DRN-4015169

The complaint

Mr B complained that he was given unsuitable advice to transfer his defined benefit (DB) Occupational Pension Scheme (OPS), to a type of personal pension.

Although trading at the time under a different name, KBFS Financial Limited is now responsible for answering this complaint. To keep things consistent, I'll refer mainly to "KBFS".

What happened

In 2017 Mr B approached KBFS for advice about his existing DB scheme. Information was gathered about his circumstances which were broadly as follows:

- Mr B was 44 years old, married and with three dependent children. He was in good health.
- He was a current and contributing member of his OPS.
- The cash equivalent transfer value (CETV) of the pension was around £985,032 and the normal retirement age (NRA) was 65.
- Mr B earned around £65,000 per year. He and Mrs B owned a home valued at approximately £600,000 and had a mortgage of £240,000. They had no other savings or liabilities.

KBFS set out its advice in a suitability letter in July 2017. It advised Mr B to transfer out of his DB scheme and invest the funds in a type of personal pension arrangement. Mr B accepted this advice and so transferred from his DB scheme to a personal pension shortly after.

Mr B says that he then became aware of having a cause to complain. He first complained to KBFS about its advice, saying he shouldn't have been advised to transfer out of his DB scheme. In response, KBFS said it hadn't done anything wrong and was acting on the financial objectives Mr B had at the time.

Mr B then referred his case to our Service. One of our investigators looked into the complaint and said it should be upheld. As KBFS hasn't agreed and the complaint couldn't be resolved informally, it's come to me for 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 considered with great care, the final response from KBFS. I've also 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).

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 KBFS'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.

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

I've used all the information we have to consider whether transferring away from the OPS to a personal pension arrangement was in Mr B's best interests.

I don't think it was, so I'm upholding his complaint.

Financial viability

KBFS referred in its transfer recommendation to a 'critical yield' rate. The critical yield is essentially the average annual investment return that would be required on the transfer value - from the time of advice until retirement - to provide the same annuity benefits as the DB scheme. The critical yield is part of a range of different things which help show how likely it is that a transferred personal pension fund could achieve the necessary investment growth for a transfer-out to become financially viable.

In Mr B's case, KBFS said the critical yield required to match the benefits of the DB scheme he was in at the time, at the age of 65, was 5.16%. It didn't calculate a critical yield if he intended to take a tax-free cash lump sum and a reduced pension. Nor did KBFS calculate any critical yield rates if Mr B was to retire earlier. As KBFS itself bases much of its transfer rationale on him potentially taking early retirement, I think this was a notable omission and one which would have caused Mr B to have less information than he needed to make an informed decision.

The advice was given during the period when the Financial Ombudsman Service was publishing 'discount rates' on our website for use in loss assessments where a complaint about a past pension transfer was being upheld. Whilst businesses weren't required to refer to these rates when giving advice on pension transfers, I consider they provide a useful indication of what growth rates would have been considered reasonably achievable when the advice was given in this case.

The relevant discount rate published by the Financial Ombudsman Service for the period before October 2017 was only 4.5% per year for 20 years to retirement (age 65), which is below the critical yield figure of 5.16%. The discount rates for retiring earlier were lower. It's important to bear in mind that small parts of a percentage point matter in these assumptions as what we're talking about here is year-on-year growth over more than two decades. I've also kept in mind that the regulator's upper projection rate at the time was 8%, the middle projection rate was 5%, and the lower projection rate was 2%.

At the time, KBFS said Mr B's attitude to risk (ATR) was balanced. So, when thinking here about his ATR, I've also considered Mr B's circumstances as a married father with three dependent children, no savings, and a mortgage. I've also noted the eventual fund recommendation from the KBFS adviser amounted to generally balanced risk funds. Indeed, the projected growth rates referred in the illustration for the recommended funds were also below the critical yield figure – the mid-rate, for example, was only 4.94% per year.

Taking all these things into account, I think a future growth assumption towards the lower half of the regulator's projections, close to the discount rate, and near to the fund illustration projection was most relevant here. All were below the critical yield figure, so I think this shows that achieving 5.16%, year-on-year, upon transferring out was more unlikely than likely, in Mr B's case.

I've noted too, that KBFS said that in order to purchase an annuity to provide benefits of an equal value to the existing scheme at retirement at the age of 65, the funds required would be around £2,032,628. This, in my view, provides a revealing window into the value Mr B could lose if he transferred out to a personal pension.

So, all these things were indicating that Mr B would likely receive lower pension benefits overall as a consequence of transferring away from the DB scheme. And there would be little point in Mr B giving up the guarantees and benefits available to him through his existing scheme only to achieve a lower level of benefits in a personal pension in the long term.

Of course, according to KBFS itself, its recommendation that he should transfer out to a personal pension was not based on the financial comparisons with his current scheme alone. Rather, KBFS said Mr B had different reasons to transfer away, so I've thought about all the other considerations which might have meant a transfer was suitable for him, despite providing the overall lower benefits I've mentioned. I've considered these below.

<u>*Other reasons given for the transfer advice*</u>

I've used the documentation from KBFS at the time to help list some of the themes the recommended transfer-away was based on. Our investigator also highlighted some themes when he issued his view. These were:

- *"The ability to start taking benefits at age 55.*

- *The option of flexible income to suit* [Mr B's] *financial needs.*

- *To protect the full value of his fund in the event of his death".*

I've also considered what KBFS said in its responses to Mr B and to our Service. I've noted, for instance, that KBFS says Mr B himself recorded some handwritten notes about why he thought transferring might be good for him.

However, what Mr B wrote on the transfer documentation was no more than some basic thoughts; things he hoped might be realised if he transferred his pension to a different scheme. His comments were rudimentary, barely 15 words long and based on information already published in the suitability letter and given to him by the adviser. In my view, what Mr B wrote down was merely aspirational statements about his pension and what anyone might hope for in their retirement when it eventually came.

On the other hand, Mr B was paying KBFS a considerable sum of money for the regulated financial advice. So KBFS's job here wasn't to simply transact what Mr B might have thought he wanted at the time. Its job was to really understand his circumstances and provide advice that was in his best interests. I don't think KBFS did this and, in my view, the supporting rationale and analysis it provided in its advice was poor and demonstrated the fundamental failures of KBFS's advice process.

For example, whilst KBFS listed as a major objective that Mr B wanted to retire early, at the age of 55, I think this was no more than a 'stock' objective used by KBFS to justify the overall transfer recommendation. I say this because there was no detailed financial analysis of a retirement at 55. And the most obvious issue here was Mr B's comparatively young age. At only 44 years old at the time, he unsurprisingly had no concrete plans for retirement. His NRA was over 20 years away and it simply isn't credible that he had an idea of what his retirement might look like, even if it was hoped for earlier, as implied by KBFS. This assumption is evidenced not only by his comparatively young age, but by his personal circumstances. He and his wife had young children who had their whole life ahead of them so planning Mr B's pension arrangements so far in advance was always going to be subject to change.

I therefore think the early retirement age of 55 was used for no other reason than it was the minimum age when someone could legally access a defined contribution (DC) pension scheme – the type Mr B was being advised to transfer into. And so, whilst retiring at 55 could have possibly been a somewhat far off aspiration, there was no other evidence showing either party had a credible and / or costed plan.

In my view, there was a failure by the KBFS adviser to properly assess whether Mr B's apparent desire for an early retirement was even financially achievable. The 'fact-find' certainly didn't indicate retiring early was credible since it wasn't a detailed enough document; it contained many omissions and no steer on his detailed financial situation. But what we do know is that Mr and Mrs B had three young children, they had no savings at that point and still had a substantial mortgage yet to pay. So, against this backdrop, retiring early certainly didn't seem obvious. There was also no analysis produced of what Mr B might need by way of a detailed retirement income if he did retire so early. KBFS was therefore recommending he transfer away from his existing DB scheme without any real knowledge of what he'd have left to live on after he met all his and Mrs B's expenses.

Of course, even if Mr B really did have aspirations to retire early he could have still considered doing this as a member of his existing scheme. I don't think this situation was likely and planning for it as an eventuality would have still been some years away because of Mr B's age and family situation. But even if retiring at 55 was being considered, in these circumstances there would have been merit in providing Mr B with all the details of what this might look like from a financial perspective and assessing them against his likely financial liabilities. There would have probably been an actuarial reduction caused by early retirement from the existing scheme which would have meant Mr B's pension benefits would have been somewhat different due to him accessing the pension earlier and for longer, so this would have needed to have been factored in. But I've seen no evidence this existing opportunity within his present pension scheme was really discussed with a view to assessing whether it was more in his best interests, rather than him just being advised to transfer away altogether.

Mr B also seemed to still be an existing and contributing member of his DB scheme and so these contributions together with any employer contributions would have been added to the overall value of his pension in the years ahead. Transferring out whilst still working for the same company would have likely seen these contributions stop.

So, everything I've seen here shows that this was probably much too soon to be recommending that Mr B ought to irreversibly transfer away from his existing DB scheme. Neither Mr B nor KBFS could have had an idea at that time of whether he'd be able to retire at 55. Nor could either party realistically judge what he'd need to financially maintain a retirement if he did so. In all likelihood this would have been substantially hampered by his comparatively young age at the time and retirement being such a distant concept.

- *Flexibility*

KBFS said that transferring would *"provide greater flexibility and choice as to how and when to take the* [pension] *benefits".*

However, I can't see that Mr B required flexibility in retirement in the way KBFS implied. As I've said, KBFS did a very poor job at identifying what Mr B's retirement income requirements might be and there were already limited degrees of flexibility still available to Mr B around retiring early in his existing scheme which KBFS failed to comprehensively explore. There was no evidence to support that Mr B needed flexibility at all and the concept of flexibility wasn't really defined by the adviser. In my view, evidence of why Mr B wouldn't use the DB pension in exactly the way it was designed, is absent.

There's also no evidence showing that Mr B had either the desire or capacity to manage these funds. There's some suggestion that Mr B understood the basic concepts of investing in money market type funds. However, he had no such investments at the time and KBFS recorded that his investment experience was limited. So, there's nothing to suggest he was knowledgeable enough in these pension related matters or that he had investment experience to call upon.

I therefore think the issue of flexibility was used to merely help justify the transfer-away recommendation. And at just short of £1 million in total value, I think Mr B would have needed significant help and advice to manage the scale and complexity of the funds. Given their value, this would have come at an ongoing and considerable cost which he didn't have with the scheme he was already in.

- *Death benefits*

In my view, what KBFS said about the death benefits of both types of schemes was misleading. It said that transferring *"enabled you to meet your objective of freeing your pension planning from* [the existing scheme] *to protect the full monetary amount in the event of your death".*

This may have sounded good, but it needed careful explanation, particularly as Mr B was still only 44 years old and in good health. For example, as an existing and contributing member, there would have been some benefits payable, most likely to Mrs B, if Mr B passed away before he started drawing from his DB pension scheme. If he died after starting to draw his pension, the pension payable to Mrs B could have been over 60% of the annual pension amount Mr B was receiving. In addition to these spousal benefits, there were likely wider child-related benefits whilst his children remained within full-time education. I think these were of use to Mr B, particularly given that his youngest child was still only five years old in July 2017. Overall, these were very good death-related benefits and they increased in value annually through indexation with certain inflation measures.

On the other hand, whilst the entire value of a pension in a personal scheme could be passed on, the whole point of a pension is to pay for one's retirement. As I've said, Mr B was in good health and only 44 years old. If he had lived a long life, it's highly likely there would be very little left in the personal pension fund to pass on. The amount in a personal scheme was also at risk to market volatility and it wasn't index linked.

So, although KBFS implied that the death benefits were discussed at the time and the personal pension arrangement would better enable the retention of the value of the funds if Mr B died, this isn't strictly the full picture. I therefore think the likely death benefits attached to the DB scheme were substantially underplayed. The spouse's pension provided by the DB scheme would have been useful to Mrs B if Mr B predeceased her and I don't think KBFS made the value of this benefit clear enough. KBFS should not have encouraged Mr B to prioritise the potential for higher death benefits through a personal pension over his security in retirement.

Like our investigator, I also saw that life insurance was discussed during the advice session. But the discussion looks like it was clearly restricted to a whole of life quotation – a comparison of the cost to match the full transfer value of his entire pension CETV. However, at his age, a term cover policy may have been a reasonably affordable product if Mr B really did want to leave a legacy for Mrs B and /or his children if he passed away.

Overall in this case, I don't think different death benefits available through a transfer to a personal pension justified the likely decrease of retirement benefits for Mr B. It was not helpful to Mr B's situation and it wasn't in his best interests.

Suitability of investments

KBFS recommended that Mr B invest in certain funds. As I'm upholding the complaint on the grounds that a transfer out of the DB scheme wasn't suitable for Mr B, it follows that I don't need to consider the suitability of the investment recommendation. This is because Mr B should have been advised to remain in the DB scheme and so the investments in the funds wouldn't have arisen if suitable advice had been given.

Summary

In this decision I've explained why I don't think the advice to transfer away from his DB scheme was in Mr B's best interests. He was giving up a guaranteed, risk-free and increasing income within his current scheme.

Mr B was still over 20 years from his NRA. I explained why, in these circumstances, I thought it was far too early to recommend that he transfer away from his DB scheme. He was still a contributing member to his DB scheme and there were no other justified financial reasons for transferring. The evidence shows he would be more likely to receive lower benefits in the longer-term as a result of transferring away.

As for the flexibility KBFS says Mr B required, I don't doubt that this and the control KBFS said he could have over the transferred funds, would have sounded like attractive features to Mr B. Similarly with the death benefits, where KBFS implied these suited Mr B's situation much better in a personal pension plan, rather than the DB scheme he was then a member of.

But KBFS wasn't there to merely transact what Mr B might have thought he wanted. Mr B wasn't experienced in these matters and he went looking for regulated financial advice. He was also paying a substantial amount for it. The adviser's role was to interpret Mr B's circumstances and to use their skills, training and professional experience to recommend what was in his best interests. Instead, they recommended an irrevocable transfer based on a series of 'stock' objectives which I believe bore very little resemblance to Mr B's situation.

I therefore think KBFS ought to have advised him against transferring out of his DB scheme. In my view, Mr B's circumstances were much more aligned to him retiring from the DB scheme when he was ready to do so and drawing a regular income. In this context, the suitable option was for him to access his DB pension in the way it was originally intended. In light of the above, I think KBFS should compensate Mr B for the unsuitable advice, using the regulator's defined benefits pension transfer redress methodology. **Putting things right**

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

KBFS 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.

For clarity, Mr B has not yet retired, and he has no plans to do so at present. So, compensation should be based on the scheme's normal retirement age (65), 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 B's acceptance of the decision.

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

- always calculate and offer Mr B redress as a cash lump sum payment,
- explain to Mr B before starting the redress calculation that:
    - the 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 their redress prudently is to use it to augment their DC pension
- offer to calculate how much of any redress Mr B receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr B accepts KBFS's offer to calculate how much of their redress could be augmented, request the necessary information and not charge Mr B for the calculation, even if he ultimately decides not to have any of their redress augmented, and
- take a prudent approach when calculating how much redress could be augmented, given the inherent uncertainty around Mr B's end of year tax position.

Redress paid to Mr B as a cash lump sum will be treated as income for tax purposes. So, in line with DISP App 4, KBFS 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 B'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.

I have also considered the impact on Mr B of the unsuitable advice and transfer. Our investigator recommended that a sum of £300 should be paid to Mr B by KBFS for what he referred to as the distress and inconvenience caused by this unsuitable transfer. I've taken into consideration Mr B's age, circumstances and the substantial amount he'd built up in his pension to that date; Mr B had built up his pension over a long time. Also, by retirement this DB pension would have been a very substantial part of his overall pension entitlement so I think the thought of losing benefits would have negatively impacted Mr B.

So, I agree that KBFS should also pay Mr B £300 for the distress and inconvenience caused by the unsuitable advice which has likely had an impact on his retirement planning.

My final decision

Determination and money award: I uphold this complaint and I direct KBFS Financial Limited to pay Mr B 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 KBFS Financial Limited pays Mr B the balance.

If Mr B accepts this decision, the money award becomes binding on KBFS Financial Limited.

My recommendation would not be binding. Further, it's unlikely that Mr B can accept my decision and go to court to ask for the balance.

Mr B 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 B to accept or reject my decision before 2 June 2023.

Michael Campbell
Ombudsman