DRN-3947661

The complaint

Mr L complains about the advice Pension Advice Specialists Limited (PAS) gave him to transfer the benefits from his defined-benefit ('DB') occupational pension scheme to a self-invested personal pension ('SIPP'). He says the advice was unsuitable for him and believes this has caused a financial loss.

Professional representatives have helped Mr L to bring this complaint. But, for ease of reading, I will refer to the representatives' comments as being Mr L's.

What happened

In 2018 Mr L spoke with a financial advice firm (which I'll refer to as 'Firm R'). Mr L met with Firm R in August 2018 and it completed a fact-find. Amongst other things it noted that Mr L was 56 years old and divorced. He had stopped working the previous year owing to ill-health. He owned his home which was worth around £150,000 and had an outstanding mortgage of £78,000. He owned two buy-to-let properties with a combined value of £370,000 with outstanding mortgages of around £80,000 in total. He received around £500 a month in rental income. He had savings of £6,000. He had regular outgoings of £1,610 a month and had a desired income of £1,760 a month. He received £348 a month income from benefits.

As Mr L wanted to discuss transferring his DB scheme to a personal pension and Firm R didn't hold the relevant permissions from the Financial Conduct Authority ('FCA') to advise on the transfer out of his DB scheme, it referred him to PAS.

PAS gathered information about Mr L's DB scheme and obtained a transfer value analysis report ('TVAS'). His DB scheme had a cash equivalent transfer value ('CETV') of £214,517. At age 57 it would pay him a full yearly pension of £4,307 or tax free cash ('TFC') of £21,545 and a reduced yearly pension of £3,231. If Mr L took his pension benefits at the scheme's normal retirement age of 65 then it would pay him a yearly pension of £11,684 or TFC of £55,014 and a reduced pension of £8,252. PAS assessed Mr L's attitude to risk as seven out of ten, with one being low and ten being high risk, it referred to this as "highest medium".

In September 2018 PAS sent Mr L its suitability report setting out its advice. It noted that, based on Mr L's discussions with Firm R, his objectives were:

- Immediate access to funds.
- Owing to ill-health he believed his life expectancy was 10 to 15 years, and he wanted to leave any funds left over from his pension as a legacy for his two adult children.
- Flexibility of drawdown, as required.

PAS said that in order to match the benefits from the DB scheme at age 65 would require investment growth (critical yield) of 10.47% a year if Mr L took a full pension. It estimated that, based on a growth rate in the SIPP of 5% a year, the SIPP couldn't match the benefits from the DB scheme at age 65. For retirement at age 57, the critical yield was 20.46% if Mr L didn't take TFC and 2.1% if he did. PAS produced a number of cashflow models that showed how Mr L might use his money in a drawdown arrangement from a SIPP.

PAS said that Mr L wanted to take TFC immediately to pay off a buy-to-let mortgage which would give him extra income. It said that if he took his benefits at age 57 then he could take TFC of £52,300 from the SIPP. It recommended that he should transfer his DB funds to a named SIPP provider chosen by Firm R.

Mr L accepted PAS' recommendation to transfer his funds into the named SIPP.

Mr L complained to PAS in 2022. In short he said its advice wasn't suitable for him. He said that PAS hadn't sought information from his DB scheme about whether he had an entitlement to enhanced ill-health benefits from the scheme. PAS replied. It didn't uphold Mr L's complaint. Amongst other things it said neither Firm R nor Mr L had made it aware of the possibility of enhanced ill-health benefits from his scheme. PAS said its advice was suitable for Mr L's circumstances.

Mr L brought his complaint to us. One of our investigators looked into it. She didn't think PAS had dealt with Mr L fairly and said it should pay compensation. PAS didn't agree it had done anything wrong. Our investigator wasn't persuaded to change her 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.

In bringing this complaint and in responding to it, both Mr L and PAS have made a number of detailed points. But in this decision I don't intend to address each and every issue raised. Instead I will focus on what I see as being the key matters at the heart of Mr L's complaint and the reasons for my decision.

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 PAS' 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 broadly similar reasons to those our investigator gave.

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

Financial viability and capacity for loss

PAS carried out a TVAS (as required by the regulator) showing how much Mr L's pension fund would need to grow by each year in order to provide the same benefits as his DB scheme (the critical yield).

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.

Mr L was 56 at the time of the advice and had already stopped working. The critical yield required to match Mr L's benefits at age 57 was 20.46% if he took a full pension and 2.1% if he took TFC and a reduced pension. If he retired at age 67 the critical yields were 10.47% and 8.21% respectively.

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 2.25% a year if Mr L took his benefits at 57 and 3.5% if he took them at 65. 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, Mr L's medium attitude to risk and also the term to retirement. So, if Mr L chose to take TFC and a pension at age 57 then he was likely to receive a broadly comparable level of benefits to the DB scheme at retirement. But, if he didn't take TFC or deferred taking his benefits he was likely to be worse off by transferring. But assuming Mr L took TFC and his pension at 57 there would be little point in him giving up the guarantees available through his DB scheme only to achieve, at best, the same level of benefits outside the scheme. So I'd need to see other evidence that persuaded me a transfer was in Mr L's best interests.

PAS has provided cashflow models which it says shows Mr L would have been able to meet his needs despite the high critical yields. It provided six such models and four of those show that if Mr L took income equivalent to his DB scheme, the funds would last him to between the ages of 81 and 96. However, each of those models would seem to show a shortfall compared to Mr L's desired income. And, critically, PAS' models also show that, if Mr L took his desired income of £1,760 a month by drawdown, then his funds would be depleted by ages 64 or 65 (depending on whether or not he took TFC). That is a couple of years before he would be able to draw his state retirement pension at age 67. So he would have a significant income shortfall and no access to pension benefits - other than his state pension – thereafter.

Further, as well as Mr L's income requirement it's also important to consider his capacity for loss. As I've said above, apart from state pension Mr L had no other pension provision. He had limited savings and, while he did have assets in the form of his buy-to-let properties, the rental income from those wasn't guaranteed and their value wasn't immediately liquid if Mr L needed cash, as he'd first need to sell the properties.

In fact it's notable that PAS said that one of Mr L's objectives was to use his TFC to pay off the funds from a buy-to-let mortgage. But giving up guaranteed benefits from a DB scheme in order to achieve that might not have been in Mr L's best interests. And it's difficult to see how PAS assessed this.

When Firm R completed the fact-find form with Mr L it didn't complete any detail about what Mr L's regular outgoings were. That is it left most of the form blank and simply recorded that his total outgoings were £1,760. So it's not clear how PAS decided that Mr L had outgoings of £1,610 but preferred an income of £1,760. And it's not clear if those regular outgoings included repayment of the mortgages on Mr L's buy-to-let properties.
It follows that I don't know how much Mr L's repayments for his buy-to-let mortgages were at the time. Nor has PAS presented information about how much more Mr L's income would increase by as a result of using TFC to pay off a mortgage. So it's difficult to analyse whether using his TFC for this purpose was in his best interests.

Also I've seen no evidence that PAS discussed alternative strategies with Mr L. For example, rather than diverting his DB funds to pay off a buy-to-let mortgage – to increase his income that way – PAS might have been better placed to advise Mr L to sell one or both of his buy-to-let properties. That could potentially have released a gross sum of around £290,000 for Mr L. He could then have reinvested any net profit or used the surplus to provide him with an income. That would have then given him further choices in terms of how and when he accessed his DB funds. For example he could have either taken those at age 57 or left them untouched until the scheme's normal retirement age of 65. In that manner his DB income wouldn't have been reduced by the scheme's early retirement factors, which would have been the case if he took benefits at any point before he turned 65. But there's no evidence that PAS put this to Mr L.

I accept that by transferring out of his DB scheme Mr L might have been able to increase his overall income because he'd be able to retain more of the rental income once he paid off one or both mortgages. But as I've indicated above, rental income isn't necessarily guaranteed. However, his DB funds were guaranteed and that income would increase each year in line with the relevant indexation. A return he stood to lose some or all of by moving it into a SIPP which had no guarantees of any return whatsoever.

Also, in my opinion, going ahead with that transfer meant that Mr L would be exposed to fees and charges unnecessarily. For example Firm R was charging him a 3% transfer fee for the initial advice and 1% of the fund value for ongoing advice. The SIPP provider would also charge Mr L: £400 to set up the SIPP; a £400 yearly charge; and 2.15% of the fund value for ten years – reducing to 1.55% thereafter. Those are charges that Mr L wouldn't have had to pay if he remained in the DB scheme. But they would potentially continue to reduce the size of Mr L's investment and his income in retirement. And, as I don't think Mr L would be materially better off by transferring his DB funds when he did, I don't think PAS' advice was suitable for him.

So, as Mr L was likely to be worse off in retirement by transferring, doing so wasn't in his 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. PAS itself acknowledged that it was unlikely that Mr L could match the benefits from his DB scheme by transferring the funds to a SIPP. In those circumstances it's all the more important that the other reasons for transferring were sufficiently compelling. I've considered this below.

Flexibility and income needs

PAS has pointed out that Mr L had health conditions which motivated him to want to take his scheme benefits early and to use the maximum TFC that he could. I don't doubt that was the information that Mr L gave. But PAS' role should have been to advise Mr L on what was in his best interests, not simply to arrange what he said he wanted at that moment in time without carefully examining what his needs, rather than simply his desires, were. And while I can see why the prospect of access to a large sum of money to potentially pay off a mortgage might have been attractive to Mr L, that doesn't mean it was in his best interests. So I don't think PAS should have recommended that course of action to Mr L without fully considering what other options he might have had including immediately selling one or both of his buy-to-let properties. Alternatively – for example – consolidating his loans to make repayments more affordable and to maximise his rental income. But there's little evidence it explored these alternatives.

Further, I'm not persuaded that PAS gathered all the information it needed in order to fully advise Mr L. When bringing his complaint Mr L said that, in 2017, the DB scheme trustees gave him a quote for enhanced DB benefits because of his ill-health. Mr L said PAS didn't explore whether or not this was something he would still have been entitled to when it gave its advice. In contrast I've noted that PAS' suitability report says Mr L had confirmed that he'd asked the trustees whether he was entitled to an ill-health enhancement but been told that he wasn't. It's not clear where this evidence came from as it's not referred to in the fact-find. But, given Mr L's ill-health, I think this is something that PAS should have found out for certain. That's because if Mr L was entitled to an enhanced ill-health benefit from his DB scheme – as he apparently had been one year earlier –then this could also have affected the suitability of PAS' advice. But there's no evidence it did that.

Death benefits

PAS recorded that as Mr L was divorced the spouse's benefit available from his DB scheme was of little value to him. And he wanted any remaining pension to pass to his adult children on his death. It said that wasn't something Mr L could achieve by remaining in his DB scheme.

Death benefits are an emotive subject and of course when asked most people would like their loved ones to be taken care of when they die. The lump sum death benefits on offer through a personal pension was likely an attractive feature to Mr L. That's because whatever was left within his SIPP at the date of his death would be passed on to his family. And, if that happened soon after the transfer then that would likely be a significant sum.

But whilst I appreciate death benefits are important to consumers, and Mr L might have thought it was a good idea to transfer his DB scheme to a SIPP because of this, the priority here was to advise him about what was best for his retirement provision. A pension is primarily designed to provide income in retirement – not a lump sum to family after death. But in transferring out of his DB scheme Mr L was essentially giving up a guaranteed, index linked, increasing income in retirement, for the potential for a lump sum for his family that they may not need for many years to come. Furthermore, PAS' cashflow models showed that if Mr L took large deductions from his SIPP in the earlier years of his retirement, then he was likely to deplete that fund entirely before he reached state pension age. And, in those circumstances, there would be very little for Mr L to live on, yet alone leave as a legacy for his family. So, I don't think the potential for higher death benefits was something that was worthwhile Mr L giving up the guarantees from his DB scheme for.

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Summary

I don't doubt that the opportunity for a higher TFC sum on offer through a SIPP and potential for higher death benefits would have sounded like attractive features to Mr L. But PAS wasn't there to just transact what Mr L might have thought he wanted. The adviser's role was to really understand what Mr L needed and recommend what was in his best interests.

Ultimately, I don't think the advice PAS gave was suitable. Mr L was giving up a guaranteed, risk-free and increasing income. By transferring, Mr L was unlikely to be any better off and in my view, there were no other particular reasons which would justify a transfer and outweigh this. So, I think PAS should have advised Mr L to remain in his DB scheme.

Of course, I have to consider whether Mr L would've gone ahead anyway, against PAS' advice. I've considered this carefully, but I'm not persuaded that Mr L would've insisted on transferring out of the DB scheme, against PAS' advice. I say this because Mr L was an inexperienced investor with a medium attitude to risk and this pension accounted for the majority of his retirement provision. So, if PAS had provided him with clear advice against transferring out of the DB scheme, explaining why it wasn't in his best interests, I think he would have accepted that advice.

In light of the above, I think PAS should compensate Mr L for the unsuitable advice, using the regulator's defined benefits pension transfer redress methodology.

Putting things right

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 Mr L whether he preferred any redress to be calculated now in line with current guidance or wait for the new guidance/rules to come into effect. He didn't make a choice, so as set out previously I've assumed in this case he doesn't want to wait for the new guidance to come into effect.

I'm satisfied that a calculation in line with FG17/9 remains appropriate and, if a loss is identified, will provide fair redress for Mr L.

For clarity, Mr L retired at 56, so this should be the basis for the calculations.

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 Mr L's acceptance of the decision.

PAS may wish to contact the Department for Work and Pensions (DWP) to obtain Mr L'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 Mr L's SERPS/S2P entitlement.

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 PAS to carry out a calculation in line with the updated rules and/or guidance in any event.

If the redress calculation demonstrates a loss, PAS should pay the compensation if possible into Mr L'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, PAS should pay it directly to Mr L 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 his 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 Mr L within 90 days of the date PAS receives notification of his acceptance of my final decision. Further PAS must add interest 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 PAS to pay Mr L.

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. In those circumstances, 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.

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 Pension Advice Specialists Limited to pay Mr L 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 Pension Advice Specialists Limited to pay Mr L any interest on that amount in full, as set out above.

Where the compensation amount already exceeds £160,000, I would only require Pension Advice Specialists Limited to pay Mr L any interest as set out above on the sum of £160,000.

<u>Recommendation:</u> If the compensation amount exceeds £160,000, I also recommend that Pension Advice Specialists Limited pays Mr L the balance. I would additionally recommend any interest calculated as set out above on this balance to be paid to Mr L.

If Mr L accepts this decision, the money award becomes binding on Pension Advice Specialists Limited.

My recommendation would not be binding. Further, it's unlikely that Mr L can accept my decision and go to court to ask for the balance. Mr L 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 L to accept or reject my decision before 4 April 2023.

Joe Scott
Ombudsman