DRN-4861973

The complaint

Mr M complained about advice he was given to transfer the benefits of a deferred defined-benefit (DB) pension scheme to a type of personal pension. He says the advice, which was provided on 31 March 2009, was unsuitable for him and believes this has caused him a financial loss.

J M Taylor Financial Services Limited is now responsible for answering this complaint. To keep things simple therefore, I'll refer mainly to "JMT".

What happened

The pension in question here related to a previous public sector DB scheme which at the time of the advice was in deferment. Mr M had accrued a number of years' service with this scheme and was given a cash equivalent transfer value (CETV) of £78,379 in 2009.

Mr M was passed to JMT for regulated pension advice as my understanding is that he already had an existing relationship with an independent financial adviser (IFA) who did not have the regulatory permissions to advise on DB pension transfers. Information gathered about his circumstances and objectives were broadly as follows:

- At the point of recommendation, Mr M was 50 years old and separated. He had no financial dependents at that time.
- Mr M had moved to a new job and had only just joined his new employer's pension scheme. His annual income (gross) was £36,000.
- Mr M had no savings or investments and no other pensions. He said that at the time he was required to pay an HMRC tax bill of around £6,000. He said he also had about £10,000 in credit card debt.
- Mr M's deferred DB scheme had a normal retirement age (NRA) of 60.
- When dealing with JMT, Mr M said that he would like to pay the tax bill and eliminate the credit card debt by accessing his pension. He also apparently wanted some cash to pay for unspecified spending going forward, such as family gifts.

JMT set out its advice in a recommendation report. In this it advised Mr M to transfer out of the deferred DB scheme, take out a 25% tax-free lump-sum to spend on some of the items I've mentioned above, and then invest the remaining funds in a type of personal pension plan. JMT said this would allow Mr M to achieve his financial objectives. He accepted this advice and so transferred later in 2009. As he approached closer to retirement, in 2023 Mr M complained to JMT about its advice. He said he shouldn't have been recommended to transfer out to a personal pension. In response, JMT said it hadn't done anything wrong and was acting on the financial objectives Mr M had at the time.

Disagreeing with this, Mr M referred his complaint to the Financial Ombudsman Service. One of our investigators looked into the complaint and issued a 'view' which comprised firstly of an explanation of why we had the powers to look into this complaint, and also that the merits of the complaint should be upheld in Mr M's favour. But JMT didn't agree either with our powers to look into the complaint (it said this was because it had been made 'out of time' under the rules we operate under) – or that Mr M's complaint should be upheld.

On 30 October 2024, I issued a jurisdiction decision explaining that the complaint *was* one we could look into. I'm now making a decision about the actual merits of Mr M's complaint.

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 also 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'). 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 this advice, but provides useful context for my assessment of JMT'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.

I have further considered that the regulator, the Financial Conduct Authority ('FCA'), states in COBS 19.1.6 (since renumbered) that the starting assumption for a transfer from a DB scheme is that it is unsuitable. So, JMT should have only considered a transfer if it could clearly demonstrate that the transfer was in Mr M's best interests.

I've used all the information we have to consider whether transferring away from the DB scheme to a personal pension was in Mr M's best interests.

I don't think it was, so I'm upholding his complaint.

Introductory issues

As I've mentioned above, the evidence shows that Mr M first went to another IFA around six months before receiving JMT's advice. The 'fact-find' documentation was dated from September 2008 and there seemed inconsistencies about exactly how much Mr M was seeking to raise in cash and specifically what the money was for. I think it's also important to point out that JMT seemed to have no clear idea what Mr M's ultimate retirement plans were, how much he thought he might need in retirement and how he was actually intending to fund retirement when it eventually came.

I've also seen nothing showing that a detailed assessment was made of Mr M's full income and outgoings as of the time when the advice was sought. As Mr M was going through a divorce, I think these types of financial issues were most likely relevant to whether irreversibly transferring from what appeared to be his only pension was in his best interests.

Financial viability

JMT should have explained in its recommendation the relevance of 'critical yield' rates. 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 annuity benefits as the DB scheme. It is part of a range of different things which help show how likely it is that a personal pension could achieve the necessary investment growth for a transfer-out to become financially viable. However, I don't think JMT explained this carefully enough and I don't think Mr M would have understood what JMT's recommendation report was really saying about the financial comparisons between his existing DB scheme, and the personal pension JMT was recommending he should join.

In its recommendation report, JMT said, *"we have carried out such a calculation which has shown a critical yield of 9.5% for pension benefits only".* But I've also seen a number of different critical yield figures relating to retiring from the scheme at various different ages and these were further split showing the percentages as regards his pension's "protected" and "non-protected" rights.

In my view, this was complicated and not fully explained to Mr M, and I don't think he would have been able to make any comparisons about whether transferring was financially worthwhile. Using JMT's 9.5% figure, I think this was already showing that there was a substantial risk to Mr M ending up with lower retirement income as a result of transferring; this is because it would have been highly unlikely he'd be able to grow a personal pension by enough to 'keep up'. More detailed transfer analysis shown elsewhere revealed that if accessing his pension savings earlier, the critical yield was around 14%[1].

On the other hand, the relevant discount rate - which is a measure of how much an investment is likely to grow by - was only 6.4% per year if assuming a retirement at 60. 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. I've also kept in mind that the regulator's upper growth projection rate at the time was 9%, the middle projection rate 7%, and the lower projection rate 5%.

JMT recorded Mr M's attitude to risk (ATR) as being "higher balanced" or 5/10. But I think this was too high. This was based on written answers given to hypothetical questions about share buying and investments in general. However, it was obvious in this case that Mr M didn't have any such current investments and he'd explicitly said he had no investment experience whatsoever. So, in my view, the levels of growth Mr M could reasonably expect if he transferred were significantly below the critical yields and other figures I've outlined above. These were clearly implying that reaching an annual growth rate outside the DB scheme, to make transferring worthwhile, would be very difficult indeed – and highly unlikely.

However, JMT's recommendation that Mr M should transfer out to a personal pension was not predicated on the financial comparisons with his current scheme alone. Rather, JMT said

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[1] *Pension Transfer Analysis*. Prepared for Mr M relating to [his] Superannuation Scheme Prepared on 23 February 2009

he had different reasons to transfer away, so I've thought about the other considerations which might have meant a transfer *was* suitable for him, despite providing the overall lower benefits mentioned above over the longer term.

I've considered these below.

Other reasons to transfer

JMT's recommendation to transfer away was essentially based on him accessing his tax-free cash to generate immediate funds for Mr M. It said he could then go on and invest the remainder in a balanced fund in a personal pension plan with a large pension provider.

The transfer pre-dated the wider pension 'freedom' reforms which followed in 2015. So the recommendation was for Mr M to transfer, access £19,594 in tax-free cash and invest the remaining amount. The plan was that Mr M could achieve some growth in the remaining £58,784 by investing in a balanced personal pension fund, until when he eventually stopped working, at which point he could buy a pension annuity.

However, I don't think JMT comprehensively looked into Mr M's financial affairs or the real need he had for immediate cash. I accept that Mr M was passed over to JMT and probably at that time had a fairly clear idea of what he thought he wanted to do. The evidence is supportive that Mr M saw his DB scheme as a source of instant cash which had become available under current legislation from the age of 50. But JMT was the regulated party here – not Mr M. He was a relative amateur in these matters and he had no investment experience to call upon. JMT was also charging Mr M several thousand pounds for its advice and so the job of the adviser wasn't to simply follow what Mr M might have thought was a good idea. JMT's job was to really look into his circumstances and recommend what was in his best interests.

Therefore, when JMT says now that Mr M was told, for example, that the remaining sum really needed to be invested for the long-term and kept within the new pension – and that he was also given certain regulatory warnings during the advice process – JMT substantially misses the point. I say this because despite the evidence of Mr M likely receiving less retirement income by transferring, JMT's advice was still for him to transfer away from the DB scheme in any event. In my view, Mr M heavily relied on that advice and he placed trust in what JMT was advising, believing it was the right thing to do in his circumstances.

In addition to this, I think it's also fair to point out that even when considering the wider rationale for transferring, JMT's recommendation lacked supporting evidence. What I mean by this is that JMT failed to really understand and assess what Mr M's requirements of that time were. It says now that he was in dire need of cash: but this certainly isn't supported by what I've seen. JMT didn't look into what Mr M's tax liabilities were in any detail, nor is there any evidence it looked into his credit card liabilities in the same depth. Whilst on 'first look' these things might seem viable reasons to take urgent action and pay down one's outstanding liabilities, I've seen conflicting evidence showing that part of Mr M's own basis for wanting cash was for discretionary spending on less critical or urgent things, like family birthdays.

Further to this, I've seen no evidence, for example, that the adviser considered whether paying down the tax bill or the credit card debt could be met in other ways. As I said, no detailed assessment was carried out of Mr M's incomings and outgoings. But I've noted that Mr M had increased his salary in the new job he was taking on, so I would have expected the first step the adviser ought to have been considering would be whether these liabilities couldn't just be met from his increased income. Of course, these things might have been met in other ways too rather than him just reverting - as a first and only step - to irreversibly leaving his DB scheme to liquidate a cash lump-sum. But there's nothing showing whether a payment plan (with either creditor) was explored.

JMT's own records show that using what it called *"current day figures"* Mr M's DB scheme could have paid him out a tax-free lump-sum at the NRA of £12,595 and an annual pension of £4,198 for the rest of his life. There was also an opportunity to access his deferred DB pension earlier and still retain the important guarantees and benefits it offered. This would have involved actuarial reductions in his pension, but it could have meant he would have still been able to meet his liabilities earlier, if not necessarily immediately.

However, there is simply no evidence that Mr M was facing a financial emergency. And by transferring away, Mr M's retirement security looked uncertain. I don't think JMT fully considered the fact that Mr M already only had a modest pension provision overall. And by removing the guarantees and benefits normally found in a DB scheme, Mr M's retirement looked even more uncertain inside a personal scheme. I accept that ultimately, the recommendation to transfer away was based on him still prudently investing the remaining 75% of his CETV with a view to eventually buying an annuity. But nevertheless, this was still exposing Mr M's pension savings to the mercy of the markets whilst, at the time, his existing DB scheme was a certainty and contained index-linking features, neither of which a personal pension would match.

Summary

I've considered all the issues in this case with great care.

I agree with our investigator who commented that JMT failed to explore what other options Mr M probably would have had with regards to paying HMRC and / or his credit card provider. I see no reason why either of these liabilities could not have been addressed by engaging with either party and making payments over time or through an amended tax-code.

It's not my role to say what JMT should have done in this regard, but the generic rationale it used to justify the DB transfer advice was flawed. What Mr M was irreversibly giving up was a guaranteed pension which had substantial index-linking attached. Although small, this pension made up all of his current security in retirement, providing as it did a pension for the rest of his life. By transferring from this DB scheme to a personal pension arrangement, the evidence shows Mr M was likely to obtain much lower retirement benefits and I don't think there were any other particular reasons which would justify the transfer and outweigh this.

On this basis, I don't think JMT should have advised Mr M to transfer away from his DB scheme.

In light of the above, I think JMT should compensate Mr M for the unsuitable advice, using the regulator's defined benefits pension transfer redress methodology.

Putting things right

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

JMT 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.

As I don't think transferring was right for Mr M, I don't need to go on to say any more about the suitability of the particular investment fund used in the personal plan. That's because if advised correctly, the transfer should have not taken place at all.

Compensation should therefore 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 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 M'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, JMT should:

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

Redress paid to Mr M 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, JMT 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 M'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 £190,000, 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 £190,000, I may recommend that the business pays the balance.

My final decision

<u>Determination and money award</u>: I uphold this complaint and require J M Taylor Financial Services Limited to calculate and pay Mr M the compensation amount as set out in the steps above, up to a maximum of £190,000.

Recommendation: If the compensation amount exceeds £190,000, I also recommend that J M Taylor Financial Services Limited pays Mr M the balance.

If Mr M accepts this decision, the money award becomes binding on J M Taylor Financial Services Limited.

My recommendation would not be binding. Further, it's unlikely that Mr M can accept my decision and go to court to ask for the balance. Mr M 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 M to accept or reject my decision before 4 December 2024.

Michael Campbell
Ombudsman