DRN-4865359

Financial Ombudsman Service

The complaint

Mrs H has complained that the advice given to her by KLO Financial Services Ltd ('KLO') to transfer her occupational defined benefit ('DB') scheme and her existing defined contribution ('DC') schemes into a new self-invested personal pension ('SIPP') held with Xafinity was unsuitable and has caused financial loss.

Mrs H is being represented in this complaint however for ease of reference I have only referred to Mrs H throughout the decision below.

What happened

Mrs H signed the KLO terms and conditions document and completed the attitude to risk ('ATR') questions on 12 March 2018. The ATR questions answered by Mrs H resulted in a 'Moderate' investor outcome.

Mrs H and KLO then completed a fact-finding exercise on 4 April 2018. This recorded Mrs H's circumstances at that time and confirmed:

- Mrs H was aged 49, married with two dependent children, and noted as being in good health.

- Mrs H was employed as a teacher, had income of £22,500 a year, and had limited cash-based savings.

- The family home was valued at £201,000, cars and contents were valued at £20,000, with a mortgage in place of £150,000 and unsecured debts of £7,300.

With regard to pensions the fact-find confirmed that Mrs H had seven pensions. These were:

- DB scheme with a transfer value of around £246,000.

- Aviva DC pension valued at around £36,000.

- ReAssure pension valued at around £27,500.

- ReAssure pension valued at around £3,500.

- Sun Life pension valued at around £3,500.

- Nest pension valued at around £20.

- Now pension valued at around £60.

Mrs H's objectives regarding these pensions were documented as being to consolidate the pensions, to have flexible options (including drawdown), to take advantage of the "high" transfer value of the DB scheme, to have an actively managed fund, and to pass any residual funds onto family upon Mrs H's death.

The pension transfer analysis completed on the DB scheme at the time of advice confirmed that the critical yield if no tax-free cash was taken was 6.5%, with this falling to 5.4% if tax-free cash was taken.

The personalised illustration for the Xafinity SIPP provided projections on what benefits may be payable in retirement based on assumed future growth rates. The growth rates used were -0.49%, 2.44% and 5.37% for the low, medium, and high projections.

KLO's transfer advice was documented in their suitability letter dated 10 September 2018.

The re-confirmed Mrs H's circumstances and objectives as per the fact find.

The transfer of the DB scheme was recommended on the basis that KLO considered the 5.4% critical yield figure achievable with the transfer also meeting Mrs H's other objectives of flexibility, control, consolidation, and improved benefits payable on death.

The charges applicable to the DC schemes were confirmed as:

- Aviva DC pension – 0.45%
- ReAssure pension – 1.66%
- ReAssure pension – 1.81% + £52.56.
- Sun Life pension – 0.75%
- Nest pension – 0.3%
- Now pension – 0.3% + £18.

These pensions were all recommended for transfer in to Xafinity SIPP.

The reasons given in support of these transfers were all broadly consistent, with the new investments to be held within the SIPP considered a more appropriate match for Mrs H's ATR, to consolidate the pensions, to take advantage of a discretionary fund management ('DFM') solution, and to try and achieve better investment returns.

The charges applicable to the new pension were confirmed as being an initial cost of £150+VAT, an initial advice fee of 2% + £350+VAT, and ongoing costs of £250+VAT each year, ongoing adviser charge of 0.75% each year and an investment management charge of 0.75% each year.

The underlying investment recommended by KLO was a DFM solution provided by Harbour Capital Management with the monies being invested in their Balanced Strategy.

KLO provided further advice in 2019 which recommended the pension be moved from the Xafinity SIPP to a personal pension held with Prudential. This stemmed from Xafinity deciding to close their agency with KLO. The new advice noted that Mrs H's circumstances remained the same with the new product having slightly higher overall annual management charges of 1.82% (including KLO's 0.75% ongoing advice charge). The underlying investment recommended by KLO was the PruFund Cautious Series E to match Mrs H's ATR – which had also remained unchanged from the earlier advice. Mrs H rejected this advice and did not transfer to the Prudential pension.

Having become aware that the advice received may not have been suitable, Mrs H

registered her complaint with KLO in June 2023.

KLO's response was issued in August 2023. This stated that they believed the advice was suitable, with the transfers being in Mrs H's best interests, meeting her retirement goals and investing the transferred monies in a way which matched her ATR.

Unhappy with KLO's response to the complaint Mrs H referred the issue to this service.

Our investigator looked into things and upheld the complaint.

With regard to the DB scheme the investigator concluded that the transfer was likely to lead to Mrs H being worse off in retirement with the non-financial reasons given in support of the transfer insufficient. Regarding the DC schemes which had been transferred the investigator concluded that the new SIPP recommended by KLO was more expensive than the ceding schemes with inadequate justification of the increased costs. As such, all the transfers were deemed unsuitable. The investigator went on to make redress recommendations.

Mrs H accepted the outcome however KLO did not respond.

As no agreement could be reached, the case was passed to me for a decision.

I issued a provisional decision which stated:

"DB transfer advice

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 KLO's actions here.

Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.

Principle 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, KLO should

have only considered a transfer if it could clearly demonstrate that the transfer was in Mrs H’s best interests. And having looked at all the evidence available, I’m not satisfied it was in her best interests.

Financial viability

KLO carried out a transfer value analysis report (as required by the regulator) showing how much Mrs H’s pension fund would need to grow by each year to provide the same benefits as her DB scheme (the critical yield).

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.

Mrs H was 49 at the time of the advice and wanted to retire at 67. The critical yield required to match Mrs H’s benefits at age the DB scheme’s normal retirement age of 60 was 6.5% if she took a full pension and 5.4% if she took tax-free cash and a reduced pension.

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 3.9% per year for 11 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%. Additionally, I think the projections rates included by the pension provider in their illustration at the point of advice are also relevant, with these being -0.49%, 2.44% and 5.37% for the low, medium, and high projections.

I've taken this into account, along with the composition of assets in the discount rate, Mrs H’s moderate attitude to risk and the term to retirement. There would be little point in Mrs H giving up the guarantees available to them through her DB scheme only to achieve, at best, the same level of benefits outside the scheme. But here, given the lowest critical yield was 5.4%, I think Mrs H 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.

KLO has provided cashflow modelling which it says shows Mrs H would’ve been able to meet their needs despite the high critical yields. I’ve considered these, but KLO’s models are based on annual investment growth rates of 6.51%, 7.7% and 8.45%, rates which I consider inconsistent with the discount rate quoted above.

Also, as KLO will know, past performance is no guarantee for future performance and so I consider the discount rates, regulator’s standard projections and the projections included by the product provider in the illustration 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.

For this reason alone, a transfer out of the DB scheme wasn’t in Mrs H’s best interests. 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 these below.

Flexibility of access at retirement

Whilst flexibility of access was noted as one of Mrs H's objectives, I would note that at the point of advice Mrs H was only 49 years of age. As such pension regulation at the time of advice meant Mrs H could have no access to any of her pension monies for at least another six years (when she reached age 55). Given this, flexibility of access can only be considered a future need, and not one which would justify a transfer in 2018 as this exposed Mrs H to years of investment risk and cost with no immediate need.

I would additionally note that the file contains limited detail as to what Mrs H would use this flexible access for. Given valuable lifelong guarantees were lost when the DB scheme was transferred, I would expect there to have been significant discussion and detail documented around how and why the DB scheme could not meet Mrs H's needs in this regard.

Actively managed investments

Whilst the SIPP did allow Mrs H to make a wide variety of investments, including the actively managed DFM solution recommended by KLO, it was Mrs H who bore the cost of this active management and bore the risk of any investment underperformance.

Within the DB scheme Mrs H's benefits were guaranteed, with the trustees of the scheme taking on the investment risk.

Overall, I do not consider a preference for a certain style of investment management to be sufficient justification for the loss of the guarantees which were forgone as a result of the DB transfer.

Death benefits

Death benefits can be an emotive subject and it is entirely reasonable for Mrs H to want to ensure her dependents were looked after in the event of her death.

The fact that after transfer the value of the SIPP would be available as a lump sum payment to Mrs H's beneficiaries would have been an attractive feature. However, the DB scheme did include a spouse's pension and would have provided Mr H with an income for life in the event of Mrs H's death.

Additionally, a pension is primarily intended to be used to provide benefits in retirement with there being other products that can be used to provide a legacy in the event of death. If Mrs H had strong opinions on leaving a lump sum in the event of her death, KLO should have considered a life insurance policy, once commenced this would provide the lump sum death benefits Mrs H required, and allow the valuable guarantees provided by the DB scheme to be retained.

Overall

Overall, I have concluded that the recommendation to transfer Mrs H's DB pension was likely to lead to Mrs H being worse off in retirement with the non-financial reasons given in support of the transfer insufficient to justify the advice.

As such I have reached the same conclusion as our investigator and have upheld this element of the complaint.

Transfer advice for the DC schemes

In 2009 the Financial Conduct Authority (FCA), then the Financial Services Authority, published a checklist for pension switching that I think is still helpful today. It highlighted four key issues it thought should be focussed on:

- *Charges - has the consumer been switched to a pension that is more expensive than their existing one(s) or a stakeholder pension, without good reason?*
- *Existing benefits - has the consumer lost benefits in the switch without good reason? This could include the loss of ongoing contributions from an employer, a guaranteed annuity rate or the right to take benefits early.*
- *Risk - has the consumer switched into a pension that doesn't match their recorded attitude to risk (ATR) and personal circumstances?*
- *Ongoing fund management - has the consumer switched into a pension with a need for ongoing investment reviews but this was not explained, offered, or put in place.*

Further, when considering the use of a discretionary fund management (DFM) arrangement, the regulator has made clear that amongst other matters, firms need to take into account issues such as:

- *Likely cost: do the overall costs justify the potential for improved performance?*
- *Size of funds under management: once a consumer has a moderately-sized fund, they may benefit from a model portfolio which is rebalanced automatically by a DFM ranging all the way up to bespoke arrangements for clients with larger funds.*
- *Investor's knowledge and experience: FCA has said the adviser needed a reasonable belief that the investor could understand the nature of the risks of the underlying investments the DFM might make.*
- *Level of disclosure: whether the benefits vs costs of the arrangement were explained to the investor in terms they were likely to (or appeared to) understand.*

There were six pensions (detailed above) which were transferred into the Xafinity SIPP.

I have considered the advice to transfer these DC schemes in light of the guidance detailed above, which is clear that advisers recommending pensions be transferred to more expensive replacements was a concern for the regulator.

The new Xafinity pension was more expensive (overall) than the majority of the pensions being transferred, and if a weighted average of the DC pensions is used the KLO recommendation is again more expensive.

However, it must be noted that the overall cost of the KLO recommendation included a 0.75% annual charge for ongoing advice, a service which Mrs H was not receiving on the ceding DC schemes.

Comparing only the Xafinity SIPP and DFM costs (without the ongoing adviser charge) the KLO recommendation is still more expensive than the majority of the DC pensions – with only the ReAssure pensions being more expensive.

In line with what our investigator has already said, I do not believe the additional features offered by the SIPP can justify the additional costs incurred.

As above, any additional flexibility offered by the SIPP was unavailable to Mrs H until at least age 55 and is therefore not considered justification for increasing costs at the time of advice.

KLO stated that the new DFM investment proposition would move the underlying investments in line with Mrs H's ATR, however having looked at the investments held within the DC schemes themselves, most of these funds were within the Mixed Investment 40%-85% Shares sector and were not inconsistent with Mrs H's ATR.

The ability to use a DFM proposition was also noted as a reason for transferring. Whilst Mrs H did have some investment experience through the existing DC schemes, I am not convinced this would have provided Mrs H with the relevant experience to justify the use of a DFM solution.

Additionally, if the DB scheme were retained, I do not believe the size of the DC pots alone would justify the use of a DFM solution.

Finally, I would note that less than twelve months later, KLO themselves concluded that DFM was no longer required when the funds were [recommended to be] *moved to a Prudential pension.*

Overall, and again in line with the outcome already communicated by our investigator I have decided the advice to transfer Mrs H's DC schemes was unsuitable and believe that had appropriate advice been given Mrs H would have retained the benefits with the existing providers."

In addition to the above I asked both Mrs H and KLO to provide any further information or commentary they wanted me to take into consideration by 7 June 2024.

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.

In response to the provisional decision KLO confirmed that the subsequent advice to transfer the Xafinity SIPP to Prudential did not proceed with KLO ceasing to be Mrs H's advisers around that time, and queried whether this would have an impact on the provisional decision issued.

Mrs H also responded to confirm that the recommendation to Prudential did not proceed, and that ultimately the pension was transferred away from Xafinity to Curtis Banks. Mrs H questioned the content of the redress instructions in relation to the transfer of her DC schemes, asking whether the notional value of the ceding scheme would be compared to the current value of the Curtis Banks SIPP, and finally whether any redress in respect of this could be paid as a cash payment rather than be paid into her pension.

I issued an additional letter to both parties covering the points above and amending the redress instructions to take into account the new information around Mrs H's current pension provider.

I explained the fact that the move of Mrs H's pension from Xafinity to Curtis Banks did not impact the outcome of my decision.

Whilst this subsequent transfer was not advised by KLO, I remained of the opinion that but for their original advice Mrs H would still retain her originally held DB / DC schemes. As such the redress calculation should be run to the date of this final decision and incorporate the current value of the Curtis Banks SIPP Mrs H currently holds.

Whilst Mrs H also requested that any redress due be paid as cash rather than into her

current pension, I explained that the purpose of the redress is to put Mrs H as close as possible to the position she would otherwise be in, and as such it would not be reasonable to allow redress to be paid simply based on Mrs H's preference in this regard. Any payment due should be made in the way outlined in the provisional decision (and the instructions below).

I asked both parties to provide any further comments by 14 June 2024.

Neither party provided any response and as such I am not amending the above commentary. I remain of the opinion that the outcome reached is fair and reasonable.

The redress instructions below remain unchanged from those included in my follow up letter.

Putting things right

A fair and reasonable outcome would be for KLO to put Mrs H, as far as possible, into the position she would now be in but for the unsuitable advice. I consider she would have likely remained in the occupational scheme and retained the DC schemes also transferred as part of this advice.

KLO should undertake the two redress calculations below and then total the resultant amounts to give an overall redress figure. If one of the calculations shows Mrs H has made a gain, that gain can be offset against any losses from the other calculation.

Calculation 1 - DB scheme redress

KLO should 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.

For clarity, Mrs H has not yet retired, and she has no plans to do so at present. So, 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 PS22/13 and DISP App 4. In accordance with the regulator's expectations, the calculation should be undertaken or submitted to an appropriate provider promptly following receipt of notification of Mrs H's acceptance.

If the redress calculation demonstrates a loss, as explained in PS22/13 and set out in DISP App 4, KLO should:

- calculate and offer Mrs H redress as a cash lump sum payment,
- explain to Mrs H before starting the redress calculation that:
    - 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 the current defined contribution pension
- offer to calculate how much of any redress Mrs H receives could be used to augment the pension rather than receiving it all as a cash lump sum,
- if Mrs H accepts KLO's offer to calculate how much of the redress could be augmented, request the necessary information and not charge Mrs H for the calculation, even if she

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 Mrs H's end of year tax position.

Redress paid directly to Mrs H 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, KLO may make a notional deduction to allow for income tax that would otherwise have been paid. Mrs H's likely income tax rate in retirement is presumed to be 20%. However, if Mrs H would have been able to take 25% tax-free cash from the benefits the cash payment represents, then this notional reduction may only be applied to 75% of the compensation, resulting in an overall notional deduction of 15%.

Calculation 2 – DC scheme redress

I take the view that Mrs H would have remained with her previous DC providers, however I cannot be certain that a value will be obtainable for what the previous policies would have been worth. I am satisfied what I have set out below is fair and reasonable, taking this into account and given Mrs H's circumstances and objectives when she invested.

To compensate Mrs H fairly, KLO must:

- Compare the performance of Mrs H's current pension investment with the notional values if they had remained with the previous providers. If the actual value is greater than the notional value, no compensation is payable. If the notional value is greater than the actual value, there is a loss and compensation is payable.

- KLO should also add any interest set out below to the compensation payable.

- KLO should pay into Mrs H's pension plan to increase its value by the total amount of the compensation and any interest. The amount paid should allow for the effect of charges and any available tax relief. Compensation should not be paid into the pension plan if it would conflict with any existing protection or allowance.

- If KLO is unable to pay the total amount into Mrs H's pension plan, it should pay that amount direct to her. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore, the total amount should be reduced to *notionally* allow for any income tax that would otherwise have been paid. This is an adjustment to ensure the compensation is a fair amount – it isn't a payment of tax to HMRC, so Mrs H won't be able to reclaim any of the reduction after compensation is paid.

- The *notional* allowance should be calculated using Mrs H's actual or expected marginal rate of tax at her selected retirement age.

- It's reasonable to assume that Mrs H is likely to be a basic rate taxpayer at the selected retirement age, so the reduction would equal 20%. However, if Mrs H would have been able to take a tax-free lump sum, the reduction should be applied to 75% of the compensation, resulting in an overall reduction of 15%.

Income tax may be payable on any interest paid. If KLO deducts income tax from the interest it should tell Mrs H how much has been taken off. KLO should give Mrs H a tax deduction certificate in respect of interest if Mrs H asks for one, so she can reclaim the tax on interest from HM Revenue & Customs if appropriate.

Portfolio name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
Xafinity SIPP which is now held with Curtis Banks SIPP	Still exists and liquid	Notional value from previous provider	Date of investment	Date of my final decision	8% simple per year from final decision to settlement (if not settled within 28 days of the business receiving the complainant's acceptance)

Actual value

This means the actual amount payable from the current pension investments at the end date.

Notional Value

This is the value of Mrs H's investments had they remained with the previous providers until the end date. KLO should request that the previous providers calculate this value.

Any withdrawal from the Xafinity / Curtis Banks SIPP should be deducted from the notional value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there is a large number of regular payments, to keep calculations simpler, I'll accept if KLO totals all those payments and deducts that figure at the end to determine the notional value instead of deducting periodically.

If the previous providers are unable to calculate a notional value, KLO will need to determine a fair value for Mrs H's investment instead, using this benchmark: FTSE UK Private Investors Income Total Return Index. The adjustments above also apply to the calculation of a fair value using the benchmark, which is then used instead of the notional value in the calculation of compensation.

Why is this remedy suitable?

I've decided on this method of compensation because:

- Mrs H wanted Capital growth with an element of risk to her capital.
- If the previous provider is unable to calculate a notional value, then I consider the measure below is appropriate.
- The FTSE UK Private Investors Income ***Total Return*** index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It's a fair measure for someone who was prepared to take some risk to get a higher return.
- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mrs H's circumstances and risk attitude.

My final decision

In line with the rationale above I am upholding this complaint against KLO Financial Services Ltd and require them to calculate and pay redress as per the methodology above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs H to accept or reject my decision before 19 July 2024.

John Rogowski
Ombudsman