldn't be paid into the PPP if it would conflict with any existing protection or allowance.

If a payment into the PPP isn't possible or has protection or allowance implications, it should be paid directly to Mrs M 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've been taken as tax-free cash and 75% would've been taxed according to her likely income tax rate in retirement – which I've decided is likely to be 20%, in line with our investigator's previous assumption. So making a notional deduction of 15% overall from the loss adequately reflects this.

The compensation amount must, where possible, be paid to Mrs M within 90 days of the date any changes to DB pension transfer redress guidance or new rules come into effect and Sovereign has received notification of Mrs M's acceptance of this final 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 pension 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 Sovereign to pay Mrs M.

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

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £160,000, I may recommend the business to pay the balance.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My decision is that Sovereign should pay Mrs M the amount produced by the calculations – up to a maximum of £160,000 plus any interest on the amount set out above.

Recommendation: If the amount produced by the calculations of fair compensation exceeds £160,000, I recommend that Sovereign pays Mrs M the balance plus any interest on the amount as set out above.

This recommendation is not part of my determination or award. It doesn't bind Sovereign. It's unlikely that Mrs M can accept my decision and go to court to ask for the balance. She may want to consider getting independent legal advice before deciding whether to accept this final decision.

The loss assessment calculation should be provided to Mrs M's Representative in an easy to understand format.

My final decision

I uphold this complaint. Sovereign Private Clients Limited must redress Mrs M as I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs M to accept or reject my decision before 15 December 2022.
Clint Penfold
Ombudsman