DRN-5144764

The complaint

Mr D complained about advice he was given to transfer the benefits of a defined-benefit (DB) pension to a Section 32 pension scheme. A Section 32 pension is a type of personal pension policy bought from an insurance company using funds from a registered pension scheme. The policy usually provides for an annuity at some point in the future.

Ashwood Law is responsible for answering this complaint. Mr D says the advice was unsuitable for him and believes this has caused him a financial loss.

What happened

The pension in question here related to a deferred DB scheme from a previous employer which Mr D had recently left. Mr D was passed to Ashwood Law for regulated pension advice. Information gathered about his circumstances and objectives were broadly as follows:

- At the point of recommendation, Mr D was 30 years old, married with one child.
- Mr D had recently moved to a new job.
- Mr D had accrued around 9 years' service with this DB scheme and was given a cash equivalent transfer value (CETV) of £10,478 in 2005. The scheme had a normal retirement age (NRA) of 65.

Ashwood Law set out its advice in a recommendation letter on 29 July 2005 (although this was 'signed for' as having been received by Mr D on 12 August 2005). In this, Ashwood Law said Mr D had a medium-to-adventurous attitude to investment risk and advised him to transfer out of the deferred DB scheme and move to a Section 32 plan.

Mr D accepted this advice and transferred his DB scheme benefits in September 2005. In 2023, as he approached closer to retirement, Mr D complained to Ashwood Law about its advice. He said he shouldn't have been recommended to transfer out to a personal pension. In response, Ashwood Law said it hadn't done anything wrong and was acting on the financial objectives Mr D had at the time.

Disagreeing with this, Mr D 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 secondly that the merits of the complaint should be upheld in Mr D's favour. But Ashwood Law 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 D's complaint should be upheld.

On 7 November 2024, I issued a jurisdiction decision explaining that the complaint *was* one we could look into. I'm now making a final decision about the actual merits of Mr D'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 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 they provide useful context for my assessment of Ashwood Law's actions here.

- The previous rules were set out in the Financial Service Authority (FSA)'s handbook at COB 5.3 (available on-line by using the time travel facility in the FCA handbook).
- COB 5.2.5 included a similar requirement to *'know your customer'*.
- COB 5.3.5(1) said that the advice had to be suitable.

Presumption of unsuitability

In 2005, the regulator's guidance also set out in its rulebook (COB - 5.3.29) which said:

"When advising a customer who is, or is eligible to be, an active member of a defined benefits occupational pension scheme whether he should opt out or transfer, a firm should:

a) start by assuming it will not be suitable, and

b) only then consider it to be suitable if it can clearly demonstrate on the evidence available at the time that it is in the customer'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 D's best interests. I don't think it was, so I'm upholding his complaint.

Financial viability

Ashwood Law set out the 'critical yield' rate in its recommendation. 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 Ashwood Law explained this carefully enough to Mr D. I don't think Mr D would have understood what Ashwood Law's recommendation report was really saying about the financial comparisons between his existing DB scheme, and the personal pension Ashwood Law was recommending he should join.

In its recommendation report, Ashwood Law said the critical yield was 10.17%. This was the only figure Ashwood Law provided in this regard and was based on matching Mr D's existing DB scheme at the NRA of 65. Ashwood Law's own recommendation report said Mr D wanted to retire earlier than 65, although as I'll explain later, this could only ever have been a completely aspirational age given he was still so young (in pension terms). Nevertheless, Ashwood Law didn't tell Mr D that retiring earlier would push up the critical yield rate because his transferred pension would have less time to grow, and if stopping work earlier he'd be likely to draw on a pension for much longer. So, by not telling Mr D about this, Ashwood Law failed to demonstrate just how much less his retirement income could be, if he transferred away. I've calculated that the critical yield for retiring at 55 would have been closer to 12%

On the other hand, the relevant discount rate - which is a measure of how much an investment is likely to grow by - was only 7.9% per year if assuming a retirement at 65 and 7.6% if retiring at 55. 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%.

There's no evidence that Mr D really understood pensions or that he had any investment experience to call upon. And as a 30-year-old with a young child and modest job, I think his capacity for loss would have been relatively low. With these things in mind, I think his attitude to investment risk – if properly explained – should have been low-to-medium. There was also the issue of charges. In my view, these charges would have been higher in the Section 32 scheme than the minimal fees typically found in a DB pension and normally already incorporated within running the scheme. We also know that the annual management charge in two of Ashwood Law's recommended funds (comprising almost half of his transferred pension amount) were actually rather high[1], and the Section 32 pension provider levied its own charges in addition to these. These fees and charges would therefore have had the effect of reducing any potential investment growth even further when Mr D transferred.

So, in my view, what all these figures were very clearly showing were that the levels of growth Mr D could reasonably expect if he transferred were below the critical yields I've outlined above. Reaching an annual growth rate outside the DB scheme, to make transferring worthwhile, was very unlikely year-on-year until Mr D retired. Whilst to some degree Ashwood Law pointed this out, it was very poorly explained and it still recommended that he should transfer away in any event. To be clear, from a comparison perspective, the transfer wasn't financially viable.

I do accept, however, that Ashwood Law's recommendation that Mr D should transfer out to a personal pension was not wholly predicated on the financial comparisons with his current scheme alone. Rather, Ashwood Law said he had other 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

Ashwood Law's recommendation to transfer away was essentially based on:

[1] *"Higher than standard"* – Recommendation report 29 July 2005

- There being a risk to the future of the existing DB pension fund caused by underfunding and the risk of Mr D's former employer ceasing to trade.

- The pension protection fund (PPF) *"might not apply to your case"*.

- He would be able to increase the amount of tax-free cash available at the point of retirement if transferring to a particular type of personal scheme.

- There would be greater flexibility to retire early if transferring.

Underfunding – the rationale provided for transferring due to Mr D's existing scheme being underfunded was flawed, in my view. This seems to have been taken from a three-year old (2002) valuation of the DB scheme which apparently showed it wasn't funded enough, although no specific details were provided by Ashwood Law to Mr D about this either at the time or to our Service when investigating the complaint. I've therefore seen no evidence that Mr D would have been able to assess whether there was a 'security of pension' risk here.

Actually, in my experience it wasn't uncommon at that time for DB schemes to show their funding at below 100% of the scheme's future liabilities. In fact, the evidence in this case is that Mr D's former employer had injected funds into the scheme recently and there was also another funding assessment which had been carried out in April 2005. As Ashwood Law made its initial recommendation in July 2005 and didn't carry out the transfer until September 2005, the fact that it appears to have failed to enquire into the updated funding picture was a material failure.

I think it's also relevant to say that Mr D's former employer was a large business with a large DB pension scheme. So portraying his former company – and its DB scheme - as somehow vulnerable to closure was, in my view, a substantial embellishment of what was actually happening. Similarly with comments Ashwood Law made about the PPF potentially not offering Mr D security if such an unlikely event unfolded – there was simply no reason to portray this in the negative way that the adviser did. By telling Mr D that the PPF might not cover him I think this is likely to have caused Mr D to fear something that probably wasn't going to happen.

Rather than the DB scheme being at risk, all the evidence I've seen is that Mr D's former employer was addressing the DB underfunding. I accept there could be a debate about whether its actions were *enough* to bring the scheme to a fully funded situation in the short-term, but in reality these comments from the adviser exaggerated the risks. In my view the risks to the DB scheme were low.

Access to more tax-free cash on retirement – Mr D was only 30 years old at the time. I therefore very much doubt whether retirement was anything Mr D had yet given any serious thought to. He'd evidently said he'd like to retire at 55, but at his age this could be no more than something he just aspired to rather than being part of any real plan. At the age of 30 he had literally decades before retirement would even come into focus for him. So, predicting whether or not he might take a lump-sum at retirement was quite obviously premature and in my view it lacked credibility.

I've noted that Ashwood Law provided some figures demonstrating how upon retiring, Mr D might be able to receive a marginally higher tax-free lump-sum from a personal pension as opposed to a DB scheme. But removing cash from any pension simply means there would be less left for the 'pensioner' to receive in their ongoing retirement years. This wasn't explained to Mr D. However, as I've implied above, this eventuality was so far in the future in Mr D's case as to make the calculations about taking a pre-retirement lump-sum

meaningless. In my view, advising a 30-year-old to transfer from a DB scheme on this basis was wrong.

Flexibility – having financial flexibity sounds good. But for largely similar reasons, I can't see that Mr D required pension flexibility in the way the adviser suggested. In any event, flexibility was poorly defined by Ashwood Law. I therefore think this was no more than a 'stock' objective used to help justify the recommendation to transfer out of his DB scheme and into a pension provider which Ashwood Law wanted to recommend.

I've seen nothing that showed Mr D needed to change how his retirement benefits ought to be paid. I don't think this could have been predicted whilst still so far away from retirement age. In all likelihood, through many years of future employment he would likely build a flexible defined-contribution (DC) pension which he and his new employer(s) could significantly contribute towards over the next 34 years until reaching NRA.

I've also seen no evidence that Mr D had either the capacity or desire to exercise control over his pension funds moving forward. Mr D himself had no experience of these types of investments and in any event, a proportion of his transferred funds was directed towards certain gilt investments to match the guaranteed minimum pension portion Mr D was giving up by leaving his DB scheme. In short, there was very little flexibility unless he departed from the recommended fund options.

Death benefits – these were also portrayed as having flexibility features. Death benefits are an emotive subject and of course when asked, most people would like their loved ones to be taken care of when they die. The DB scheme already contained certain benefits payable to a spouse (and likely children) if Mr D died. Once again, this shows a significant lack of foresight by the adviser. I think it's obvious, that as a 30-year-old male in apparently good health, there was every reason to assume this wasn't a significant factor in considering whether to transfer away on this basis.

Summary

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

I agree with our investigator who said we should uphold this complaint. At the time, the financial regulator said that when advising a customer who is a member of a defined benefits pension scheme whether they should opt out or transfer, a firm should start by assuming it will not be suitable. However, I've seen nothing explaining why Mr D wouldn't want to continue membership of his deferred DB scheme and to use that pension in exactly the way it was originally intended.

What Mr D was irreversibly giving up was a guaranteed pension which had index-linking features attached. Although small, this pension made up all of his current security in retirement at that time, providing as it did a pension on retirement for the rest of his life. By transferring from this DB scheme to a Section 32 arrangement, the evidence shows Mr D was likely to obtain 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 Ashwood Law should have advised Mr D to transfer away from his DB scheme.

In light of the above, I think Ashwood Law should compensate Mr D 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 Ashwood Law to put Mr D, as far as possible, into the position he would now be in but for the unsuitable advice. I consider Mr D would have most likely remained in the deferred DB pension scheme if suitable advice had been given.

Ashwood Law 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 D, I don't need to go on to say any more about the suitability of the particular investment funds 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 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 D'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, Ashwood Law should:

- calculate and offer Mr D redress as a cash lump sum payment,
- explain to Mr D 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 D receives could be augmented rather than receiving it all as a cash lump sum,
- if Mr D accepts Ashwood Law's offer to calculate how much of the redress could be augmented, request the necessary information and not charge Mr D 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 D's end of year tax position.

Redress paid to Mr D 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, Ashwood Law 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 D'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

Determination and money award: I uphold this complaint and require Ashwood Law to calculate and pay Mr D 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 Ashwood Law pays Mr D the balance.

If Mr D accepts this decision, the money award becomes binding on Ashwood Law. My recommendation would not be binding. Further, it's unlikely that Mr D can accept my decision and go to court to ask for the balance. Mr D 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 D to accept or reject my decision before 11 December 2024.

Michael Campbell
Ombudsman