DRN-4158245

The complaint

Mr W complains about the advice given by Ethos Financial Solutions Ltd ('Ethos') to transfer the benefits from his defined-benefit ('DB') occupational pension scheme, the British Steel Pension Scheme ('BSPS'), to a personal pension. He says the advice was unsuitable for him and believes this has caused a financial loss.

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

What happened

Mr W held benefits in the BSPS. In March 2016, Mr W's employer announced that it would be examining options to restructure its business including decoupling the BSPS (the employers' 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.

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 W's employer would be set up – the BSPS2.

The RAA was signed and confirmed in August 2017 and the agreed steps were carried out shortly after. Updated transfer valuations were then provided by the BSPS trustees to qualifying members, reflecting the improved funding position – with the cash equivalent transfer value ('CETV') of Mr W's pension being £431,980.05. And 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 a decision about joining the BSPS2 was 11 December 2017 (later extended to 22 December 2017).

Mr W was referred to Ethos by another business in November 2017 for advice about his BSPS pension. I understand the other business was not in a position to provide advice before the time to choose deadline.

Ethos completed a fact-find to gather information about Mr W's circumstances and objectives. Mr W was 47, in good health, married with two non-financially dependent children. He and Mrs W were both employed. They owned their own home with an outstanding mortgage. This had a remaining term of 14 years, but notes indicate that they intended to make overpayments and repay this in full within the next 9 years. They had a further loan for £14,000 due to be repaid in the next 5 years and held £10,000 in savings.

In addition to his BSPS pension, Mr W was a member of a new defined contribution ('DC') pension set up by his employer. It was also noted that Mrs W was a member of her employer's pension scheme and had been for 29 years. But details of its value were not obtained.

Mr W's normal retirement age was recorded as 65. Ethos noted that he was potentially looking to move to part time work from age 55 and so may access some of his pension benefits at that time. It said Mr and Mrs W expected to need an income of £18,000 - £20,000 per year in retirement. A statement was ticked, from a list of options, indicating Mr W may consider taking the maximum possible tax-free cash ('TFC') sum at retirement, but there was no purpose for needing this recorded. Other tick box options were completed which indicated that Mr W liked the idea of having control and flexibility in terms of how he could take his retirement benefits and the death benefits that would be available. Similar questions were answered indicating he agreed he was comfortable taking some risk. Mr W was also asked to select from a list of options what he thought his attitude to risk was. The option for 'balanced' was selected.

Ethos says that it met with Mr W on 7 December 2017 and discussed its advice with him. Its notes said that, following the discussion, Mr W had decided he would like to transfer his benefits away from the BSPS. And it said the reasons for this were that he was concerned about the future of the scheme, preferred to have flexibility and control over his pension benefits and thought having lump sum death benefits with his pension would be more useful to his family. Some forms to enable the transfer were signed at that time.

On 11 December 2017, Ethos sent Mr W a written summary of its advice (often referred to as a suitability report). This confirmed that Ethos' recommendation was that Mr W transfer his pension benefits into a personal pension on a named providers platform and invest in funds it thought met Mr W's attitude to risk. The suitability report said the reasons for this were that although its analysis indicated the existing scheme would likely meet his income requirements in retirement, it still recommended a transfer as this provided flexibility, access to potentially greater TFC and addressed the other things he'd discussed with it previously.

Mr W complained to Ethos in 2022 about the suitability of the transfer advice. Ethos didn't uphold Mr W's complaint. It said it believed its advice was suitable based on Mr W's objectives.

Mr W referred his complaint to the Financial Ombudsman Service. One of our Investigator's considered it and said they thought it should be upheld. He thought Mr W was always likely to receive lower benefits at retirement by transferring. He also thought Mr W could meet his income requirements within the scheme, didn't have a genuine need for flexibility or control and that the alternative death benefits offered by a personal pension didn't mean that a transfer was in his best interests. So, he recommended that Ethos compensate Mr W for any losses caused by the unsuitable advice and pay him £300 for the distress he'd incurred.

Ethos disagreed. It said it thought the returns required to match the benefits Mr W was giving up by transferring were realistic. And the recommendation was suitable based on his objectives. It also said it disclosed the relevant risks and thought Mr W had made an informed decision to proceed.

The investigator wasn't persuaded to change their opinion. He still didn't consider Mr W was likely to improve on the benefits he was giving up. And he noted the advice resulted in Mr W's pension being exposed to investment risk, when his plans for retirement weren't confirmed. He also made the point that Ethos' role was to give objective advice, not to put in place what Mr W might've thought he wanted.

As agreement could not be reached 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 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 Ethos'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, Ethos should have only considered recommending a transfer if it could clearly demonstrate that the transfer was in Mr W's best interests. And having looked at all the evidence available, I'm not satisfied it was in his best interests. I'll explain why.

Ethos was required, by the regulator, to produce a transfer value analysis ('TVAS'). This included calculating critical yields which showed how much Mr W's pension fund would need to grow by each year in order to provide the same benefits as his DB scheme at retirement. Ethos calculated critical yields required to match the benefits that the BSPS2 and PPF would provide from ages 65, 60 and 55.

If Mr W retired at age 65 the critical yield required to match the full pension the BSPS2 would've paid him was 5.87%. And to match the maximum TFC and reduced starting pension the BSPS2 would've offered was 4.97%. To match the full pension the PPF would've paid from that age the critical yield was 4.55% and to match the TFC and reduced pension the PPF would've offered it was 4.25%.

For retiring at age 60 the critical yields were higher, which is common in such calculations, as the funds have less time to grow. To match the full pension the BSPS2 would've paid the critical yield required was 6.98%. And to match the TFC and reduced pension the BSPS2 would've provided at that point it was 5.76%. In respect of the benefits the PPF would've offered the yields were 5.31% for a full pension and 4.95% if taking maximum TFC.

And to replicate the benefits both schemes would've offered from age 55, the yields were higher still. In respect of the BSPS2 benefits they were 9.66% for a full pension and 7.64% if taking TFC. And for the benefits the PPF would've provided in the same scenario the yields were 7.19% and 6.88% respectively.

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 rates at the time were 4.4% for 17 years to retirement – relevant if Mr W retired at age 65, 4.0% for 12 years to retirement (retiring at 60) and 3.4% for 7 years to retirement (at age 55).

There would be little point in Mr W giving up the guarantees available to him through his DB scheme and taking on the associated risks only to achieve, at best, the same level of benefits outside the scheme. And by transferring Mr W would have to pay annual fees and charges for the personal pension, which would reduce any gains the funds made. And those are not charges he would have had to pay if he didn't transfer.

I'm not sure that asking Mr W to select his own risk profile from a list of options was a sufficiently robust way of truly determining his attitude to risk. But nevertheless, even with his recorded 'balanced' attitude to risk, given the discount rates and considering the regulator's standard projection rates at the time of 2%, 5% and 8% for low, medium and high rate returns respectively, I think he was always likely to receive pension benefits of a lower value than those he'd have been entitled to under the BSPS2 or the PPF by transferring. Particularly so, in the case of early retirement.

And the critical yields aren't the only thing that, in my view, indicated Mr W would likely be worse off in retirement by transferring. The TVAS estimated that the cost, or pension fund value that would be required, to purchase equivalent benefits at age 65 to those the BSPS2 would provide was £855,766.68 for a full pension or £735,779.81 for taking equivalent TFC and reduced pension. But a personalised illustration from the recommended pension provider said if its mid-rate of growth was achieved until age 65 the projected value the fund Mr W might have was £451,000. Which is significantly below what would be needed to replicate the guaranteed benefits that Mr W was giving up.

Ethos felt the critical yields were achievable, considering the historic performance of the recommended fund. But as Ethos will know, past performance is no guarantee for future performance and so I consider the discount rates and the regulator's standard projections to be more realistic in this regard in the long term rather than projecting historic returns forward, particularly over such a long period of time. Ethos has also said that the 'hurdle' rates were achievable. But those rates are not based on replicating the guaranteed benefits Mr W was giving up as they do not account for a spouse's pension nor the pension continuing to escalate while in payment. So, I don't think these support that a transfer was in Mr W's best interests.

Ethos has said there were other reasons that meant the transfer was suitable for Mr W. It said he wanted flexibility and control to potentially be able to access his pension benefits before the normal scheme retirement age and to vary his income. It also suggested in the suitability report that he may be entitled to greater TFC if he transferred and that this was of interest to him. And it says he was interested in the alternative lump death benefits a personal pension offered. I'll go on to address these other reasons. But I'd also add that Ethos's role wasn't that of wish fulfilment or to put in place what Mr W might've thought he wanted when seeking advice. It was to give him objective advice about what was in his best interests.

The suitability report indicated Mr W may be able to draw a greater sum of TFC from his pension on retirement by transferring. But Mr W had no recorded need to access TFC. The fact-find indicated that his and Mrs W's personal loans were going to be repaid before he reached retirement. And, while the term of the mortgage was due to run beyond Mr W reaching 55, it was recorded that Mr and Mrs W intended to clear this sooner, within nine years. There was no suggestion that they intended to use or rely on accessing pension funds in order to do so. And there was no other expenditure or purpose recorded for requiring access to TFC. So, I don't think the potential for higher TFC, which in any event would be dependent on investment performance and involved exposing Mr W's pension to risk, meant a transfer was in his interests when he didn't have a need to access TFC.

The fact-find noted Mr and Mrs W expected to need an income of £18,000 - £20,000 per year in retirement and that Mr W was potentially thinking of accessing his benefits before the normal retirement age of his scheme. But Mr W could've taken benefits under the BSPS2 or the PPF before age 65. It is true that these would've been subject to actuarial reductions. But that was to reflect the fact that benefits would've been payable for longer than if he waited to his normal retirement age. And, as I've already explained, Mr W was unlikely to be able to improve on the benefits he'd have been guaranteed by the scheme from age 60 or 55 by transferring.

Ethos also acknowledged in the suitability report that the scheme benefits were likely to meet his income needs in retirement. Which is supported by the TVAS reports. Under the BSPS2 Mr W was expected to be entitled to a pension of £18,800 from age 60 – which met their needs. Or a pension of £17,273.81 from the PPF. From age 55, he was expected to be entitled to a pension of £14,906 from the BSPS2 or £14,332.88 per year from the PPF. Which fell short of their expected needs. But the fact-find suggested Mr W also intended to continue working part-time, if he did phase into retirement from age 55. So, would've expected to receive further income for that work. And he would've also had access to benefits he'd built up in his employers new DC scheme in that time. And that is before even taking into account Mrs W's ongoing salary or benefits she may've been able to draw from her pension. So, I don't think Mr W needed to transfer to meet his income requirements. And I can't see that he had a genuine need to be able to vary his income in retirement or for flexibility.

And ultimately, I don't think Mr W's plans for retirement were confirmed. The fact-find recorded that he may look to move into part time work and retire before his normal retirement age. But there isn't anything to suggest this was little more than an aspiration. And further notes indicate that Mr W was unsure when he would do this, as Ethos referenced this potentially happening in his "late fifties". I don't doubt that Mr W liked the idea of potentially retiring early. I think, when asked, most people would say they would like to do so. But, when it had come to it, he may've felt differently or opted not to retire early. And overall, I think it was too soon for Mr W to make an irreversible decision to transfer out of his DB scheme. Particularly when he had the option of joining the BSPS2, which, would've met his needs and because by joining it he would retain the option to transfer out at a later date if his circumstances required it.

Ethos said Mr W was interested in the lump sum death benefits of a personal pension. But Mr W was relatively young and in good health, so there was no reason to believe he wouldn't be reliant on his pension to meet his own needs in retirement – which is a pensions primary purpose, not to provide a legacy to the holder's estate. And 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. It would be subject to market risks and fluctuations and would be reduced by any income Mr W took during his lifetime, which given Ethos's advice seems to have been on the basis of him drawing sums from age 55 were likely to result in it being reduced. So, the pension may not have provided the legacy Mr W might've thought it would. 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.

If Mr W was concerned about leaving a legacy, insurance was an option. Ethos has provided evidence indicating it obtained a whole of life insurance quote, based on the CETV less the lump sum that the existing scheme provided, but Mr W discounted this because of the cost. Notwithstanding that Ethos's role was to advise Mr W about what was in his best interests, basing the quote on the transfer value of Mr W's pension benefits essentially assumed that he would pass away on day one following the transfer, and that isn't realistic. Rather the starting point ought to have been to ask Mr W how much he would ideally like to leave to his family, which also would've served to illustrate that this wasn't in fact just a generic objective. And if Mr W was still unhappy with the cost, this could've also been explored on a term assurance basis, which was likely to be a lot cheaper to provide.

Overall, I don't think different death benefits available through a transfer meant it was in Mr W's best interests. And ultimately Ethos should not have encouraged Mr W to prioritise the potential for alternative death benefits through a personal pension over his security in retirement.

I don't doubt that Mr W was likely to have been upset by what had happened with his pension to that point. Or that he had negative feelings about his employer and might've thought moving his pension away from it was appropriate. I think that would have been a very natural emotional response to what was happening. But I don't think, based on what I've seen, that he was committed to that course of action. And again, Ethos's role was to give impartial, objective advice. Mr W's employer and pension scheme were not one and the same. And Mr W intended to continue in his job and was paying into a new pension scheme with his employer. So, the relationship may not have irretrievably broken down as suggested.

Mr W may have held concerns about the prospect of his deferred benefits entering the PPF. But the BSPS2 was being established as an alternative. This was expected to provide better benefits than the PPF and still provide Mr W the option to transfer closer to retirement. But even if this hadn't happened, the PPF still provided Mr W with guaranteed income and the option of accessing his benefits early, which he was unlikely to be able to replicate or improve on 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.

And I can't see that Mr W had an interest in or the knowledge to be able to manage his pension funds on his own. Indeed, the recommendation to transfer was on the understanding he would take ongoing advice about how his pension was invested, at a further cost. So, I don't think that having control over his pension was a genuine objective for Mr W – it was simply a consequence of transferring away from his DB scheme.

Overall, I can't see persuasive reasons why it was clearly in Mr W's best interest to give up his DB benefits and transfer them to a personal pension.

Ethos says that Mr W made an informed decision to transfer. And I can see that it did give him information about some of the risks involved in a transfer, when it made its recommendation. But ultimately, it advised Mr W to transfer. And I think he relied on that advice. If Ethos, a professional adviser whose expertise he had been recommended, had explained why it wasn't in his best interests to transfer I think he'd have accepted that advice.

As a result, I'm upholding this complaint as I think the advice Mr W received from Ethos was unsuitable.

Our Investigator recommended that Ethos make a payment for the distress caused to Mr W. I accept that Mr W has likely been worried to find, when he discussed matters with his representative, that the advice might not have been suitable for him. And given the circumstances and uncertainty under which he first asked for this advice, I don't doubt he has been concerned. This wouldn't have occurred but for the advice that is the subject of this complaint. So, in the circumstances, I think the recommended award of £300 is fair and reasonable.

Putting things right

A fair and reasonable outcome would be for Ethos to put Mr W, as far as possible, into the position he would now be in but for the unsuitable advice. The suitability report noted that Mr W opted to join the BSPS2 before taking advice. So, if suitable advice had been given, I consider Mr W would have most likely remained in the occupational pension scheme and joined the BSPS2.

Ethos 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.

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

For clarity, Mr W 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, 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 W'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, Ethos should:

- calculate and offer Mr W redress as a cash lump sum payment,
- explain to Mr W 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 the redress prudently is to use it to augment his DC pension
- offer to calculate how much of any redress Mr W receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr W accepts Ethos's offer to calculate how much of his redress could be

augmented, request the necessary information and not charge Mr W 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 W's end of year tax position.

Redress paid to Mr W as a cash lump sum includes compensation in respect of benefits that would otherwise have provided a taxable income. So, in line with DISP App 4, Ethos 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 W'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.

In addition, Ethos should pay Mr W £300 for the distress caused by the disruption to his retirement planning.

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

<u>Determination and money award</u>: I uphold this complaint and require Ethos Financial Solutions Ltd to pay Mr W the compensation amount as set out in the steps above, up to a maximum of £170,000.

<u>Recommendation:</u> If the compensation amount exceeds £170,000, I also recommend that Ethos Financial Solutions Ltd pays Mr W the balance.

If Mr W accepts this decision, the money award becomes binding on Ethos Financial Solutions Ltd.

My recommendation would not be binding. Further, it's unlikely that Mr W can accept my decision and go to court to ask for the balance. Mr W 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 W to accept or reject my decision before 29 December 2023.

Ben Stoker
Ombudsman