DRN-4386567

The complaint

Ms M complains that Morton Hill Limited, trading as McKnight Financial (MF), provided unsuitable advice to switch her employer's auto-enrolment pension to a new self-invested personal pension (SIPP).

Ms M is concerned that the funds that MF recommended were too high risk for her circumstances and as such, her pension has gone down in value for which she'd now like MF to recompense her for.

What happened

For context, Ms M has also raised a complaint about the advice that she received from MF to transfer her cash ISA. I have addressed that complaint, but under separate cover.

In June 2021, Ms M met with an adviser from MF to discuss her retirement planning needs. During the meeting, the adviser completed a fact-find document with Ms M to gain an understanding of her circumstances and subsequently issued a suitability letter the following month, setting out his recommendations to her.

MF's suitability letter explained that Ms M had recently opted out of her employer's company pension scheme because she wanted a plan that could accept ad-hoc lump sum payments. In addition, the letter explained that she wished to continue contributing £115 per month into a pension. MF's letter went on to explain that she was content to leave the monies invested for the long term, had an attitude towards risk of 'six – high medium' and had the capacity to take risks at that level. MF went on to recommend that Ms M switch her existing Royal London plan to the new AJ Bell SIPP and start regular premiums into the new plan. MF stated that the new AJ Bell SIPP would meet Ms M's needs because it would permit ad-hoc payments to be made.

In March 2023, Ms M decided to formally complain to MF after reviewing the online valuation of her SIPP. In summary, she said that she was surprised her investment had gone down by so much and, having looked at the funds her pension was invested in, stated that she believed MF had invested her savings outside of the level of risk that she was prepared to take.

After reviewing Ms M's complaint, MF concluded that they were satisfied they'd done nothing wrong. They also said, in summary, that their adviser had completed a risk questionnaire with Ms M and the funds that they had recommended, matched overall, the same 'high medium' risk level as her stated profile. MF said that they felt their advice was appropriate.

Ms M was unhappy with MF's response, so she referred her complaint to this service. In summary, she explained that she didn't believe MF's original advice was appropriate because the level of risk they'd concluded she was happy to invest at was above what she was actually content with.

The complaint was then considered by one of our Investigators. In summary, he concluded that MF hadn't treated Ms M fairly because they should have advised her to opt back into her employer scheme. In addition, from what he'd seen, her existing Royal London scheme was already able to accept ad-hoc payments, so there appeared to be little need to set up a new pension with higher charges. He didn't agree, however, that the funds which MF had recommended Ms M invest in were unsuitable for her circumstances.

MF, however, disagreed with our Investigator's findings. In summary, they said that they felt Ms M's complaint was about the performance of her funds which was as a consequence of the markets in general rather than their original advice. They also explained that Ms M's father, who is also her employer, wanted a separate pension scheme setting up for his daughter because he wanted complete confidentiality in making the pension contributions to her scheme rather than making them through the company payroll. In addition, MF questioned the redress approach that our Investigator had set out which explained that a lump sum payment Ms M's father had made into the plan should be included within the loss methodology.

Our Investigator was not persuaded to change his view about the pension switch being unsuitable for Ms M. However, after reflecting upon what MF had had to say, our Investigator felt that on balance, it was likely that even had the Royal London switch not gone ahead, the AJ Bell SIPP would still have been set up to take the ad-hoc payments. He therefore decided it was fair and reasonable to deduct the lump sum payment that Ms M's father had made when asking MF to undertake the loss calculation. After considering the Investigator's comments, MF agreed with the outcome so that the complaint could be resolved.

However, Ms M wasn't happy with the Investigator's updated assessment. She felt that the funds which MF recommended were too high risk for her and she felt it unreasonable that the lump sum payment that had been made into her pension wasn't included within the loss assessment. After reflecting on Ms M's comments, the Investigator didn't believe that she had presented any new arguments that he'd not already considered or responded to. Unhappy, Ms M then asked the Investigator to pass the case to an Ombudsman to review that outcome.

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 have summarised this complaint in less detail than Ms M has done and I've done so using my own words. The purpose of my decision isn't to address every single point raised by all of the parties involved. If there's something I've not mentioned, it isn't because I've ignored it - I haven't. I'm satisfied that I don't need to comment on every individual argument to be able to reach what I think is the right outcome. No discourtesy is intended by this; our rules allow me to do this and it simply reflects the informal nature of our service as a free alternative to the courts. Instead, I will focus on what I find to be the key issue here, which is the suitability of MF's pension advice.

My role is to consider the evidence presented by Ms M and MF in order to reach what I think is an independent, fair and reasonable decision based on the facts of the case. In deciding what's fair and reasonable, I must consider the relevant law, regulation and best industry practice, but it is for me to decide, based on the available information that I've been given, what's more likely than not to have happened. And, having done so, I'm upholding Ms M's complaint and it's largely for the same reasons as our Investigator. I'll explain why below.

The list 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 MF'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).

I've also considered the provisions in COBS 9, which deals with the obligations when giving a personal recommendation and assessing suitability. In addition, the regulator's checklist (published in 2009) for pension switching, which highlighted four key issues it thought should be focussed on, have also been considered:

• 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?)

• Risk (has the consumer switched into a pension that doesn't match their recorded 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?)

The regulator's guidance above was all issued prior to MF providing advice in 2021.

1. <u>Was the original advice to switch Ms M's Royal London pension suitable?</u>

When thinking carefully about the guidance that the regulator provided, it meant that MF needed to obtain relevant information about Ms M's overall profile and, given that it considered a pension switch for her, it was also obliged to address the 2009 checklist related to her profile, circumstances and objectives at the time. The switch had to be in her best interests. It had to be worth the movement away from her Royal London scheme and it should have had meaningful prospects of being better for her than the existing plan – otherwise there would arguably have been no point in switching and no justification in incurring the costs associated with the switching process. It follows from this that a comparison should also have been made between Ms M's plan and the proposed AJ Bell plan in order to illustrate whether or not the latter was in her best interest.

I've looked closely at Ms M's circumstances at the time of the advice in June 2021. At that point, she was 26 years old, held £40,707 in cash (£34,207 of which was in a cash ISA and she owned 50% of £13,000 in a joint deposit account with her partner), she had an outstanding mortgage of £158,366 and aside from her employee pension scheme, she'd not invested previously and was therefore an inexperienced investor. MF's adviser noted that she earned a salary of £40,000 per annum and had a monthly net disposable income (with her partner) of £1,450 after expenditure and no major expenditure in the foreseeable future. The fact-find noted that she was in good health and happy to invest for the medium to long term.

MF provided Ms M with a suitability report that set out the main themes of their discussions, along with their recommendation. MF's suitability letter explained that Ms M's primary aim was to set up a new pension to build a pot for her future retirement. The pension also needed to be capable of accepting ad-hoc lump sums from her employer. Having thought about this carefully, I'm not convinced that the objectives above, when considered against the wider evidence within the file, are strong enough reasons to support the recommendation to switch away from the Royal London pension and into the AJ Bell plan. I'll explain why.

<u>1a. Charges</u>

As I've already explained, charges play a very important part when considering whether it's in the consumer's best interest to switch their pension or not. Whilst they can't be viewed in isolation, higher costs would generally point towards being a good reason not to move. So, that means there'd need to be other, more compelling reasons to justify a switch. From what I've seen from the file, Ms M's existing Royal London pension had an annual charge of 0.75% p.a. Following the recommendation, the AJ Bell plan had a platform charge of 0.25% of the fund value, an investment charge of 0.74% p.a. and an ongoing advice fee of 1.00% p.a. This meant that Ms M saw her costs increase by almost a third, ignoring the 1.00% ongoing advice charge (or 165% including the new ongoing fee). MF's suitability letter justified the AJ Bell offering, in part, because it was competitively priced, but I don't think their letter was as clear as it could have been. That's because, whilst the costs of the Royal London plan were included, they weren't detailed until the last page of the letter making a comparison difficult.

So, I don't think that Ms M was aware to what extent the charges on the new plan were higher compared to her existing pension. That's problematic because when firms are undertaking switch business, the Regulator expects consumers to be given the costs (in pounds and pence) of what they're currently paying against the new recommendation, so they're placed in a fully informed position before agreeing to commit. Whilst Ms M was given an illustration at the point that she signed up, just because she was advised of what the new costs were doesn't then make the advice suitable.

In addition, I think MF's own analysis should've highlighted the flaw in their recommendation because on page nine of their suitability letter, it showed that the existing Royal London plan was likely to outperform the new AJ Bell plan based on 2.2% return by nearly £1,000 more. MF explained that whilst their analysis showed the Royal London plan may provide a better return based on that static 2.2% comparison alone, in their opinion, the funds which they recommended were likely to outperform her existing plan because they were able to better take account of her attitude to risk. However, I think that view is flawed because the funds that MF ultimately recommended were broadly in line with the equity content of Ms M's existing Royal London fund.

The end result meant that Ms M would be paying an additional cost each year over what she was previously paying with her Royal London plan. This meant that the new pension would need to outperform her existing fund every year to make switching worthwhile.

<u>1b. Existing benefits</u>

As I've already explained above, in considering a pension switches, the Regulator expects advisers to carefully review any existing features that the consumer's existing plan holds that could be lost following a recommendation to move to a new provider. Those features should be brought to the consumer's attention so a balanced discussion can be held on the importance of those benefits before deciding whether to proceed with the switch. Having looked at Ms M's existing Royal London plan, it appears she was eligible to take part in their 'ProfitShare' scheme. From what I've seen from their literature, as a mutual society, Royal

London distribute some of the profits back to their plan holders via that mechanism and whilst only modest in nature, at around 0.15% to 0.18% p.a., it was a valuable benefit that Ms M lost following the switch and one that MF's suitability letter was silent on.

<u>1c. Risk</u>

During their discussions, MF completed a questionnaire with Ms M to establish how much risk she was prepared to take with both her ISA and pension investment. Their assessment determined that she had an attitude to risk of six, or 'high medium'. Having reviewed the questionnaire MF completed with Ms M, I think there's some inconsistencies in the responses she provided compared to the end output:

"I would rather know that I was getting a guaranteed rate of return than be uncertain about my investments – Agree".

"I do not feel comfortable with financial uncertainty - Agree".

Both statements are at odds with a consumer who is happy to accept equity-based risk. MF have explained that they're satisfied with the accuracy of Ms M's risk profile because their electronic questionnaire calculated the 'high medium' score off the back of her answers to the questions. But, the FCA has previously cautioned firms about relying solely on the output of electronic risk scoring questionnaires and whilst they've acknowledged their importance in the advice process, they should only be considered as the starting point for establishing the consumer's final attitude to risk. Even though MF have stated that they held a detailed discussion with Ms M about the inconsistencies, the file is silent on the nature of the conversation. Whilst I feel that Ms M's responses to those two questions should've put MF on a path of discovery that the 'high medium' output was too high for her ISA investment, despite that, I'm broadly satisfied, given Ms M's circumstances, that that outcome wasn't unreasonable for her retirement risk profile. I say that because at the time of the advice, Ms M was 26 years old and around 35 to 40 years away from retirement, had a good salary with strong disposable income and reasonable expectations of pay increases and therefore the capacity to take risks at that level.

MF recommended that Ms M invest into four funds within the AJ Bell SIPP in differing proportions – Baillie Gifford Managed B Acc (35% of her funds), Liontrust Sustainable Future Managed (32%), Sarasin Global Equity Real Return (16%) and Vanguard LifeStrategy 80% (15%). Whilst the equity content of each of the four funds will change over time, the Baillie Gifford and Liontrust funds work on the basis that up to 85% of the monies can be invested in equities at any one time, the Sarasin fund typically invests at least 75% in equities and the Vanguard fund 80% in equities. So, I don't really find it surprising that when economic events dampened the value of Ms M's portfolio, she complained. Importantly though, those economic events have impacted many consumers portfolios across a range of risk spectrums and from the complaints that this service has seen, it doesn't necessarily follow that had MF invested Ms M's pension in lower risk funds, that that would have sheltered her monies from those market events. However, having looked at the nature of those funds, I don't find them to be incompatible for a consumer who has a high medium risk appetite and was willing and able to leave her funds invested for the long term.

Ms M was invested in Royal London's Balanced Lifestyle Strategy fund. So, based on her age, that meant the weight of her monies were invested in equities and as she approached her selected retirement, her monies would be progressively switched to lower risk funds. The fund fact sheet suggests that this fund is suitable for a consumer who is a medium or balanced investor. I therefore don't think the existing fund that Ms M was already in, appeared unreasonable compared to the output of MF's attitude to risk questionnaire.

MF justified the switch to the new plan on the basis that it would give Ms M a greater choice of investments and funds over what the Royal London plan offered. However, from what I've seen, the existing Royal London plan already offered a wide choice of existing funds – 99 in total, so if Ms M was unhappy with her existing arrangement, she could have altered her funds internally. And whilst MF mentioned that a fund switch was possible, it was discounted because she didn't want to have multiple pension contracts. Whilst Ms M may have taken that view, the adviser wasn't there just to transact what Ms M wanted and I think that they missed an opportunity to explain that, whilst a sole plan may have offered the convenience of a single annual statement instead of two, that needed to be balanced against the cost of a higher charging plan.

When I think of the modest size of Ms M's pension, I can think of no reason why an inexperienced consumer in her position would need access to a wide range of specialist investments or a wider investment choice than the collective 99 options that were already on offer in her existing defined contribution scheme. In addition to this, I think that by recommending four different funds, MF placed Ms M in a position where she then had a greater reliance on the need to take advice than she had previously.

Finally, just because the risk level that MF reached looked reasonable, that didn't make the recommendation suitable.

1d. Ongoing Fund Management

In their suitability letter to Ms M, MF justified their advice, in part, by stating that she'd benefit from an ongoing review service which would cost 1% p.a. of her funds under management. Whilst I well suspect that many consumers would find that service beneficial, based on the modest size of Ms M's pension fund (£6,700), I think the regular review service was likely to be less useful to her in the early years of her investment, combined with the fact that she was so far away from retirement. However, I am cognisant of the fact that Ms M's father, who is also her employer, was planning to make large ad-hoc contributions to the plan which he later did, maximising her annual allowance. But, MF didn't need to switch Ms M's fund away to a new provider to deliver an ongoing service; that's because looking at the existing Royal London plan, it offered an ongoing adviser charging feature which would have allowed MF access to manage that policy.

Suitability of switch advice - Summary

I don't doubt the flexibility, control and potential for greater returns sounded like attractive features to Ms M. But MF wasn't there just to transact what Ms M might have thought she wanted. The adviser's role was to really understand what Ms M needed and recommend what was in her best interest. With the reasonable performance track record of her existing fund, the Royal London pension already matched the aim of Ms M's retirement planning needs. In contrast, the recommended SIPP compared less favourably in terms of cost and the performance drag that this would have on the new, more expensive funds. The new SIPP would've needed to outperform her existing pension just to match the future benefits that her Royal London plan would've provided.

From what I've seen of Ms M's circumstances from the time, I'm not persuaded that moving from Royal London was in her best interests. I think that Ms M could've met her objectives by not transferring the Royal London plan and retaining her pension in its existing format. She could've then continued to benefit from a low-cost solution. I think that, had MF recommended that Ms M retain her pension, she would've more likely than not followed their advice, given that she was an inexperienced consumer who was taking direction from them. Therefore, I don't think that MF's recommendation to switch Ms M's Royal London pension was suitable and I require them to take the actions that I'll later set out to put things right for her.

2. Should MF have recommended Ms M opt back into her employer's pension scheme and use that plan for the ad-hoc payments?

Having carefully considered the appropriateness of the switch advice, I've also thought about why Ms M engaged MF in the first place, and that was to look at a solution that would be capable of accepting large ad-hoc pension payments. And, having looked at the existing Royal London pension, I don't believe there's any doubt that plan would have been capable of accepting those ad-hoc payments. From what I've seen, MF have already conceded that too - however, I don't think this issue is as necessarily straight forward as it seems and I'll explain why.

Ms M is employed by her father's business where he is also the director of the firm. Looking at the most recent Royal London statement, it would seem that Ms M's last payment into that plan was made from her May 2021 salary, at which point she opted out of the pension. She then met with MF's adviser the following month. MF have explained that Ms M had already opted out of the scheme prior to meeting with them and have also stated that at no point did they recommend she opt out – they say she'd already made that decision herself. However, Ms M has said that she was told by MF that she would need to cease membership of the employer's scheme as she couldn't have that and also receive ad-hoc payments at the same time.

So, whilst I can't say conclusively who directed Ms M to opt out of her scheme, what I can say is that MF were her financial adviser, and as such, should have directed her to opt back into the Royal London scheme because typically, it's always in the consumer's best interests to do so. And, whilst Ms M's father may have been planning to make large ad-hoc payments into the plan, there's no certainty that he would've been in a financial position to do so in subsequent years. Having looked at MF's suitability letter to Ms M, it's silent on the benefits of re-joining that scheme so it seems to me that this discussion never took place.

MF have explained that because of the proposed size of the ad-hoc payments that Ms M's father was considering making, he wanted to ensure complete confidentiality. They went on to explain that he didn't wish to make those payments through his company payroll scheme and wanted the funds keeping separate from the workplace contributions. Our Investigator asked for evidence of that instruction, but MF have explained that those conversations happened in person. So, despite the lack of available evidence, I think on the balance of probabilities, it's reasonable to conclude that it was always the desire to have a separate standalone plan because, had Ms M's father wished to make large ad-hoc pension payments to her Royal London scheme, he could have simply instructed his payroll department to do this, but he chose not to. Instead, MF were engaged to facilitate the setting up of a new plan - which was also the point at which they decided to explore switching Ms M's existing scheme too. So, it seems to me that even if MF hadn't undertaken the pension switch, they would've still set up the AJ Bell pension to receive the ad-hoc payments.

Following MFs advice to set the new AJ Bell SIPP up, Ms M's father made a payment to her plan, making use of her annual allowance. Subsequent to this, the value of Ms M's new SIPP, which included her Royal London monies and the new ad-hoc payment decreased and Ms M then complained. However, as I've already explained, I've seen nothing to persuade me that the level of risk that MF arrived at for Ms M's retirement planning objective was unsuitable. In addition, having carefully studied Ms M's complaint letter, it seems to me that she doesn't necessarily disagree that a high medium risk appetite is unreasonable for this need area either, and rather, she is unhappy about her funds going down in value.

I should explain that, whilst I do sympathise with Ms M and the concerns she must have had at seeing her pension savings decrease in value, this is a long term investment of some 40 years and during that window, consumers should expect to see their funds fall as well as rise. Based on Ms M's individual circumstances and more specifically, the time horizon she has until she needs to access those funds, I don't think either the risk categorisation or the four funds that MF recommended for the ad-hoc lump sum were unsuitable for her. As I've already set out above, the four funds that MF recommended had equity content of around 75 to 85% and the existing Royal London fund, that Ms M was already in, had a similar level, so I can't say that MF exposed her monies to too much risk. So, I'm not going to instruct MF to undertake any loss calculations on that element (the ad-hoc payment) of Ms M's pension.

However, as I've already explained, I've not been persuaded that the Royal London switch was in Ms M's best interests and so I therefore require MF to take the following steps to put things right for Ms M:

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put Ms M as close to the position she would probably now be in if she had not been given unsuitable advice to switch the Royal London pension.

I take the view that Ms M would have likely stayed where she was but may have invested differently. It is not possible to say *precisely* what she would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Ms M's circumstances and objectives when she invested.

What must MF do?

To compensate Ms M fairly, MF must:

Compare the performance of Ms M's AJ Bell SIPP (specifically the defined contribution funds she transferred into the plan and excluding any ad-hoc or further payments made since the switch) with the notional value if those monies had remained within the same funds at Royal London. 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.

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

If there is a loss, MF should pay into Ms M's pension plan to increase its value by the 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 MF is unable to pay the compensation into Ms M'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 compensation 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 Ms M won't be able to reclaim any of the reduction after compensation is paid.

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

It's reasonable to assume that Ms M is likely to be a basic rate taxpayer at the selected retirement age, so the reduction would equal 20%. However, if Ms M 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 MF deducts income tax from the interest, it should tell Ms M how much has been taken off. MF should give Ms M a tax deduction certificate in respect of interest if Ms M asks for one, so she can reclaim the tax on interest from HM Revenue & Customs if appropriate.

Investment name	Status	Benchmark	From ("start date")	To ("end date")	Additional interest
AJ Bell SIPP	Still exists and liquid	Previous Royal London Balanced Lifestyle Strategy fund	date switched to AJ Bell SIPP	Date of my final decision	8% simple per year if MF have not paid any redress due within 30 days of the consumer accepting the final decision

Actual value

This means the actual amount payable from the investment at the end date.

Notional value

This is the value of Ms M's investment had it remained within the Royal London fund until the end date. MF should calculate this value.

Any withdrawal, income or other distributions paid out of the investment 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.

Why is this remedy suitable?

I've chosen this method of compensation because:

- Ms M didn't need to switch her Royal London GPP to AJ Bell and therefore, this will place her back in as close to the same position that she would've been in, as if the sale had not taken place.

Trouble and upset

Given the inconvenience MF have caused Ms M, they should pay her £100 for the trouble they've caused to her retirement planning.

MF should provide details of its calculation to Ms M in a clear, simple format.

My final decision

I uphold Ms M’s complaint. My decision is that Morton Hill Limited, trading as McKnight Financial, should pay the amount calculated as set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Ms M to accept or reject my decision before 28 March 2024.

Simon Fox
Ombudsman