DRN-3832004

The complaint

Mr D complains about the advice given by KLO Financial Services Ltd ('KLO') to transfer the benefits from his defined-benefit ('DB') occupational pension scheme to a self-invested personal pension. He says the advice was unsuitable for him and believes this has caused a financial loss.

What happened

In March 2016, Tata Steel UK Ltd announced that it would be examining options to restructure its business including decoupling the BSPS (the DB pension scheme) from the company. The consultation with members referred to possible outcomes regarding their preserved pension benefits, one of which was a transfer to the Pension Protection Fund ('PPF') – the PPF is a statutory fund designed to provide compensation to members of defined benefit pension schemes when their employer becomes insolvent. The BSPS was closed to further benefit accrual from 31 March 2017.

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

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. The deadline to make their choice was 11 December (and was later extended to 22 December 2017). Mr D joined the BSPS2 before he got advice from KLO.

Mr D approached KLO in July 2018 to discuss his pension and retirement needs. He was also concerned about the situation with his employer and the BSPS2. He says he was dealing with the fear of losing his job as well as the pension changes. And he had wanted to think about transferring away earlier but delays within the DB scheme had made this difficult.

KLO completed a fact-find to gather information about Mr D's circumstances and objectives. This showed that he was 56 and married with two children. One of which was financially dependent and would be for a few more years. He was employed with a yearly income of £26,000. Mr and Mrs D owned their home outright and they had no debts or liabilities.

KLO also carried out an assessment of Mr D's attitude to risk, which it said was 'moderate'. But there are a number of references throughout the point-of-sale information that suggest Mr D was tending towards being 'reasonably cautious' rather than wanting to take significant risks with his pension planning.

In respect of Mr D's pension arrangements, he had:

- Received a cash equivalent transfer value ('CETV') from the BSPS in June 2018. This showed that he had 38 years service. He was entitled to a pension of about £25,600 at the date of leaving the scheme. The CETV was about £486,000

- Joined his employers new defined contribution ('DC') scheme. He was contributing 4% of his salary into this and his employer was contributing 6%. It had a current value of around £2,000.
- A personal pension into which he was paying £200 a month. This pension was valued at about £100,000.

On 20 July 2018, KLO advised Mr D to transfer his pension benefits into the self-invested personal pension and invest the proceeds in a range of funds that met his attitude to risk. The suitability report said the reasons for this recommendation were, in summary to:

- Have control over his pension benefits in line with recent pension freedom legislation.
- Maximise the amount of tax-free cash he could take and to do this immediately to purchase a holiday home.
- Ensure his beneficiaries inherited as much of his pension as possible in the event of his premature death.
- Invest in a diverse, mixed-asset investment strategy, with regular reviews, in line with his attitude to risk.
- Mr D accepted KLO's recommendation and transferred his DB scheme benefits into the self-invested personal pension

Mr D complained in 2022 to KLO about the suitability of the transfer advice. He said that he didn't have any experience of investments or pensions. He said the advantages of the transfer were given prominence over the advantages of the BSPS2. He also thought the advice to transfer wasn't suitable for him and may have caused him a loss.

KLO didn't uphold Mr D's complaint. It provided a detailed response which I have read in full but, in summary, it said that the starting point of the advice was that the transfer was unsuitable for Mr D. But it met his objectives for higher tax-free cash, used a generous CETV, it increased the benefit flexibility and provided increased death benefits. It would pay a comparable or higher income than the DB scheme. All of this led to KLO to think that the advice was suitable for Mr D.

Mr D referred his complaint to the Financial Ombudsman Service. An Investigator upheld the complaint and recommended that KLO pay compensation. She didn't think the transfer was in Mr D's best interests as he was likely to receive lower benefits because of it. The BSPS2 was likely to have met his needs for tax-free cash or a pension and the improved death benefits didn't outweigh the overall reduction in benefits due to the transfer.

KLO disagreed, saying that the advice was suitable for Mr D and it reiterated that it met his needs at the time. It felt that the Investigator had concentrated on the financial outcome of the transfer and hadn't taken into account his other objectives such as leaving a legacy for his family. Mr D was not a low-risk investor and he had investment experience with his personal pension portfolio.

The investigator wasn't persuaded to change their opinion, so the complaint was referred to me to make a final decision. There was some further correspondence, but no new issues were raised.

And moving forward the regulator has since developed, and now provides access to, a BSPS-specific redress calculator. Both parties to the complaint have been informed that I'm likely to award compensation based on this.

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 Businesses ('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 KLO'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, KLO should have only considered a transfer if it could clearly demonstrate that the transfer was in Mr D's best interests. And having looked at all the evidence available, I'm not satisfied it was in his best interests.

- KLO was required to carry out a transfer value analysis ('TVAS') report by the regulator. This calculated the critical yield which was how much Mr D's pension fund would need to grow by each year in order to provide the same benefits as his DB scheme. I've not seen an actual TVAS and KLO has indicated in the suitability letter that it may not have made a full analysis. But some of the information I would expect to see in the TVAS was in the suitability letter. This showed that Mr D needed a return of 10.1% to match the full pension he'd have been entitled to under the scheme at age 65. Or to match the maximum tax-free cash and reduced pension the scheme would provide at that age, the critical yield was 8.8%.

- As far as I can see KLO didn't look at these calculations at Mr D's preferred retirement age, which was 62. Whilst it did do cashflow reports, I think it really should have produced a full critical yield analysis at age 62 as he did want to retire earlier. The fact that it didn't was a significant failing and led to Mr D making the decision to transfer on incomplete information.

- The discount rate, which represents a reasonable assumption about future growth, was 3.5% for eight years to retirement in this case. And given this, and Mr D's recorded attitude to risk, and the regulator's middle projection rate of 5%, I think Mr D was always likely to receive pension benefits, from age 65, of a substantially lower value than those he'd have been entitled to under the BSPS2 by transferring and investing in line with that attitude to risk. And critical yields are usually higher at earlier retirement ages, so I think he was even more likely to receive lower benefits than the BSPS2 if he retired early.

- KLO strongly feels that Mr D had a 'moderate' attitude to risk, as recorded at the point of sale, rather than a lower attitude to risk as our Investigator thought was more reasonable. But given that the transfer proceeds needed to increase above the regulators highest growth rate of 8%, and by some distance, I don't think this is really relevant. It's clear that Mr D would likely lose out financially, as things stood at the time of advice, if he transferred.

- The main reason it was recorded that Mr D wanted to transfer was to access his pension benefits flexibly. And it is true to say that the personal arrangement did offer more flexibility as he could withdraw some amounts, or take an income, on a more ad hoc basis to match his changing needs. When he took benefits from the DB scheme he would need to take the tax-free cash and income at the same time.

- Mr D wanted to retire at age 62 with an income of around £20,000. He also wanted as much tax-free cash as he could receive to purchase a holiday home. And I note that Mr D did withdraw the maximum tax-free cash and has used this, as he said, for a holiday home and to make some house repairs and so on. Mr D has said that he wouldn't have taken the tax-free cash if he was advised that it was in his best interests to stay in the DB scheme. So, I've looked to see if his existing provision did meet his needs.

- The suitability letter said that at 65, Mr D could expect to receive from the scheme either a yearly income of about £31,500 or a tax-free lump sum of about £136,500 and a reduced pension of £20,487. Mr D would also receive his state pension in time and he had a significant amount already in two DC schemes into which he was still contributing. He could use these flexibly to provide tax-free cash or an income when he needed it. I think it's reasonable to say that at 65 Mr D had access to the cash and income that he said he wanted

- As I said above, KLO didn't look at the benefits Mr D could have received from the DB scheme at age 62 (or at other times). It's hard to see how it could have properly advised Mr D about his retirement without doing this. But even without a full analysis I think it's likely that at 62 Mr D would also have more than his recorded tax-free cash income wants from his existing provision.

- The FCA's compensation calculator shows that if Mr D retired three years early then the pension would be reduced by about 90% to account for the earlier payment. This is still well in excess of £20,000. And Mr D already had a significant sum he could use flexibly if he wanted to. So, his need for tax-free cash from the DB scheme may have been limited. And consequently, the income he could receive from the DB scheme could have been relatively high or taken earlier than the scheme's normal retirement date. And still provided what he wanted or needed.

- Whilst Mr D's aim for the tax-free cash was clearly important to him. I don't think that KLO should have advised him to alter his retirement provisions, at a significant potential overall cost, without fully exploring any alternatives he could have used to meet these aims. Such as using the provision he already had.

- The pension under the BSPS2 or the PPF was guaranteed. And appears to have been a more appropriate way to meet Mr D's income needs in retirement – which is the primary purpose of a pension.

- Overall, I'm not persuaded that Mr D needed to transfer to increase the flexibility in how he took his pension benefits at this time.

- KLO said Mr D was interested in the improved death benefits a transfer offered to his family. But the priority here was to advise Mr D about what was best for his retirement. And the existing scheme offered death benefits, by way of a spouse's pension, that could've been valuable to his family in the event of his death.

- While the CETV figure would no doubt have appeared attractive as a potential lump sum, the sum remaining on death following a transfer was always likely to be different. As well as being dependent on investment performance, it would've also been reduced by any income Mr D drew in his lifetime. And so may not have provided the legacy that Mr D may have thought it would.

- If Mr D had wanted to leave a legacy for his family, KLO could've explored life insurance as an alternative. And this could've been considered on a whole of life or term assurance basis – which was likely to be cheaper. But there's little evidence KLO did so.

- Overall, I don't think the different death benefits available through a transfer justified the likely decrease of retirement benefits for Mr D. I don't think that insurance was properly explored as an alternative. And ultimately KLO should not have encouraged Mr D to prioritise the potential for alternative death benefits through a personal pension over his security in retirement.

- I think Mr D's desire for control over how his pension was invested was overstated. I can't see that he had an interest in or the knowledge to be able to manage his pension funds on his own. Even though he already had a DC fund, he didn't manage this himself. And the recommendation seems to have been given on the basis he'd receive, and pay for, ongoing support with his pension. So, I don't think that this was a genuine objective for Mr D – it was simply a consequence of transferring away from his DB scheme.

- Mr D may have legitimately held concerns about how his employer had handled his pension and the prospect of entering the PPF. But it was KLO's role to objectively address those concerns. At the time of the advice, the BSPS2 had been established and the prospect of his pension moving to the PPF may have seemed remote. But even so, the PPF would still have provided Mr D with guaranteed income and the option of accessing tax-free cash. Mr D was unlikely to improve on these benefits by transferring. So, entering the PPF was not as concerning as he might've 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 D's best interests to give up his DB benefits and transfer them to a personal pension. And I also haven't seen anything to persuade me that Mr D would've insisted on transferring, against advice to remain in the DB scheme. So, I’m upholding the complaint as I think the advice Mr D received from KLO was unsuitable for him.

Putting things right

A fair and reasonable outcome would be for KLO to put Mr D, as far as possible, into the position he would now be in but for the unsuitable advice. I consider Mr D would most likely have remained in the BSPS2 if suitable advice had been given.

KLO 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.

KLO 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 D and the Financial Ombudsman Service upon completion of the calculation together with supporting evidence of what KLO based the inputs into the calculator on.

For clarity, while he has accessed some tax free cash Mr D has not yet retired, and isn’t certain when he will do. 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 D’s 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, KLO should:

- calculate and offer Mr D redress as a cash lump sum payment,
- explain to Mr D 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 DC pension
- offer to calculate how much of any redress Mr D receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr D accepts KLO’s offer to calculate how much of his redress could be augmented, request the necessary information and not charge Mr D 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 D’s end of year tax position.

Redress paid to Mr D as a cash lump sum will be treated as income for tax purposes. So, in line with DISP App 4, KLO 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 D’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 KLO Financial Services Ltd to pay Mr D 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 KLO Financial Services Ltd pays Mr D the balance.

If Mr D accepts this decision, the money award becomes binding on KLO Financial Services Ltd.

My recommendation would not be binding. Further, it's unlikely that Mr D can accept my decision and go to court to ask for the balance. Mr D 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 D to accept or reject my decision before 8 December 2023.

Andy Burlinson
Ombudsman