DRN-4573511

The complaint

Mr V through a professional representative complains about the advice given by AFH Independent Financial Services Limited to transfer the benefits from his defined-benefit ('DB') occupational pension scheme to a drawdown arrangement. They say the advice was unsuitable for him and believes this has caused a financial loss.

What happened

The investigator set out the background to this complaint in his view, this has not been disputed so I've included an amended version below to set the context of this complaint.

Mr V through the professional representative raised a complaint with AFH on 19 December 2022.

They stated that Mr V received negligent advice from AFH and had suffered a loss as a result, and he now seeks to be restored to the position he would've been in if not for that advice.

The representative said Mr V had a final salary pension which he was advised to transfer by AFH. Mr V had originally approached them to discuss possibly accessing his pension. But the representatives say that AFH never explained to Mr V the benefits he would be losing by transferring out of the final salary pension, and had they done so, he wouldn't have proceeded to transfer.

The representative also explained that they believe Mr V was a vulnerable client at the time of the advice. This is because Mr V's wife had recently gone through a major operation and Mr V was suffering from anxiety and depression. It therefore believes AFH ought to have treated Mr V as a vulnerable client but didn't do so.

Mr Vs objectives were described as being to pay off his mortgage and to buy a new car. However, they say he was meeting his mortgage repayments and buying a new car wasn't essential. It was also explained that Mr V's original pension included guaranteed death benefits for Mr V's spouse, which have now been lost.

AFH explained that Mr V and his wife met with their adviser on 11 August 2016, where his personal/financial circumstances, needs and objectives were recorded. According to their records, Mr V was:

- 56 years old
- Married
- Employed as a Warehouse Team Manager with an annual income of £27,000
- Mr V solely owned the main residence valued at £120,000, with £3,000 remaining on the repayment mortgage
- £1,600 to repay on a personal loan
- £4,000 and £1,000 sums held 'on deposit' as emergency funds.
- Attitude to risk of moderate

AFH stated that on 31 August 2016, Mr V signed a pension transfer attitude questionnaire. It was recorded in this that he wanted to retire at age 62 although he felt this probably wasn't affordable, wished to break ties with his former employer, had serious concerns over the security of his employer, wished to place a significant portion of his pension to limited risk, wanted flexibility at retirement, maximum lump sum, he didn't mind a reasonable degree of risk, and that death benefits weren't a priority as his dependants would already receive a significant sum if he died.

A pension transfer report was then issued by AFH and the report estimated the final salary scheme's benefits at Mr V's 65th birthday being: an annual pension of £9,086, or a lump sum of £41,035 and a reduced annual pension of £6,155.

The report indicated that in order to provide an annuity matching Mr V's scheme benefits, a critical yield of 9.63% would be needed or 7.29% in the case of the lump sum and reduced annual pension figures.

A retirement options report was sent to Mr V on 24 November 2016, it noted he wished to spend £5,000 on home improvements, increase his emergency fund by £5,000 and repay the remaining £3,000 on his mortgage. It noted that Mr V wanted to use his pension lump sum to do this, as well as draw an income of £650 per month to replace his wife's income (as she was unable to work due to ill health).

As a result, AFH recommended in this report that Mr V transfer to a flexi access drawdown pension.

AFH say that Mr V's circumstances required a flexible income, which wasn't something the existing scheme could provide him with. They say they provided Mr V with detailed analysis in the two reports and ensured he understood the risks involved before transferring away from a defined benefit pension. For these reasons, AFH didn't uphold the complaint.

Mr V's representatives said in response:

- Mr V felt it would be handy to repay his mortgage, but there was only £3,000 left and he was meeting the repayments, so it wasn't a need.
- It wasn't clear at the time if his wife would ever return to work, but even if she didn't, he'd be able to afford their lifestyle with his own income.
- Mr V feels AFH are incorrect to say he had an objective of increasing his emergency fund, as he didn't consider this an objective at the time.
- Mr V says he was living comfortably with disposable income at the time and so accessing pension cash wasn't a necessity, it was just a preference.

As a result, Mr V remained of the opinion that the advice to transfer was unsuitable and asked our service to investigate the matter further.

The investigator also noted the fact find document showed that the personal loan, was actually a loan taken to help Mr V's son buy a car and in reality his son was repaying the loan, not Mr V.

After considering all of the above the investigator decided to uphold the complaint. He explained that due to the critical yield required and higher cost of the new arrangement the transfer wasn't in Mr V's best interests. And the requirements driving Mr V's consideration of transferring weren't compelling reasons to give up a secure guaranteed income in retirement. The debts were small and being met and whilst AFH's advice may have met Mr

V's objectives, it was their job to give him best advice and explain that these objectives weren't important compared to the risk he was taking on by transferring his main source of income in retirement.

AFH responded to say it would look into carrying out a loss calculation without liability but some time has passed and we've heard nothing further from it regarding any progress on this matter.

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 BUSINESS'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, BUSINESS should have only considered a transfer if it could clearly demonstrate, on contemporary evidence, that the transfer was in Mr V's best interests. And having looked at all the evidence available, I'm not satisfied it was in his/her best interests.

Financial viability

AFH carried out a transfer value analysis report (as required by the regulator) showing how much Mr V's pension fund would need to grow by each year in order to provide the same benefits as his DB scheme (the critical yield).

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.

Mr V was 56 at the time of the advice and the normal retirement age of his scheme was 65. The critical yield required to match Mr V's benefits at age 65 was 9.63% if he took a full pension and 7.29% if he took TFC and a reduced pension. These figures aren't for the actual product Mr V transferred to but a slightly earlier transfer analysis for a different product produced approximately a month before the recommendation which formed the basis of the transfer.

The relevant discount rate closest to when the advice was given which I can refer to was published by the Financial Ombudsman Service for the period before 1 October 2017, and was 3.7% per year for 9 years to retirement. I've kept in mind that the regulator's projection rates had also remained unchanged since 2014: the regulator's upper projection rate at the time was 8%, the middle projection rate 5%, and the lower projection rate 2%.

I've taken this into account, along with the composition of assets in the discount rate, Mr V's moderate attitude to risk and also the term to retirement. There would be little point in Mr V giving up the guarantees available to them through his DB scheme only to achieve, at best, the same level of benefits outside the scheme. But here, given the lowest critical yield was 7.29%, I think Mr V was likely to receive benefits of a substantially lower overall value than the DB scheme at retirement, as a result of investing in line with that attitude to risk.

For this reason alone a transfer out of the DB scheme wasn't in Mr V's best interests. Of course financial viability isn't the only consideration when giving transfer advice, as AFH has argued in this case. There might be other considerations which mean a transfer is suitable, despite providing overall lower benefits. I've considered this below.

Flexibility and income needs

I don't think Mr V required flexibility in retirement. This is because based on the evidence I've seen, I don't think he had a genuine need to access his tax-free cash earlier than the normal scheme retirement age. I say this because the reasons given by Mr V for what he required the tax-free cash for were not essential in my view. They were things that were as the investigator said, 'nice to haves' and shouldn't have been prioritised over security in retirement. Little analysis was done of Mr V's income and expenditure needs but it appears his outgoings were low and there's no indication Mr V couldn't meet his essential needs. And Mr V has told us he took benefits as the option presented itself, it wasn't essential. And he had disposable income at the time. The advice was given to transfer to access tax-free cash to use for home improvements, to increase his emergency funds, repay his mortgage and personal debt. However, Mr V already had some emergency funds in place, his mortgage only had £3,000 left on it and the personal debt was in fact a loan taken out to buy his son a car which his son was repaying to him. I understand Mrs V had to stop work due to ill health and income was taken to replace this but there's no evidence to suggest this was a necessity either.

Mr V continued to make ad hoc withdrawals upon the advice of AFH following the transfer, money was taken out for further home improvements and a new car and repairs to a garage roof. And a three year annuity was taken out to increase his income up to the higher income bracket until Mr V's state pension age. This left Mr V's pension fund heavily depleted. It appears Mr V began to use his pension benefits almost like a bank account to increase the income available to him upon the recommendations of AFH. I think his actions were likely a result of the initial unsuitable advice to transfer for what were inconsequential needs in relation to the importance of the previously guaranteed income in retirement.

Mr V's alleged concerns about the scheme

The funding of the DB scheme was not in a position such that Mr V should have genuinely been concerned about the security of his pension. Whilst it was at the time underfunded, this is not unusual, more recently over half of FTSE 100 firms were found to have underfunded pension schemes. And it was still paying unreduced transfer values which suggests the underfunding wasn't in anyway critical. Furthermore, if the scheme did end up moving to the PPF, I think AFH should have explained that this was not as concerning as it may sound.

Summary

I don't doubt that the flexibility, control and the availability of tax-free cash and further withdrawals offered through a personal pension would have sounded like attractive features to Mr V. But AFH wasn't there to just transact what Mr V might have thought he wanted. The adviser's role was to really understand what Mr V needed and recommend what was in his best interests.

Ultimately, I don't think the advice given to Mr V was suitable. He was giving up a guaranteed, risk-free and increasing income. By transferring, Mr V was very likely to obtain lower retirement benefits and in my view, there were no other particular reasons which would justify a transfer and outweigh this. Mr V shouldn't have been advised to transfer out of the scheme just to repay a mortgage that was affordable, a loan his son was essentially paying back and for home improvements. If Mr V required additional income to meet his expenses, AFH should've carried out an analysis of this. Mr V has told us that he had disposable income and didn't need additional funds he has withdrawn from his pension. And I've seen no evidence to suggest this isn't the case.

So, I think AFH should've advised Mr V to remain in their DB scheme.

Of course, I have to consider whether Mr V would've gone ahead anyway, against AFH's advice.

I've considered this carefully, but I'm not persuaded that Mr V would've insisted on transferring out of the DB scheme, against AFH's advice. I say this because Mr V was an inexperienced investor with a moderate attitude to risk and this pension accounted for the majority of Mr V's retirement provision. So, if AFH had provided him with clear advice against transferring out of the DB scheme, explaining why it wasn't in his best interests, I think he would've accepted that advice.

The investigator awarded £200 for the distress and inconvenience the unsuitable advice will have caused Mr V and I don't think this is unreasonable. Whilst Mr V will have enjoyed the proceeds of the benefits he's withdrawn to date, this has left his retirement income severely reduced. And I think this will have caused him distress.

Putting things right

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

AFH 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, had suitable advice been given I think Mr V would've remained in the scheme and accessed his benefits at his normal retirement age. So, compensation should be based on the scheme's normal retirement age of 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 PS22/13 and 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 V'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, AFH should:

- calculate and offer Mr V redress as a cash lump sum payment,
- explain to Mr V before starting the redress calculation that:
    - their 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 V receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr V accepts AFH's offer to calculate how much of their redress could be augmented, request the necessary information and not charge Mr V 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 V's end of year tax position.

Redress paid to Mr V 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, AFH may make a notional deduction to cash lump sum payments to take account of tax that Mr V 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 V'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.

AFH should also pay Mr V £200 for the distress and inconvenience caused.

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 require AFH Independent Financial Services Limited to pay Mr V 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 AFH Independent Financial Services Limited pays Mr V the balance.

If Mr V accepts this decision, the money award becomes binding on AFH Independent Financial Services Limited.

My recommendation would not be binding. Further, it's unlikely that Mr V can accept my decision and go to court to ask for the balance. Mr V 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 V to accept or reject my decision before 15 March 2024.

Simon Hollingshead
Ombudsman