DRN-4430220

The complaint

Mr K has complained about the advice he was given by JM Independent Financial Advisers Ltd to transfer his personal pension to another pension provider. He says the funds recommended in the new pension weren't in line with his attitude towards risk. He also says the charges increased and they weren't properly disclosed.

What happened

Mr K's complaint was considered by one of our investigators. He sent his assessment of it to both parties on 13 October 2023. The investigator's understanding of the background and circumstances to the complaint were set out in that assessment. Both parties have subsequently disputed some of the circumstances. Whilst I've taken everything into account, I've focused on the key points which I think are material to deciding the fair outcome of the complaint, which in my view turns on the suitability of the advice given.

Mr K had transferred his previous pension arrangement to a personal pension on the advice (given in 2016) of JM IFA. His transfer value was invested in one of the pension providers' own funds. Mr K's attitude to risk was moderate at the time. The total charges on the personal pension were 1.75%, which included a 0.75% ongoing service charge.

In late 2021 JM IFA advised Mr K to transfer his personal pension to a Self-Invested Personal Pension (SIPP) and invest in a range of funds. The transfer value was approximately £428,000. Mr K's attitude towards risk was still moderate (3/5). It was recorded that Mr K's existing fund had a risk rating of 2/5.

The reasons recorded for recommending the transfer included:

- Mr K could build and manage a retirement portfolio that met his attitude towards risk.
- Through JM IFA, Mr K's portfolio would be regularly reviewed, taking into account his other areas of financial planning. This was likely to be on a quarterly basis.
- JM IFA would build a bespoke investment strategy to meet Mr K's needs and ensure that should his views on risk change JM IFA would alter the funds within the plan accordingly.
- JM IFA were recommending that Mr K invest in a plan that had access to a good selection of funds in the marketplace whilst still offering a competitive cost.

The suitability report said charges on the new plan, including an ongoing annual service charge of 1%, were 2.06%. Including the initial fee, the charges were 2.1%.

In 2023 Mr K complained to JM IFA about the advice he'd been given. JM IFA didn't uphold the complaint, and Mr K subsequently referred it to us.

Our investigator thought that Mr K's complaint should be upheld. He referred to the Financial Service Authority's (the industry regulator as it was known at the time) report and checklist for pension switching published in 2009. He said he thought it was still applicable. He said the checklist identified areas where consumers had lost out which included:

- They had been switched to a pension that was more expensive than their existing one(s) or a stakeholder pension (because of exit penalties and/or initial costs and ongoing costs) without good reason.
- They had switched into a pension that didn't match their recorded attitude to risk (ATR) and personal circumstances.

The investigator said the new SIPP Mr K had been transferred to was more expensive than his existing pension, albeit he was satisfied that the increased charges had been properly disclosed to Mr K.

The investigator said Mr K had been recorded as being a moderate risk investor which was described as:

"You are prepared to take a moderate amount of investment risk in order to increase the chance of achieving a positive return. Capital protection is less important to you than achieving a better return on the investment. A typical Moderate investor will usually invest in a variety of assets to obtain diversification and therefore reduce risk. Equities and property, which can boost longer term returns but are associated with more risk, would often account for a higher proportion of assets than fixed interest gilts and bonds or cash. At shorter investment terms the proportion of higher risk assets is usually reduced. The range of asset types helps reduce the overall risks while increasing the chance of better returns."

The investigator said the risk score for the fund Mr K had been invested in with his original provider was 49 out of 100. He thought this indicated Mr K was invested in line with his attitude to risk.

The investigator said the risk score for the new funds Mr K was advised to transfer to was quoted as 77 out of 100. He said he'd looked at the individual funds in question. He said the vast majority of these funds were categorised as either above average or higher risk funds. The investigator didn't think Mr K had been invested in funds aligned to his moderate attitude towards risk. He said if Mr K had wanted to increase the amount of risk he wanted to take he could have switched funds with his existing pension provider.

Overall, the investigator said he thought it was difficult to see what the benefit of transferring was to Mr K. He said Mr K was reliant on the advice he'd paid for. And he thought if JM IFA had advised Mr K against the transfer he wouldn't have transferred.

JM IFA didn't agree with the investigator's findings.

Mr K said he accepted the investigator's conclusions. However he said there were some inaccuracies in JM IFA's account of events.

Both parties provided further evidence and arguments for consideration.

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.

Having done so, I've come to the same conclusion as the investigator that the complaint should be upheld, and largely for the same reasons.

Both parties provided further evidence and arguments in response to the investigator's view. The investigator also sent an e-mail on my behalf setting out my thoughts on Mr K's partner's complaint which both parties responded to. The complaints are similar in nature, and evidence and arguments have been provided which are relevant to both.

JM IFA said we (the Ombudsman Service) had explained ‘What’ should have been done regarding the advice given. However it had gone three additional steps further and considered ‘When’ ‘How’ and ‘Why’. It said an example of ‘When’ and ‘How’ it went beyond the norm was ‘When’ in 2021 it advised Mr K’s partner on a partial transfer it didn’t recommend any investments in Fixed Income, but did have Property and Alternatives. It said with the changes in interest rates over the following 18 months this proved to be the correct decision. Then in late 2022 it started to re-introduce Fixed Income to portfolios.

Although it accepted it didn’t get it right all of the time, by reviewing clients regularly and actively managing their position it usually provided better outcomes for clients. JM IFA went onto explain how the analytics system it used helped it provide better outcomes for its clients. It said it was a tool that allowed it to minimise risk through diversification, not only in asset classes, but also within regions of asset classes and shares within funds.

In terms of ‘Why’, it said it had made the recommendation in the first place after Mr K and his partner had contacted it about moving out of their existing fund due to its slow recovery following Covid. It didn’t initially facilitate the request, as it thought that Mr K and his partner would benefit from the smoothing element of their existing fund. It contacted them after the Unit Price Reset had happened to say it would now consider moving their funds.

JM IFA said that our assessment of suitability had been based on a snapshot in time, and no allowance had been made for time as a factor. It said we’d focussed on asset allocation, which it agreed would be the approach if the initial advice wasn’t going to be reviewed. But it said it only took on clients who believed in an ongoing service, as advice could change with legislation and economic cycles. It said its tools allowed it to assess risk/volatility and diversification of a portfolio at fund and stock level.

JM IFA said although I’d said following the transfer Mr K and his partner would have about 80% allocated in equities (it thought it was about 75%), this made no allowance for the smoothing effect of the existing fund or the diversification of the different equity funds following the transfer. It said whilst its initial recommendation may have had a higher weighting of equities, over time that changed to levels in line with the weightings I‘d referred to.

JM IFA said all this showed that using asset allocation only as a tool was incredibly inaccurate, which is why it used risk score and volatility levels. JM IFA said as a regulated entity it followed guidelines, not rules. And the guidelines didn’t provide a pre-determined risk score/level of volatility to allocate to a category of risk. It said it thought it had worked within the guidelines and there was no one correct answer

Ultimately, JM IFA considered the funds it recommended were aligned to Mr K’s moderate attitude to risk. It explained the working of the analytics system that it used. And said Mr K’s funds were consistent with the risk score provided by the analytics system for moderate risk. It said it was within its own parameters for a moderate risk investor, and well within it when Mr K’s funds were blended together with his partner’s funds and considered in the round.

As I said above, I think a key point here is that the outcome of the complaint turns on the suitability of the advice given. So I’ve focused on that issue in this decision, and I haven’t commented on all the evidence and arguments provided unless I think it’s material to deciding the fair outcome of the complaint or otherwise appropriate to do so.

I’ve carefully considered what JM IFA has said about the analytics system’s risk scores and corresponding construction of appropriately weighted portfolios. I agree that there are no specific rules defining suitable portfolios for different levels of risk. Portfolio construction isn't an exact science, and there's no hard line against which to judge where one level of risk ends and another starts. Different businesses and advisers may have different methods and theories behind building suitable portfolios. However I don't think it's disputed that diversification *is* a widely accepted principle of investment risk management.

I realise that both parties have strong opinions about the outcome of the complaint. I'm required to make a decision by reference to what is, in my opinion, fair and reasonable in all the circumstances of a case.

Mr K's existing fund had approximately 48% invested in Equities, 21% in Fixed Interest, 14% in Property, 9% in Others and 8% in Alternative Investment Strategies. This provided some protection against any significant underperformance of any particular asset class.

Following the transfer Mr K's pension, even when considered together with his partner's pension following her transfer, had a heavy weighting in equities. And several of the funds recommended presented above average and higher risks.

There are a number of tools, systems and sources of information to help advisers construct suitable portfolios - for example the FTSE Private Investors Index Series or MSCI PIMFA Investor Index Series provide performance benchmarks made up of differing levels of risk. There was about 80% equity content following the transfer (taking Mr K and his partner's pension together). JM IFA has said it was more like 75%. Whether it was 80/75% or around those figures, that is significantly and materially above the allocations used in the benchmarks I've referred to above that might be used for a moderate risk investor at the time. And when Mr K's pension was considered on a stand-alone basis the equity content was in the 90% range.

It was also, in my experience, a weighting significantly above what would be considered reasonable for a client wanting a moderate degree of risk. And then when taking into account the nature and risks of the equity funds recommended – several funds were above average or higher risk – it presented, in my opinion, a greater degree of risk than Mr K had agreed to accept. That is considering the matter both for Mr K in isolation, and in the context with his partner's circumstances.

JM IFA has said no allowance has been made for the smoothing effect of the existing fund or the diversification of the different equity funds following the transfer. It said whilst its initial recommendation may have had a higher weighting of equities, over time that changed to levels in line with those weightings.

I accept the funds recommended had exposure to different areas and underlying assets and so provided some diversification. And I've taken into account the nature and features of the original fund in considering the levels of risk (in the context of this case and taking into account the position including Mr K's partner's pension following transfer). However I don't think that sufficiently mitigates the lack of appropriate weighting in other assets and level of risk presented by the funds recommended. In my view the position after transfer presented a greater degree of risk than Mr K had agreed to take – whether taken together with his partner's pension or on a stand-alone basis.

Whilst I accept the make-up of the funds may have changed over time, what I'm considering here is the complaint about the suitability of JM IFA's original advice and its recommendation to transfer and how to invest.

There has been comment from both parties about the fund with Russian exposure. The recommendation was to invest 7% of the transfer value in it. I don't think there was anything wrong in recommending a fund with Russian exposure in itself at the time. Different investment managers will have different opinions about the future direction of asset prices, and they will take into account wider events in making their decisions.

The issue here is that the Russian fund was recommended along with a number of other funds presenting significant risks. Investing some capital in a higher risk investment isn't unsuitable for a moderate risk investor in itself, if the overall portfolio has sufficient weightings of lower risk assets and so is appropriately balanced to moderate risk overall. However for the reasons given above, I don't think they were appropriately balanced in Mr K's case, even if taking his partner's pension into account.

Mr K's existing pension valued at over £428,000 was invested in a single fund. My understanding is that Mr K wasn't able to partially transfer some of the pension to another provider – it was the whole amount or nothing. And for the reasons I've outlined above, I'm not persuaded the recommendation to transfer the whole fund and invest as he did was suitable.

My understanding is that Mr K may have been able to switch some of his money out of his existing fund to another fund with the same provider. So with suitable advice Mr K may have switched some of his pension with his existing provider. However it's not clear exactly which funds with the provider he would have switched into. Although Mr K's existing fund was at the lower end of the risk he wanted to take, I'm satisfied it's reasonable to base fair compensation measured against the performance of the original fund assuming Mr K hadn't transferred following JM IFA's unsuitable advice.

JM IFA has said given the nature of the fund Mr K was invested in prior to the transfer it applied a reduced ongoing service charge by 0.25%. I accept that if Mr K had switched some or all of his pension out of that fund (for example wholly to a new provider or partly with the original provider) to diversify, the charges would have increased by 0.25% on that proportion of the fund in any event. However I don't think any slight differential in charges is key to the outcome of the complaint either way. As I've said, I think what's key here is whether the recommendations made by JM IFA were aligned to Mr K's moderate attitude to risk.

JM IFA has said it has spoken to the FCA during one of its recent visits about its investment process and how it assesses risk and builds its portfolios. It said the FCA didn't have any concerns in its approach to building portfolios and that these were based on risk score and volatility rather than asset allocation alone. It said the FCA was happy with its process and it had followed that process in this case.

My conclusions here are specific to the particular circumstances of the complaint. My role isn't to consider the process used by JM IFA, it's to decide whether the advice it provided to Mr K was suitable. As I've explained, my decision isn't based solely on asset allocation – I've considered the nature and degree of risk presented by the underlying funds which were largely above average and higher risk in themselves. I agree with JM IFA that having a range of funds invested in different areas provides some diversification and mitigates risk to some degree. But I'm not persuaded that is sufficient to align the risks presented by the portfolio recommended to a moderate risk investor here.

There is balance to be had. As I've said, diversification of assets is a well-known risk management strategy. The firm has said it has advised against investing in certain asset classes in the past and, although not right all of the time, it has often provided better outcomes for clients. It's a matter of professional opinion what direction prices will head, and it may turn out favourably to avoid a particular category of asset for any particular period. But if there is a very high concentration of capital in *one* particular asset type, that clearly presents more risk than having capital in a balanced spread of assets. And particularly if the high concentration is in assets that themselves present significant risks. In most circumstances it's not possible to know for certain where prices are headed – even if they are regularly reviewed markets can change quickly.

JM IFA said that Mr K and his partner each wanted to move 50% of their pensions, and if that had been possible it thought the complaints would likely have been found in its favour. It said it wasn't possible to transfer 50% of Mr K's pension as he couldn't transfer partially. It said had it been able to move 50% of Mr K's pension, it would have moved more funds for his partner. It said if the complaint was upheld, the redress should reflect the clients' wishes to move 50% to equities.

The complaint I'm considering is the advice Mr K was given by JM IFA to transfer his entire pension to a SIPP. Mr K and his partner may have had their own thoughts on what they wanted to do with their pension. But JM IFA was acting in its capacity as a professional adviser, and it was JM IFA's responsibility to provide suitable advice. Mr K's losses flow from that unsuitable advice, and I'm not persuaded it's appropriate to calculate redress on the basis suggested by JM IFA.

Different professionals can have different reasonable opinions about risk. But taking everything into account, for the reasons outlined above, I think JM IFA's recommendation clearly presented a greater degree of risk than Mr K had agreed to take. That is considering the matter in the context of both his and his partner's pensions and on a stand-alone basis.

Putting things right

My aim in awarding fair compensation is to put Mr K back into the position he would likely have been in had it not been for JM IFA's unsuitable advice. For the reasons outlined above, I think it's fair and reasonable to use the return on Mr K's original fund as a proxy for the return he might have got had suitable advice been given.

Therefore JM Independent Financial Advisers Ltd should obtain a notional value of Mr K's pension from the previous provider assuming he hadn't originally transferred out of it and as at the date he transferred his pension again which I understand was 10 August 2023.

It should compare this notional value with the transfer value of his actual pension as at the same transfer out date. If the notional value is higher, then there is a loss and compensation is due.

If the value of his actual pension was higher then there is no loss and no redress is payable.

If there is a loss calculated as at 10 August 2023, it should then be revalued in line with the performance of Mr K's original fund from 10 August 2023 to the date of decision. Interest at the rate of 8% simple should then be added from the date of the decision to the date of settlement if it's not paid within 42 days of us notifying JM IFA that Mr K accepts the decision.

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

If Mr K has remaining tax-free cash entitlement, 25% of the loss would be tax-free and 75% would have been taxed according to their likely income tax rate in retirement – presumed to 20%. So, making a notional reduction of 15% overall from the loss adequately reflects this.

JM Independent Financial Advisers Ltd should also pay Mr K £300 for the distress and inconvenience caused to him by the matter.

My final decision

My final decision is that I uphold Mr K's complaint.

I order JM Independent Financial Advisers Ltd trading as JM Independent Financial Advisers to calculate and pay compensation to Mr K as set out above under 'Putting things right'.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr K to accept or reject my decision before 25 April 2024.

David Ashley
Ombudsman