The complaint

Mr R complained that he was given unsuitable advice to transfer his deferred defined benefit (DB) Occupational Pension Scheme (OPS), to a type of personal pension arrangement recommended to him by a financial adviser. The transfer took place in 1993.

Sesame Limited is now responsible for answering this complaint. To keep things consistent, I'll refer mainly to "Sesame".

What happened

At the time, Mr R was a deferred member of his OPS, having been employed from the late 1970s and he had accrued around 12 years' worth of benefits. Sesame's recommendation was to transfer away from his deferred DB scheme. Mr R's circumstances of the time showed:

- He was aged around 33 and in good health. He was married and had two dependent children.
- Mr R lived in a mortgaged property with his family. He earned around £10,000 per year from self-employment.
- The cash equivalent transfer value (CETV) of the DB pension was around £15,539. The normal retirement age (NRA) of the scheme was 60.

Sesame advised Mr R to transfer out of his DB scheme and invest in a 'with profits' personal pension arrangement. He complained in 2022, first to Sesame itself, about this advice being unsuitable. Mr R thinks he's lost out financially as a result. He later complained to the Financial Ombudsman Service.

Sesame said the complaint had been brought too late under the rules we operate by. I issued a jurisdiction decision on 4 July 2023 saying I thought the complaint *was* one we could look in to. I've then gone on to look into the merits of the complaint and am now making 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.

Our investigator explained that at the time of the advice, the firm Mr R dealt with was a member of the Financial Intermediaries, Managers and Brokers Regulatory Association ('FIMBRA'). He pointed out that the FIMBRA rulebook set out the expectations on members when giving advice in 1988. There were some additions and amendments in the subsequent years up to the transfer date in this case which was in January 1993. For example:

Rule 4.2.1 required an adviser to take reasonable steps to obtain relevant information concerning a client's personal and financial circumstances in order to provide investment services.

Rule 4.3.1 required FIMBRA members to take all reasonable steps to satisfy themselves that the client understood the risks involved in a transaction.

Rule 4.4.1 required members to establish, based on their knowledge of the client and 'any other relevant information which ought reasonably to be known' to them, which types of investment that were the most suitable for them.

Further amendments to the guidelines specified that advisers should ensure their recommendations were made based on the best interest of the client, rather than any income the adviser may generate. And it should also have been clearly demonstrated that the beneficiaries' rights in the scheme were fully considered.

I've used all the information we have to consider whether transferring away from the DB scheme was in Mr R's best interests. I don't think it was, so I'm upholding his complaint.

<u>Financial viability</u>

When advising Mr R on his pension transfer Sesame issued 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 retirement benefits as the DB scheme.

Sesame says the critical yield in Mr R's case was 10.4% although it's not entirely clear whether this was based on him retiring at the NRA of 60 and whether taking a tax-free lump sum, or just a normal annual pension without any lump sum. Nevertheless, this gives me some indication of the amount of growth Mr R's pension would need to grow by outside the DB scheme, to make transferring away from it worthwhile.

By of comparison, the advice was given during the period of the industry-wide Pensions Review, so the rate the regulator published for Financial Viability Tests (FVTs) are directly relevant here. When the advice was given, the regulator's upper limit for an FVT was 10.9% per year for 26 years to retirement. For further comparison, the regulator's upper projection rate at the time was 13%, the middle projection 10.75%, and the lower projection rate 8.5% per year.

It's also important to consider Mr R's attitude to risk (ATR) and whether he had any capacity for loss. Mr R was transferring from a well-known public sector pension which contained a number of valuable guarantees. He was a family man of 33 years of age and had two dependent children. Whilst he had started another personal pension, this was still very modest. Mr R was in the early stages of running a business as a self-employed person. In this context, I think his ATR would at best, be balanced, which was broadly in accordance with how he was treated by Sesame. In my view, he had a similarly modest capacity for loss.

All these things lead me to say that there was little opportunity for Mr R to improve the financial benefits of his future retirement by leaving the DB scheme. I say this because we know Mr R was advised to leave a DB pension scheme that was costing him effectively nothing to be a member of. So, even if the costs associated with the particular recommended personal pension were reasonably low, there was still charges / fees that he'd need to pay. Looking at the FVT and regulator's middle growth assumptions, these were very marginally above the critical yield rate of 10.4%.

So, what all this was showing at the time is that considering the costs of operating a personal pension, Mr R might reasonably expect to get broadly similar financial benefits if he transferred away. However, he'd lose other benefits and guarantees, which I'll come on to. But he'd need to exceed the critical yield rate year-on-year, and for many years, just to get similar financial benefits. He'd also need to accept risk, something he didn't need to think about with his current scheme. And in my view, there would simply be no point in Mr R transferring from his DB scheme to achieve returns that were, at best, only similar to those he could achieve by remaining where he was - in the DB scheme.

The adviser didn't appear to promote or really explain any financial rationale for transferring. However, I've noted Sesame now says the CETV was low and it represented only a small portion of what would eventually become his overall retirement income 'pot'. It implies that taking a risk with this small pension was therefore justified.

But this appears to me to be supposition. There is no evidence that this sort of thinking came from either party at the time and I think if Mr R had wanted to take some higher risks, this would have been recorded in more detail. In any event, categorising him as a "balanced" risk investor doesn't add any weight to this argument. I also don't think the pension being relatively small holds water either. The CETV may have seemed small, but this was in 1993 prices and DB schemes are calculated differently to personal schemes. So, what needed to be considered is the annual pension this DB scheme would promise to pay in the future. There's no evidence this formed part of the advice Mr R received.

For these financial comparison reasons alone, a transfer away from the DB scheme wasn't in Mr R's best interests or suitable for him. 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. I've considered this below.

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

There is only limited information and documents still available to us. However, Sesame says Mr R's file shows that his main focus in seeking out advice in May 1992 was *"planning for your retirement and general financial advice."* And I can see the advice he received was over a period of several months during 1992, with the eventual pension transfer occurring in January 1993. Sesame also refers to documents from the time saying that he had an intention to retire early and it implies that because he had left his previous employer, Mr R wanted the independence to manage his pension affairs from thereon in.

- *Early retirement*

Like our investigator, I have found conflicting evidence from the advice sessions, around the matter of early retirement. I start from the obvious position that Mr R was only aged 33. With a growing family and a relatively new career pathway, its's therefore simply not credible that he could have had any concrete early retirement plans. For him, retirement in any capacity was around three decades away and if there was indeed a discussion at all about retirement, I think the adviser should have been pointing these very obvious facts out to Mr R.

I also note that various documents from the time refer to a retirement at 60, rather than a notion of early retirement. Mr R's written application form for the 'new' pension even refers to the age of 65. So, I think any reference to an early retirement was no more than a 'stock' objective used by the adviser to help justify the transferring away from Mr R's DB scheme. Early retirement was not relevant in these circumstances.

- *Control and independence of the funds*

As for financial independence, there’s no evidence that Mr R was an experienced investor. Nor is there any evidence he had the desire or capacity to manage this pension going forward. I do accept he’d started a personal pension of his own which looks like it was linked to his self-employment venture. But staying in the DB scheme required no work from Mr R. And in my view, if he’d ultimately managed to use his own personal pension in the forthcoming years to build up an effective ‘money market’ pension fund, then I think he’d have been in an agreeable position if he’d kept his DB pension exactly where it was. I say this because Mr R would have saved in a long-term defined contribution (DC) scheme, which was complemented upon retirement by a deferred DB scheme which contained a number of benefits and guarantees.

- *Death benefits*

I can’t be sure the extent to which death benefits were discussed at the time, but Sesame sent us an information sheet Mr R was given as part of the overall advice session(s). As this set out some of the differences in the DB and personal scheme with regards to death benefits, I think it’s fair to say the matter probably came up.

However, in my view, the death benefits on offer through the DB scheme were good. We know, for instance, that upon death after his retirement, the spouse benefits provided a 50% pension increasing with the retail prices index (RPI). If death occurred before retirement – and of course, Mr R was still only 33 at the time – there was a spouse’s pension of 50% revalued to the date of death, again with RPI, plus 50% between dependent children. In the event of incapacity rather than death, there were other benefits to consider.

These were, in my view, important benefits because Mr R was married and had children. These types of benefits were not generally present outside the scheme and I think they were likely underplayed, substantially so, during the course of the advice. I think the adviser should have been promoting these to Mr R and explaining how valuable they were to his and Mrs R’s situation. I think the adviser failed in their duty in this regard.

<u>Summary</u>

In this decision I’ve explained why I don’t think the advice to transfer away from Mr R’s DB scheme was suitable for him or in his best interests.

Mr R was giving up a guaranteed, risk-free and increasing income within his current DB scheme. From a financial comparison perspective, no real transfer analysis was carried out which allowed Mr R to make reasonable comparisons with his existing scheme and the one he was being recommended to transfer into. I accept the regulatory requirements were different at the time, but the advice still ought to have been clear enough for Mr R to make an informed decision.

In any event, I think there was no indication that Mr R could be better off by leaving the DB scheme. His ATR and capacity for loss indicated he’d only be likely to ever grow the transferred funds to an extent which implied broadly similar financial benefits, at best, to the DB scheme he was advised to leave. There was simply no financial case for transferring away.

As for implied flexibility, I’ve explained how the notion of early retirement was never applicable to Mr R’s situation. He was a young man with a young family and there was no credibility in yet saying he planned to retire early when he was still only 33 years of age. There were no other reasons to support the advice to leave the DB scheme.

I’m sure Mr R had some aspirations at the time. But the adviser wasn’t there to just transact what Mr R thought he wanted. Their responsibility was to their client; to really understand his situation and to provide advice that was suitable and in his best interests. I think the evidence shows this didn’t happen here. So, I don’t think the advice given to Mr R was suitable. In fact, I think the much stronger case by far was for Mr R to use the DB pension in the way it was originally intended.

I therefore think Sesame should compensate Mr R for the unsuitable advice, using the regulator's DB pension transfer redress methodology.

Putting things right

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

Sesame 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.

Compensation should be based on the scheme’s normal retirement age of 60, 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 R’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, Sesame should:

- calculate and offer Mr R redress as a cash lump sum payment,
- explain to Mr R 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 R receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr R accepts Sesame’s offer to calculate how much of her redress could be augmented, request the necessary information and not charge Mr R for the calculation, even if he ultimately decides not to have any of her redress augmented, and
- take a prudent approach when calculating how much redress could be augmented, given the inherent uncertainty around Mr R’s end of year tax position.

Redress paid to Mr R as a cash lump sum will be treated as income for tax purposes. So, in line with DISP App 4, Sesame 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 R's likely income tax rate in retirement – presumed to be 20%. So making a notional deduction of 15% overall from the loss adequately reflects this.

Where I uphold a complaint, I can award fair compensation of up to £170,000, plus any interest and/or costs that I consider are appropriate. Where I consider that fair compensation requires payment of an amount that might exceed £170,000, I may recommend that the business pays the balance.

My final decision

Determination and money award: I uphold this complaint and I now direct Sesame Limited to pay Mr R 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 Sesame Limited pays Mr R the balance. If Mr R accepts this decision, the money award becomes binding on Sesame Limited.

My recommendation would not be binding. Further, it's unlikely that Mr R can accept my decision and go to court to ask for the balance. Mr R 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 R to accept or reject my decision before 3 August 2023.

Michael Campbell
Ombudsman