DRN-3765042

The complaint

Ms M complains about the advice given by Hilltop Finance Limited ('HFL') to transfer the benefits from her defined-benefit ('DB') occupational pension scheme to a personal pension. She says the advice was unsuitable.

Ms M is being represented by a third party but for ease of reading this decision I'll largely refer to representations as being made by Ms M.

What happened

Ms M was put in contact with HFL in late 2017 by her trade union, to discuss her pension.

A summary of the transfer value of Ms M's benefits was obtained from the DB scheme in January 2018. This set out the length of pensionable service, her normal retirement date (which was in February 2019) the pension she was entitled to at the date she left the scheme and gave the cash equivalent transfer value ('CETV') of her pension benefits, which was £71,230.84.

HFL completed a fact-find to gather information about Ms M's circumstances and objectives. It noted she was 63, single and had a daughter in her twenties, who was not financially dependent on her. Ms M was not working and indicated she'd left her previous job due to ill health so was effectively medically retired. Ms M informed HFL of several health conditions she was dealing with. Ms M's income was made up entirely of benefits at the time. She owned her own home with no mortgage and had an outstanding credit card balance of approximately £1,000, which she was repaying at a rate of £100 per month. Ms M indicated she expected to begin receiving her state pension from age 65. And her DB scheme was the only private retirement provisions she had in place.

The fact-find indicated that Ms M wanted to know what her pension benefits were worth and when she could access them. It also said she hoped to maintain a similar income in retirement to what she was receiving at the time through benefits. It said Ms M didn't have any set plans for her pension but thought flexibility to allow her to access money as and when needed, rather than a fixed income might be useful. It also noted that she may choose to take tax-free cash ('TFC') to purchase a new car and may want to help her daughter with a deposit on a house in the future. But it said her main concern was to ensure, in the event of her death, her daughter received the maximum possible benefit.

HFL also carried out an assessment of Ms M's attitude to risk, which it deemed to be 'cautious to moderate'.

On 21 February 2018, HFL advised Ms M to transfer her pension benefits into a personal pension. The suitability report said Ms M was now 64 and would like to start accessing her pension funds at age 65. It said she wanted an income of £9,104 per year in retirement, which was in line with what she currently received. Based on what Ms M had told HFL she thought her state pension entitlement was likely to be, it said this, plus the portion of her state benefits that would continue into retirement, would meet, and indeed exceed, her income need (although it said she should obtain confirmation of her state pension entitlement). HFL said, after it had discussed the DB scheme with Ms M, she wanted the option to access TFC as and when needed, rather than having to take a fixed income. And it reiterated she was interested in alternative death benefits.

HFL said there were drawbacks of transferring. It said Ms M would be taking on risk and there was the possibility her fund could run out depending on the level of income she took. It also said it thought the growth required to allow her to purchase equivalent pension benefits to the DB scheme at age 65 was unlikely to be achieved. But overall, it recommended a transfer because the TFC Ms M could take from a personal pension would be higher than under the DB scheme and a personal pension would provide the flexibility and alternative death benefits she wanted. It said it expected the recommended fund to grow by 4.1% per year and estimated that if it did so, by age 90 Ms M would still have a significant sum available to leave to her daughter if she took the pension amount she said she needed each year – although it wasn't clear how much of this would be taken from the transferred scheme.

Ms M complained to HFL in July 2021 about the suitability of the transfer advice. She said the information she'd been given was unclear and confusing, HFL hadn't given her a clear explanation of what she was giving up and she didn't think the transfer was suitable based on her needs and objectives.

HFL didn't uphold Ms M's complaint. It said during the calls it held with Ms M, she'd made it clear she was in poor health, and it was important to her that her daughter benefitted from the pension in the event she passed away. The DB scheme didn't provide this option whereas a personal pension did. So, it felt the transfer was suitable. It also disagreed that it had been unclear in its explanations. HFL said it had made it clear in its recommendation and via phone to Ms M, and her daughter at Ms M's request, the repercussions of the transfer.

Ms M referred her complaint to our service. An investigator upheld the complaint and said HFL should compensate Ms M for any loss the transfer had led to. He said, while Ms M might've had reasons for thinking a transfer was in her interests, it wasn't HFL's role just to put in place what Ms M might've thought she wanted. Rather it needed to give her advice on what was in her best interests. Overall, he thought Ms M was always likely to receive benefits of a lower value as a result of transferring. And, given a pension's purpose is to provide for the holder in retirement, he didn't think any of the other reasons given for transferring outweighed this or made accepting this reduction in benefits suitable for Ms M.

HFL disagreed. It said Ms M's retirement income needs would be met by her state pension and benefits so, not only did she have capacity for loss, she also didn't need to access her DB scheme and to take a regular pension. Therefore, it felt the flexibility provided, which would've allowed Ms M to take TFC for purposes she wanted to use it towards, was a useful feature. And it said Ms M had been very clear that the provision of death benefits was important to her. So, HFL said it thought the advice was suitable based on her specific circumstances and objectives.

Ms M noted in response to the Investigator's opinion that the state benefits HFL said she would be receiving were subject to assessment, so not guaranteed to continue in retirement. And she said these weren't to cover living expenses anyway but the additional costs her health condition might bring about. So, she argued she didn't have the capacity for loss that HFL had said.

The investigator wasn't persuaded to change their opinion, so 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 HFL'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.

Having considered all of this and the evidence in this case, I've decided to uphold the complaint for largely the same reasons given by the investigator.

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, HFL should have only considered a transfer if it could clearly demonstrate that the transfer was in Ms M's best interests. And having looked at all the evidence available, I'm not satisfied it was in her best interests.

Financial viability

HFL carried out a transfer value analysis report (as required by the regulator) showing how much Ms M's pension fund would need to grow by each year in order to provide the same benefits as her DB scheme (the critical yield). This said, as Ms M was about to turn 64 and the normal retirement age of her scheme was 65, the critical yield required to match the benefits the DB scheme would provide from age 65 was 41.96%. So, her fund would need to grow by that much in one year. This was based on her taking a full pension and no TFC. The critical yield wasn't calculated for if she took TFC and a reduced pension. But while this was likely to be lower, it was unlikely to be significantly so.

The advice was given after the regulator gave instructions in Final Guidance FG17/9 as to how businesses could calculate future 'discount rates' in loss assessments where a complaint about a past pension transfer was being upheld. Prior to October 2017 similar rates were published by the Financial Ombudsman Service on our website. Whilst businesses weren't required to refer to these rates when giving advice on pension transfers, they provide a useful indication of what growth rates would have been considered reasonably achievable for a typical investor.

The relevant discount rate closest to when the advice was given which I can refer to was published by the Financial Ombudsman Service for the period before 1 October 2017, and was 2.3% per year for a year to retirement. I've kept in mind that the regulator's projection rates had also remained unchanged since 2014: the regulator's upper projection rate at the time was 8%, the middle projection rate 5%, and the lower projection rate 2%.

I've taken this into account, along with the composition of assets in the discount rate, the term to retirement and Ms M's recorded attitude to risk. There would be little point in Ms M giving up the guarantees available to her through her DB scheme only to achieve, at best, the same level of benefits outside the scheme. But here, I think it is clear that the critical yield was highly unlikely to be achieved and Ms M was always likely to receive benefits of a substantially lower overall value than the DB scheme at retirement, as a result of investing in line with that attitude to risk.

Indeed, the suitability report acknowledged this in the "drawbacks of transferring" section, saying this was extremely unlikely to be achieved. It also said the estimated capital value of Ms M's projected scheme benefits was valued at over £27,000 more than the CETV. So, by taking the value offered she was accepting a potential difference of that amount in her future retirement benefits. But it didn't really explain why accepting this was in her interests.

HFL said in the suitability report that if the fund were to grow by 4.1% per year, which it felt was achievable, and Ms M took a *"net annual income of £9,104 from the age of 65"* it estimated that by age 90 she would have funds remaining in the pension of over £62,000. But it made no reference to how much of this net income amount would be drawn from the personal pension in this apparent estimate. And the 'cashflow analysis' section of the appendices it provided was blank. This level of growth was not guaranteed. And although in calls with Ms M it made reference to the past performance of the recommended fund, as HFL knows, past performance is no guarantee of future returns. The rest of the report also seems to have been based on Ms M's income needs being entirely met by different sources – and her not needing to take any income from the personal pension. But I don't think her drawing no income was a reasonable assumption, as the pension was there to provide for her retirement and her taking no income would mean that *she* was significantly worse off in terms of the retirement benefits received.

Overall, based on what I've seen, from a financial viability perspective I think a transfer out of the DB scheme wasn't in Ms M's best interests.

Of course, financial viability 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 – as HFL has suggested here. I've considered this below.

Flexibility and income needs

HFL says Ms M wanted flexibility to be able to take TFC and income as and when she wanted, rather than receiving a regular income. And she intended to use TFC to purchase a new car – which it argues she needed – and potentially help her daughter with a deposit for a house. So, as the transfer would allow access to more TFC and flexibility, it thinks it was suitable.

Again though, the advice seems to have been based on Ms M's retirement income needs being met by her state pension and benefits and her not needing to or wanting to take a regular income from her retirement provisions. Which again I don't think is reasonable or realistic. HFL has provided our service with call recordings between it and Ms M and Ms M's daughter. In the call with Ms M's daughter, she talked about wanting her mother to have some money to enjoy her retirement and wanting to ensure she wasn't left with nothing. And again, given a pension is designed to provide for the holder in retirement, I think this should've been the focus throughout.

As Ms M has pointed out, the state benefits she was entitled to at the time of the advice were subject to review. These were not guaranteed to continue indefinitely. Her estimated state pension entitlement appears likely to have gone a long way to meeting her income need. But not entirely. The guaranteed pension she'd have received from the DB scheme – if she took either a full pension or TFC and a reduced pension – when combined with her state pension, would've met her stated need. And the pension from the DB scheme would've continued to escalate while in payment. Whereas the amount that could be drawn from a personal pension would be subject to investment risk and could run out. So, taking a guaranteed pension from her DB scheme, would've ensured Ms M received the income she expected to need, throughout her lifetime. It might have provided more than she needed – but she could've enjoyed this in her retirement or used the excess to help her daughter if she so chose. And this would've enabled any state benefits she was entitled to be used for their intended purpose. So, I don't think she needed flexibility for this purpose.

I'm also conscious that the transfer quote from the DB scheme included information suggesting that Ms M could defer taking benefits beyond her normal retirement age. And that her benefit entitlement would increase if she did so. So, if she genuinely hadn't needed to take an income from the DB scheme at age 65, this could've been considered as an alternative. But I can't see that it was.

TFC could've been taken from the DB scheme when Ms M took retirement benefits. HFL indicated Ms M would be able to take more TFC from a personal pension. But I'm not sure she needed this.

There is dispute over how pressing a need purchasing a new car was. But from listening to the call recordings, while this seems to have been something Ms M had thought about, I don't think it was something that she needed to do immediately. And in any event, there was no discussion about how much she'd need for this purpose. Ms M has said that she in fact purchased a new car with financial help from her brother, and this cost approximately £6,000, well below the amount of TFC that the DB scheme could've provided. So, I don't think she needed to transfer to enable this purchase.

HFL has said that Ms M wanted to also potentially help her daughter with a house deposit. And from the call recordings I've been provided, I'm satisfied that this is something that she talked about. But the conversations were also clear that Ms M's daughters living arrangements and requirements were unknown and unlikely to be known for several years as she was still to complete a doctorate and have her employment, and where this would be, confirmed. So, I don't think this was a pressing need at the point of the advice or for that matter a need at all, but rather something that Ms M might like to potentially do in the future. And in the conversation with Ms M's daughter, she explained what they were actually thinking about doing was purchasing a property together, once her arrangements were known, and either renting it out or renting out Ms M's property and living together in the new property, with the aim of providing a further income via rent, at least partially for Ms M in her retirement. So, the focus again from Ms M's daughter's perspective was providing for Ms M's retirement, which the DB scheme already guaranteed to do.

Overall, I don't think Ms M required flexibility in retirement. I don't think she had a strong need for a variable income or a confirmed need for TFC that exceeded what the DB scheme offered. And so, I don't think it was a suitable recommendation to give up her guaranteed benefits, particularly bearing in mind that she was likely to receive lower benefits overall as a result of transferring.

Death benefits

HFL says that death benefits and ensuring the pension provided for her daughter were Ms M's main concern. Having listened to the call recordings provided by HFL, I don't think these support that this was something that Ms M specifically had in mind when she was put in touch with HFL. The recordings indicate it was HFL that first indicated the DB scheme was unlikely to provide death benefits to Ms M's daughter. And that this might be a reason to transfer.

It is clear that this became a concern of Ms M's after this prompting. And this does seem to have been something she became keen to address. But whilst I appreciate death benefits are important to consumers, and Ms M seems to have thought it was a good idea to transfer her DB scheme to a personal pension because of this, the priority here was to advise Ms M about what was best for her retirement provisions. A pension is primarily designed to provide income in retirement. But again, this doesn't appear to have been the focus of HFL's advice, as it seems to have been based on Ms M's state pension and benefits meeting her needs and income from the DB scheme not being needed at all. Which I don't think appropriately considered what was in her best interests.

I don't doubt that the CETV would've been attractive as a lump sum. Indeed, in the call recordings I've been provided, when this figure was first mentioned, Ms M was clearly surprised by it and that so much was potentially available. But the sum remaining on death in a personal pension was dependent on investment performance and how much was withdrawn during Ms M's lifetime. I don't think it was a reasonable assumption that no income would be withdrawn. And the advice didn't cover in any great detail what a sustainable level of income would be. Ms M did have some health conditions. But has said in her complaint that these would not necessarily have impacted her life expectancy. And I agree that Ms M not reaching her life expectancy was only a possibility at the time of the advice and it was also possible that she would exceed this, in which case she'd have been drawing from the pension for longer and the fund may not have had a large sum left by the time it came to be passed on. In any event, HFL should not have encouraged Ms M to prioritise the potential for higher death benefits through a personal pension over her security in retirement. And I don't think different death benefits available through a transfer to a personal pension justified the likely decrease of retirement benefits for Ms M.

Suitability of investments

HFL recommended that Ms M invest in a particular fund with her new pension provider. As I'm upholding the complaint on the grounds that a transfer out of the DB scheme wasn't suitable for Ms M, it follows that I don't need to consider the suitability of the investment recommendation. This is because the investments wouldn't have arisen if suitable advice had been given.

Summary

I don't doubt that the flexibility and potential for alternative death benefits on offer through a personal pension would have sounded like attractive features to Ms M. But HFL wasn't there to just transact what Ms M might have thought she wanted. The adviser's role was to really understand what Ms M needed and recommend what was in her best interests.

Ultimately, I don't think the advice given to Ms M was suitable. She was giving up a guaranteed, risk-free and increasing income. By transferring, Ms M was very likely to obtain lower retirement benefits and in my view, there were no other particular reasons which would justify a transfer and outweigh this. As I've explained I don't think Ms M had a need for flexibility. And I don't think the potential for higher alternative death benefits was worth giving up the guarantees associated with her DB scheme and impacting the benefits the pension would provide to her in retirement – its main purpose.

So, I think HFL should've advised Ms M to remain in her DB scheme.

Of course, I have to consider whether Ms M would've gone ahead anyway, against HFL's advice.

It is clear that Ms M was motivated by being able to help her daughter financially. And that this extended to her thoughts about her pension. But I don't think she'd have insisted on transferring out of the DB scheme, against HFL's advice because of this. Ms M was an inexperienced investor and, although HFL said she had a 'cautious to moderate' attitude to risk, I think it is clear from the conversations I've heard that she was largely risk averse. This pension was her only private retirement provision. And she'd been referred to HFL by her employment union, to discuss her retirement needs. So, if HFL, a professional adviser whose expertise she had sought on recommendation from her union, had provided her with clear advice against transferring out of the DB scheme, explaining why it wasn't suitable for her or in her best interests, I think she would've accepted that advice.

In light of the above, I think HFL should compensate Ms M 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 Ms M, as far as possible, into the position she would now be in but for HFL's unsuitable advice. I consider Ms M would have most likely remained in her DB scheme if suitable advice had been given.

On 2 August 2022, the FCA launched a consultation on new DB transfer redress guidance and set out its proposals in a consultation document - https://www.fca.org.uk/publication/consultation/cp22-15.pdf

In this consultation, the FCA 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 Ms M whether she preferred any redress to be calculated now in line with current guidance or to wait for the new guidance / rules to come into effect. She has chosen not to wait for any new guidance to come into effect to settle her complaint.

I am satisfied that a calculation in line with FG17/9 remains appropriate and, if a loss is identified, will provide fair redress for Ms M. So, HFL must therefore undertake a redress calculation in line with the regulator's pension review guidance as updated by the Financial Conduct Authority in its Finalised Guidance 17/9: Guidance for firms on how to calculate redress for unsuitable DB pension transfers.

For clarity, although Ms M was effectively medically retired at the point of the advice, I don't think she'd have taken benefits under the DB scheme prior to her normal retirement age of 65, but for the unsuitable advice. So, compensation should be based on her normal retirement age of 65, as per the usual assumptions in the FCA's guidance.

This calculation should be carried out as at the date of my final decision and using the most recent financial assumptions at the date of that decision. In accordance with the regulator's expectations, this should be undertaken or submitted to an appropriate provider promptly following receipt of notification of Ms M's acceptance of the decision.

HFL may wish to contact the Department for Work and Pensions (DWP) to obtain Ms M's contribution history to the State Earnings Related Pension Scheme (SERPS or S2P). These details should then be used to include a 'SERPS adjustment' in the calculation, which will take into account the impact of leaving the occupational scheme on Ms M's SERPS/S2P entitlement.

If the redress calculation demonstrates a loss, the compensation should if possible be paid into Ms M'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 Ms 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 have been taken as tax-free cash and 75% would have been taxed according to her 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 payment resulting from all the steps above is the 'compensation amount'. This amount must where possible be paid to Ms M within 90 days of the date HFL receives notification of her acceptance of my final decision. Further interest must be added to the compensation amount at the rate of 8% per year simple from the date of my final decision to the date of settlement for any time, in excess of 90 days, that it takes HFL to pay Ms M.

It's possible that data gathering for a SERPS adjustment may mean that the actual time taken to settle goes beyond the 90 day period allowed for settlement above - and so any period of time where the only outstanding item required to undertake the calculation is data from DWP may be added to the 90 day period in which interest won't apply.

If the complaint hasn't been settled in full and final settlement by the time any new guidance or rules come into effect, I'd expect HFL to carry out a calculation in line with the updated rules and/or guidance in any event.

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 uphold this complaint and require Hilltop Finance Limited to pay Ms M 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 Hilltop Finance Limited to pay Ms M any interest on that amount in full, as set out above.

Where the compensation amount already exceeds £160,000, I would only require Hilltop Finance Limited to pay Ms M any interest as set out above on the sum of £160,000.

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

If Ms M accepts this decision, the money award becomes binding on Hilltop Finance Limited.

My recommendation would not be binding. Further, it's unlikely that Ms M can accept my decision and go to court to ask for the balance. Ms 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 Ms M to accept or reject my decision before 22 March 2023.

Ben Stoker
Ombudsman