complaint

Mr S has complained that he should not have been advised by ECS Financial Services Limited to transfer his final salary occupational pension to a personal pension plan (PPP). He says he was not made sufficiently aware of the guaranteed nature of the benefits, and that the transfer exceeded his attitude to risk.

background

In 1998 Mr S became self-employed. At the time, he and his wife held a joint share (with other participants) in some residential rental properties but no other significant investments. The occupational pension scheme represented the majority of Mr S's pension provision accrued to that point.

ECS recorded Mr S's attitude to risk on its 'fact find' document as being the highest of three categories: speculative (to which it added, *'as evidenced by investment properties'*). The definition of this risk category was:

'You are prepared to take risks with your investment strategy & will consider volatile funds in return for potentially high returns.'

At the foot of the same page (which Mr S then signed) the adviser noted, *'Consideration of occupational transfer to personal pension & then consider SIPP route for commercial property'.*

The subsequent 'reasons why' letter issued by ECS then repeated that Mr S was 'considering' commercial property purchase – although this was followed by the qualification (with my emphasis) *'**If** you propose Self Investment almost immediately I would recommend the Cash fund'.* Mr S proceeded to invest 100% of his transfer into the Managed fund.

The reasons why letter also appeared to confirm that Mr S was not in the 'speculative' risk category, as it gave him a description of the 'moderate' category from ECS's fact find:

'My understanding is that you are prepared to accept a reasonable risk over the long term and recognise that equity investment is required to produce above average returns.'

The transfer went ahead and review meetings took place for some four years afterwards. During that time, Mr and Mrs S sold their investment in rental properties to pay down their mortgage. Mr S's pension remained invested in a managed fund until recently.

Our adjudicator considered that the complaint should succeed. His main points were:

- The occupational benefits would form a substantial component of Mr S's eventual pension provision, given that he had become self-employed and would not benefit from employer's pension contributions.
- The 'critical yield' (investment return required) of 8.8% per year for the PPP to match the occupational benefits given up was near the upper industry projection rate at that time. Being able to maintain this over a 20-year term in future was questionable.
- He was not persuaded that Mr S was a speculative investor, either as a result of his occupation or past experience of holding a share in rented residential property.
- He did not consider sufficient had been done to make Mr S aware of the risk that the PPP might not deliver the benefits guaranteed under the occupational scheme.

ECS did not agree with the adjudicator. Its main points in response were:

- It had demonstrated repeatedly to Mr S that he was a speculative investor. Mr A did not inform ECS that the residential property portfolio was a jointly held investment, or that he did not wish to expand into commercial property.
- Mr S was a high earner with high financial ambitions and a desire to maintain his standard of living in retirement.
- He said that due to the nature of his occupation he read everything, and would take his time before making any decisions. He did this over a period of several months.
- His circumstances later changed when he sold his property portfolio to move into a larger home, meaning he did not proceed to self-invest his pension either.
- Mr S had above-average financial awareness and knew that the occupational benefits (other than future revaluation on those benefits) were guaranteed.
- The adviser had explained the transfer process including the transfer analysis, and had gone through a checklist which included explaining the critical yield and risks.
- The transfer analysis was presented with the reasons why letter; it showed that at 6% annual growth the PPP would only replace 57% of the occupational benefits.
- The regulator had specified an upper limit for the critical yield as part of revised guidance on pension transfers at that time. An 8.8% critical yield was within that limit and achievable both with long-term property investment or equities.
- The reasons why letter would be more extensive if it was being written currently, but this was not the standard in 1999.
- In a letter the adviser sent to Mr S the following year, he quoted Mr S as saying *"let's have fun with these funds".*

Mr S has seen ECS's responses to the adjudicator's opinion and commented as follows:

- He did not remortgage to a significantly more valuable home when he sold his residential property share, which was simply used to pay down his mortgage.
- He was not a speculative investor and the reasons why letter confirmed this.
- ECS did not adequately highlight the loss of guaranteed benefits, either verbally or in its correspondence.
- The phrase *"let's have fun with these funds"* was the adviser's and not his.

As agreement could not be reached, the matter was passed to me for a final decision. I wrote to ECS on 16 January 2015 to explain my understanding that the regulator only ever specified a 'maximum' critical yield for a pension transfer (and with it, the concept that the transfer could 'pass' or 'fail' a suitability test) in respect of past cases that were included in the industry-wide review of pensions sold between 1988 and 1994.

I also explained that during the same review the regulator published tables of assumed future investment returns ('discount rates'), which were to be used in calculating any losses consumers had suffered from pensions mis-selling between 1988 and 1994. These were determined by a leading actuarial firm, and were thought to be reasonable expectations for future growth at the points they were published.

I considered this was potentially relevant to Mr S's case, because at the time of his pension transfer, the future growth rate in these tables (for a 20-year investment term) was in the range 6.7% to 6.9% per year. That was considerably lower than the critical yield of 8.8% in this case. I invited ECS to respond, and it made the following new comments:

- It could remember the regulator issuing guidance every so often in the late 1990s *'…which* [gave] *an indicative critical yield, above which it was highly unlikely that a transfer from a* [defined benefit scheme] *would be appropriate advice'.*
- Other compliance consultants it has contacted recall the same information, and in their combined recollection a critical yield of around 9% was considered reasonable in 2000. This reflected a downward trend since the maximum critical yield of 11% for Pensions Review cases transacted over Mr S's investment term in 1994.
- It was different to the Pensions Review discount rates I had mentioned, which are only relevant to transfers that fell in the review period from 1988 to 1994.
- ECS arranged relatively few pension transfers since 1995, and only (as in this case) when there were good reasons to do so – not solely based on the critical yield.
- Mr S drove the advice by his keenness to self-invest, and unusually negotiated a part-refund of some of the commission the adviser had received.
- He had asked the adviser to source a SIPP before the transfer was investigated. It was Mr S (and not ECS) who felt that self-investment into property would be to his financial advantage long term.
- Mr S's complaint began by saying that he was not aware he had lost guarantees under the former scheme. ECS had already demonstrated that Mr S was aware of this, and investment performance itself was not a valid reason for complaint.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. That has led me to the same overall conclusion as the adjudicator, for essentially similar reasons.

I accept that the transfer analysis referred to the occupational benefits as guaranteed, and this is likely to have been apparent to Mr S or to have come up in the separate telephone conversations or meetings which were held to discuss the content of that document. I take ECS's point that the nature of Mr S's profession might have placed him in a slightly better starting position to understand some of the further nuances of the advice.

However more importantly, I also take the view that Mr S was relying on the adviser to explain the factors on which a suitable course of action should properly be determined. Mr S had turned to ECS for advice as he was not qualified himself to advise on a pensions transfer, or in fact 'financial planning' in general. The overarching requirement imposed by the regulator on ECS was for it to ensure that its advice was suitable for him. So this is what I have to assess, having regard to Mr S's circumstances at the time.

In its most recent letter ECS has gone on to suggest that it was Mr S who was 'driving' the advice. But Mr S was not the regulated adviser in this case. If it was apparent to the adviser that Mr S was not requiring advice, it was open to him to treat Mr S as an 'execution-only' client (in which case the regulator would have expected to see a credible written request from Mr S to that effect). Alternatively, it could have treated Mr S as an 'insistent customer' who was acting against its advice – but in that case it would firstly have needed to set out what the suitable advice would be in Mr S's circumstances.

ECS considers that its reasons why letter demonstrates why the transfer was suitable, and that its brevity was consistent with the requirements of the time. I consider the letter is lacking in detail even for 1999, bearing in mind the more stringent requirements that had been imposed by regulators at the outset of the industry-wide pensions review.

The guidance suggested firms would need to take into account their clients' future career plans – and their specific attitude not only to investment risk, but also in relation to the security offered by guaranteed pension benefits. The risk of future changes in annuity rates rather than just future investment risk were also to be considered. ECS's own regulatory body at the time (the Insurance Brokers Registration Council) went on to say in its guidance:

'The 'reason why' letter should demonstrate a real link between the circumstances, objectives and risk profile of the investor, and the recommendation made… It should not be a mechanistic recitation of stock motives applicable to any and every transaction.'

As the adjudicator mentioned, Mr S's transition to self-employment meant that his existing final salary pension was unlikely to be bettered in terms of security by subsequent schemes in the near future. Whilst it recorded Mr (and Mrs) S's holding in residential property at twice the value subsequently realised – possibly because the shared ownership was not clear – ECS maintains that these properties were also part of Mr S's retirement plans. So those plans were already exposed to some of the risk of overconcentration in one asset class.

In my view the adviser ought to have recognised that Mr S's *capacity* to take further risks by making this pension transfer was limited – and the standard of living he wanted to maintain in retirement could in fact be jeopardised if investment returns or annuity rates did not meet expectations. I also cannot see that Mr S's *attitude* to investment risk was established from the starting position that he had guaranteed pension benefits he would be giving up. All of the three options available were descriptions of investments outside the final salary scheme.

I have taken into account Mr S's signature on a form describing him as 'speculative', but this does not fully absolve ECS from fairly assessing his attitude to risk in respect of this pension transfer. The adviser's qualifying comment suggested he made this assessment because Mr S had already invested in property *outside* his pension. Based on Mr S's circumstances, and his subsequent single investment in a managed fund, I consider the 'moderate' or 'reasonable' attitude to risk ECS went on to describe in the reasons why letter to be a more credible assessment. In my view the adviser's suggestion that the critical yield was consistent with that moderate risk approach would then have given false comfort to Mr S.

The only 'maximum' rate I have been able to find that the regulator published for pension transfers from time to time was an assumption that was required to be used for the 'annuity interest rate'. This was used in transfer value analysis to value the occupational benefits (it was regarded as a maximum as firms were allowed to use a more cautious assumption if they wished). It was not an upper limit for investment growth – and in any event the last time the annuity interest rate was as high as 9% was back in 1997.

I have not been able to find any periodic announcements from the regulator about an upper limit for investment growth itself since the Pensions Review period ended in 1994. Nor do I consider such announcements would have been likely when the conduct of business rules already placed the responsibility of assessing how much investment risk a customer should be willing to accept in future on their adviser. (The discount rates were however published out of necessity in order to deal with the legacy of past Pensions Review cases.)

ECS correctly says that the discount rates were only set for the purpose of Pensions Review loss assessment calculations. But they could reasonably have been used to form a view, in addition to any other evidence a firm wished to take into account, of what future investment returns were likely to be achieved. By the time of Mr S's transfer the discount rates had fallen below 7% per year over a 20-year term to retirement. I understand why ECS says 11% per year had been thought reasonable in 1994; the discount rates also remained above 10%

during 1995. But these bear little resemblance to the prevailing climate of lower investment returns in 1999.

ECS has not been able to provide any evidence other than recollections that a critical yield of 8.8% per year was reasonably achievable in 1999. In fact the regulator's projection rates, which had just been lowered to 5, 7 and 9% at the time of the advice, also tended to indicate that achieving 8.8% per year was going to be difficult on a sustained basis without taking significant risk. Based on the evidence available to me, I therefore consider Mr S's transfer would fairly have been regarded as a high-risk proposition at the time it was recommended. I consider it exceeded the more balanced risk outlook he is likely to have had at that time.

Mr S disagrees that he had introduced the idea of commercial property investment himself. I accept that the letter from ECS did indicate this was his intention, and it could have been questioned by Mr S if it were not. However this does not seem to change ECS's conclusion at the time that the transfer was reasonably viable, whether Mr S self-invested or not. Mr S did not yet have a particular commercial property investment in mind, and it is likely the adviser knew he was proceeding to invest in a managed fund. I do not consider a transfer should have been contemplated until any need for self-investment was paramount. It does not seem from the history of this case that this point would ever have been reached.

There has been much dispute about the phrase *"let's have fun with these funds"* in 2000. Two of those funds were Mr S's wife's, and even in total they were not as substantial as this pension transfer. Again I accept that this comment could have been questioned by Mr S or Mrs S if they did not agree with it. But any acceptance of greater risk with these particular funds in 2000 does not materially affect my conclusion that Mr S would not have agreed to transfer a much larger pension in 1999 if he had been appropriately advised and informed.

my final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £150,000, I may recommend the business to pay the balance.

determination and award: I uphold the complaint and require ECS Financial Services Limited to conduct a loss assessment on an 'actual loss' basis as at the date of this decision in accordance with the guidance established for the Pensions Review, using the latest set of financial assumptions published on our website.

ECS Financial Services Limited must pay Mr S the amount produced by that calculation - up to a maximum of £150,000 - plus simple interest at 8% per year on that amount from the date of this final decision until the date of payment.

recommendation: If the amount produced by the calculation of fair compensation exceeds £150,000, I recommend that ECS Financial Services Limited pays Mr S the balance plus simple interest at 8% per year on that balance from the date of this final decision until the date of payment.

This recommendation is not part of my determination or award. It does not bind ECS Financial Services Limited. It is unlikely that Mr S can accept my decision and go to court to ask for the balance. Mr S may want to consider getting independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr S to accept or reject my decision before 5 March 2015.

Gideon Moore
ombudsman