DRN-4044565

The complaint

Mr D complains that he was advised by Carpenter John Financial Services Ltd to switch a personal pension from Royal London to Prudential, losing a Guaranteed Annuity Rate (GAR) in the process. He believes the advice was unsuitable and wants to be put back in the position he would have been in if not for that advice.

What happened

Mr D approached Carpenter John for advice on his occupational pension scheme, a Defined Benefit (DB) scheme of which he had been a member for over 20 years. Carpenter John referred him to another adviser for specialist advice on that scheme.

During this process, Mr D discussed his other pensions with Carpenter John. He had £19,718 in a Royal London personal pension (PP). This was invested in the With Profits fund and had a GAR which meant that, at retirement and if Mr D chose to take an annuity from Royal London, the amount he would receive wouldn't be dependent on open market annuity rates. And given market changes to these rates since Mr D's policy started, this guarantee was likely to be very valuable.

The Royal London illustration showed that the effect of the GAR would be to roughly double the level of income from around 2.5% of the fund, which Royal London said was the standard open market rate, to about 5.0%. Although the policy conditions only provided the GAR at age 65, Royal London said they were currently extending it for retirement from age 60 to 75. There were options available on the type of annuity, but the underlying guarantee would still apply. The ongoing costs of the policy were 'no greater than 1%.'

A fact find was completed, which said that Mr D wanted to retire at 60. His wife was an active member of a DB scheme and Mr D had his new workplace money purchase scheme. The transferred DB scheme was their largest asset and the Royal London scheme was fairly small in comparison.

Carpenter John issued a suitability report advising him to move the Royal London money to Prudential, investing in the PruFund Cautious fund because they said this met his desire to consolidate his pensions and the smoothed fund matched his cautious risk profile. The report said, in relation to the GAR, that the Royal London scheme "does include guarantees and we have discussed these, It is your intention to retire at 60, well before any guarantees would be obtainable. You are happy to forgo these for the reasons above."

Mr D accepted the advice and his Royal London plan was moved to Prudential as advised. Later, when he became aware of potential issues with the advice he had received, Mr D complained to Carpenter John and the other adviser business.

The complaint was split into two separate complaints by this service and our investigator said that he thought the advice was unsuitable because there was no real advantage to switching from Royal London to Prudential, and the GAR was lost.

Following the investigator's opinion, Carpenter John provided further information. This included some research that they said showed that the Prudential fund projected a higher fund value than Royal London. They were concerned that they had not had the opportunity to provide a final response to Mr D. Mr D was aware of the guarantees and felt they were worth losing; and finally Mr D had taken tax free cash at age 55, which would have meant losing the GAR.

Since Carpenter John did not accept the investigator's opinion, the case was referred to me for a final decision.

My provisional decision

I issued my provisional decision on 9 March 2023. It said:

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Before I look at the advice itself, I first want to say why I think I can consider this complaint. Although Carpenter John has not issued a final response to Mr D in relation to this advice, they have had plenty of opportunity to do so. They have known of this complaint since at least May 2020, by their own admission. Since more than eight weeks have elapsed since then, whether they issued a final response or not I am satisfied that this is a complaint I can consider.

In any case I believe that Carpenter John made their position clear in emails to our investigator, including one dated 24 March 2022. I would also remind Carpenter John that this is my provisional decision, so they will have the chance to respond and make their case before any final decision.

What I have to decide is whether the advice to switch was suitable and, if I decide that it was not, what Carpenter John must do to do put things right.

The FCA Handbook gives the rules that regulated advisers must follow. Key parts of the handbook in respect of this case are:

COBS 9.2.1R

"(1) A firm must take reasonable steps to ensure that its recommendation is suitable for its client;"

COBS 9.4.7R

"The suitability report must, at least:

(1) specify the client's demands and needs;

(2) explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and

(3) explain any possible disadvantages of the transaction for the client."

The Royal London With Profits fund and the recommended PruFund were both based on a diversified portfolio of shares, bonds, property and other assets with a smoothing process to shelter policyholders from the full effect of market movements. I think both funds matched Mr D's cautious risk profile and term to retirement, so there was no real advantage or disadvantage to switching from an investment perspective.

The Royal London scheme cost no more than 1% a year; the Prudential illustration showed that its scheme cost 1.07% a year (excluding adviser charges). While the Prudential scheme appears slightly more expensive, I do not consider that the difference is material enough to make the switch unsuitable, although equally it does not support the recommendation to switch either.

Carpenter John has said that their advice was based on illustrations, which showed that the Prudential scheme would provide better growth than the Royal London scheme. But as I have said, the charges were similar, it was only the assumed growth rates that were different. And both funds had a similar risk profile, so I can see no reason why Prudential was likely to produce higher growth. I have reviewed some of the other research tools used by Carpenter John and I have some concerns about these. For example, one of the projections is based on inaccurate Prudential charges and uses a different fund to the one that was recommended (costing 0.22% a year rather than 0.72% as per the illustration) so I don't think these change my mind on this point.

Mr D apparently wanted to consider consolidating his pensions. At the time of advice he had the former DB scheme, now transferred to Prudential; the Royal London scheme; and the replacement workplace scheme. While there is a small benefit to be had from reduced administration, I don't think it was that important since the Royal London scheme would not have taken much managing. And Mr D would still have had to keep the workplace scheme to receive contributions, so he would have two schemes anyway. So I don't consider that consolidating offered any reason to switch providers either.

The single material difference between the Royal London and Prudential schemes was that the Royal London scheme had the GAR. Now the report did say that this had been discussed and that Mr D was prepared to forego the guarantee to meet his other objectives. But Mr D was not particularly knowledgeable, and the report wasn't explicit about the level of the guarantee (which could have doubled Mr D's income from the scheme) so I don't think he was in a position to make that decision. He had asked for advice from a regulated adviser, and I think he was entitled to rely on that advice as being in his best interests.

Furthermore, the report said that Mr D was intending to retire at 60, "long before any guarantees would be obtainable" but this was not true. The scheme information provided by Royal London said clearly that they would honour GARs for retirement from 60-75 (albeit as a concession that could be withdrawn). By not realising or discussing this with Mr D I don't think that Carpenter John took reasonable steps to ensure that their recommendation was suitable.

COBS 9.4.7R requires the report to explain why the adviser thinks the recommendation meets the objectives, and any possible disadvantages of the advice. As I have said there were no material advantages to switching providers, and the loss of GAR is a clear disadvantage so I don't think Carpenter John has met this requirement.

I understand the point that the income from the scheme was likely to be a relatively small part of Mr D's retirement income but switching was likely to have halved the income available from the scheme as an annuity. And there were no real advantages to offset the loss of the GAR.

It has been suggested that Mr D was willing to give up the GAR so he could access his fund flexibly, i.e. not by means of an annuity. While that is possible, I think he was still too far away from taking his benefits to make a definitive decision on that. If that was the reason for the switch, I think Mr D should have been advised to wait until closer to retirement, since there was no obvious advantage to the switch, and by doing so at age 53 he closed off the option of accessing the GAR. In any case the DB scheme that had just been transferred was *many times the size of the Royal London fund, so adding just a little more to that pot did not offer a material advantage.*

Carpenter John discounted the GAR because they thought it was only available from age 65. Had Mr D been made aware that the guarantee could effectively double his income from this pension, and that it might have been available at his preferred early retirement age I think he would have made a different decision, or at least have waited until closer to retirement.

So I find that the advice to switch was unsuitable. I don't think Carpenter John acted fairly or reasonably in their advice to switch pensions. So, based on the evidence I've seen so far, I intend to uphold Mr D's complaint.

I think that suitable advice would have been to retain the Royal London policy and to revisit this choice closer to retirement.

Response to my provisional decision

Both parties have responded to my provisional decision.

Mr D's representatives had nothing further to add and accepted the decision.

Carpenter John made substantially the same points previously made in their response to the investigator's opinion, and which I have already covered in my provisional decision.

Carpenter John continue to argue that the increased growth potential from the Prudential scheme meant that there was a clear advantage to the switch. But as I have said, the GAR meant potentially double the level of annuity. So to offset the GAR the Prudential scheme would need to produce twice the growth available from Royal London on that part of the scheme that had the GAR and I don't think that was likely.

The adviser says that because Mr D took tax free cash at age 55 this shows that he would never have been able to take advantage of the GAR. I've looked at the circumstances at the time though. Carpenter John didn't identify that releasing a pension commencement lump sum (PCLS) was one of Mr D's objectives. It wasn't a reason for the transfer. It considered he wanted to retire at 60. Being able to access the PCLS that he did may have become attractive once this transfer value was combined with the, much larger, transfer value of the DB scheme. Put simply, taking the PCLS was something that only really became an option for Mr D after following the advice. Which I've explained was unsuitable. If he hadn't been more suitably advised, I think it's more likely that he would have left this pension until he reached age 60. He had enough in the DB transfer value to take the PCLS that he did, as he took below the maximum he was entitled to take .

Finally Carpenter John has said that the GAR did not apply to the full value of the scheme. This is correct. But Carpenter John advised Mr D to switch the whole pension scheme in a single piece of advice, which I have found to be unsuitable for the reasons already given. If the GAR only applied to some of the Royal London pension, that will be reflected in any redress calculation.

So I have considered Carpenter John's arguments carefully and I can see no reason to change my provisional 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.

For the reasons already given I remain of the view I set out in my provisional decision and explained further above. I uphold Mr D's complaint against Carpenter John Financial Services Ltd.

Putting things right

My aim is to put Mr D as close as possible into the position he would have been in if not for the unsuitable advice. I have already said that I think he should have been advised to remain in the Royal London scheme so that he still had the GAR option open to him.

With the much larger fund available to him from the DB transfer offering access to lump sums, I think that on the balance of probabilities he would likely have taken advantage of the GAR since this would have offered the most valuable benefit, and he had no need to access this fund flexibly. For the same reason, I don't think he would have taken tax free cash from this pension. Since his wife's provision was smaller, I also think that he would probably have included a spouse's benefit.

Mr D has taken tax free cash though, from his new pension which included both the DB transfer and the Royal London switch. But he took £55,000, which was less than the available maximum, and could easily have been funded from the DB transfer value. So if he had been advised to retain the Royal London scheme, it would have had no effect on his subsequent decision to partially crystallise his larger personal pension. So I don't consider that Mr D has actually taken benefits from the fund switched from Royal London.

To compensate Mr D fairly, Carpenter John must carry out the following steps:

1) Ask Royal London to calculate the notional value of Mr D's policy on the date of calculation, as if the policy had never been transferred.

2) Obtain details of the GAR applying at Mr D's age at the date of calculation (in years and months) on a monthly in advance basis with 50% spouse's pension and a five-year minimum period of payment.

3) Look up annuity rates on the date of calculation to determine a rate payable on the open market for the same format and age.

4) Assuming (2) is greater than (3), increase the value in (1) by the ratio of (2) divided by (3). Otherwise leave the value in (1) unchanged.

5) Obtain the fund value (attributable to the Royal London personal pension transfer) at the date of calculation from the current provider of Mr D's personal pension. It should be calculated based on the fund growth and assuming that Mr D hadn't taken the PCLS from this part of the fund, effectively being the uncrystallised part of Mr D's pension. If Carpenter John are unable to obtain the actual fund value in this way, I think it will be reasonable to instead assume that the fund would have performed broadly in the same way as the ceding pension did. And they should instead use the notional value obtained at step 1.

6) The loss to Mr D's pension funds at the date of calculation is calculated as the result of (4) – (5). If the answer is negative, there's a gain and no redress is payable.

The loss should if possible be paid into Mr D'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 Mr D as a lump sum after making a notional reduction to allow for future income tax that would otherwise have been paid.

As I've explained, the purpose of my proposed redress is to put Mr D back into the position of being able to replace the valuable annuity that he could have purchased if Carpenter John had given him suitable advice. And I don't think Mr D would have taken tax free cash from this pension, so all of the fund would have been taxed according to his likely income tax rate in retirement – presumed to be 20%. So making a notional reduction of 20% overall from the loss adequately reflects this.

If compensation is not made within 60 days of Carpenter John receiving Mr D's acceptance of my final decision, interest must be added to the compensation at the rate of 8% per year simple from the date of my final decision to the date of payment.

Income tax may be payable on any interest paid. If Carpenter John deducts income tax from the interest, it should tell Mr D how much has been taken off. Carpenter John should give Mr D a tax deduction certificate in respect of interest if Mr D asks for one, so he can reclaim the tax on interest from HMRC if appropriate.

I am allowing Carpenter John up to 60 days because they will need to obtain information from third parties, which I understand is to some extent beyond their control.

My final decision

For the reasons given I uphold Mr D's complaint against Carpenter John Financial Services Ltd. Carpenter John must complete the loss calculation exercise set out above and pay all and any sums due to Mr D as described above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr D to accept or reject my decision before 24 April 2023.

Martin Catherwood
Ombudsman