

The complaint

Mr W complains about the outcome of the review carried out by Merlin Financial Services Limited (“Merlin”) in connection with the FCA’s consumer redress scheme for the British Steel Pension Scheme (“BSPS”) – to make my findings easier to follow, I’ll refer to this as the “redress scheme”.

What happened

The sequence of events isn’t in dispute, so I’ve only set out a brief summary of what happened.

Mr W had built up 12 years and 3 months’ pensionable service in the BSPS between March 1995 and June 2007. The BSPS was a defined benefits (“DB”) pension scheme that provided a guaranteed lifetime income to members. In August 2017, the BSPS issued a transfer value of £177,176.55 to Mr W in respect of his DB pension. He was interested in transferring this value to a private pension arrangement so that he could access his benefits flexibly including taking the maximum tax-free lump sum immediately to buy an investment property. He was introduced to Merlin to get advice on his options.

In October 2017, Merlin recorded the following information about Mr W and his wife:

- Mr W was aged 55 and his wife was aged 51. They were both in good health although Mr W had previously suffered a heart attack. They had one adult child;
- Mr W was employed as a health and safety manager and paid gross annual income of around £66,000. The age at which he wanted to retire wasn’t recorded. His pension provision comprised the following: (1) entitlement to a full state pension from age 67; (2) his preserved DB pension in the BSPS which had a cash equivalent transfer value of £177,176.55; (3) a defined contribution (“DC”) workplace pension plan offered by his then employer into which 15% of his annual salary was being contributed (Merlin didn’t record the fund value at that time);
- His wife’s employment status and the age at which she wanted to retire weren’t recorded. Her pension provision comprised the following: (1) entitlement to a full state pension from age 67; (2) entitlement to a DB pension based on around 20 years’ pension service (Merlin didn’t record further details such as the annual pension at the date of leaving or the projected benefits available at the scheme normal retirement age);
- Their joint assets comprised the main residence valued at £200,000, two investment properties with a combined value of £340,000 and cash savings of around £20,000 set aside as an emergency fund. The investment properties generated annual rental income of around £21,600;
- Their liabilities comprised total mortgage debt of around £80,000 (Merlin didn’t record further details such as the interest rate or remaining term). They didn’t have any other debts or liabilities;

- After paying for bills and essentials, they had surplus disposable income of around £2,500 available every month;
- Mr W and his wife required joint gross annual income of around £24,000 from all sources when they retired. As noted above, their target retirement ages weren't recorded by Merlin;
- He wanted to use the value of his pension benefits to buy another investment property (Merlin didn't record further details such as the expected cost of the property and the costs associated with buying it); and
- Mr W had a 'Low medium' risk profile.

In November 2017, Merlin advised Mr W to transfer the capitalised value of his DB pension in the BSPS to a PPP provided by Prudential. Mr W accepted the recommendation. The transfer to the PPP was completed shortly afterwards. Prudential received an amount of £182,954.05 after the BSPS increased the transfer value during the period Merlin was advising Mr W. In January 2018, Mr W withdrew the maximum tax-free lump sum of £45,756.36 from the PPP and left the residual fund invested.

The redress scheme

In November 2022, the FCA announced its final rules (set out in PS22/14) for the redress scheme after it had identified that many former members of the BSPS were given the wrong advice to transfer away from the scheme. The redress scheme started in February 2023. The rules for the redress scheme require firms to identify scheme cases following certain criteria. Once identified, firms need to review the advice they gave to former BSPS members in these cases – and then tell them if the advice was suitable or not. As part of the review process, firms are required to use the FCA's BSPS Defined Benefit Advice Assessment Tool ("DBAAT"). The review can lead to one of two outcomes:

- The advice is rated as "suitable" and the case is closed; or
- The advice is rated as "unsuitable" – if so, the case progresses to a calculation and the payment of redress if it's shown the consumer suffered a financial loss

If the consumer disagrees with the outcome, they can ask the Financial Ombudsman Service ("FOS") to look at whether the review was carried out correctly in line with the redress scheme rules.

Merlin's review of the advice it gave Mr W

In June 2023, Merlin completed its review of the advice it gave to Mr W to transfer out of the BSPS. The DBAAT generated a suggested suitability rating of "potentially suitable" based on Merlin's answers. It finalised the rating as "suitable" and closed Mr W's case.

Merlin confirmed the review outcome to Mr W and told him that it wouldn't be taking any further action.

FOS's assessment

Mr W disagreed with Merlin's assessment of his case. So he referred the matter to FOS.

One of our investigators recommended that this complaint be upheld because he had concerns Merlin hadn't followed the FCA's redress scheme rules. He explained the reasons why in his assessment. To put things right, our investigator recommended that Merlin amend the review outcome on Mr W's case under the redress scheme to "unsuitable" and then go on to calculate and pay any redress due to him in line with the redress scheme rules.

Mr W accepted our investigator's view and provided some additional comments about Merlin's record keeping at the time it advised him. However, Merlin didn't accept it and provided substantial comments in response. In summary, it stated that Mr W knew exactly what he wanted to do, understood and accepted the risks in transferring and believed that he would be better off using the value of his DB pension to invest in property instead. It remained satisfied that it had provided a suitable recommendation to transfer. It also thought its answers on the DBAAT were correct and supported its view that the advice was suitable. It also provided details of a loss assessment it carried out that showed Mr W hadn't suffered a financial loss.

Our investigator considered Merlin's additional comments but wasn't persuaded to change his mind. He explained to Merlin that – at this stage – the loss assessment outcome is essentially irrelevant until such time as agreement is reached on the redress scheme outcome.

Since agreement couldn't be reached, this complaint has now been allocated to me to review and decide. This is the last stage of our process.

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.

Scope of this final decision

Mr W has specifically complained about the outcome of Merlin's assessment of his case under the redress scheme. Therefore the scope of this final decision is limited only to evaluating the adequacy of Merlin's assessment of Mr W's case under the redress scheme. This means that in deciding this complaint I won't be considering the loss assessment calculation carried out by Merlin.

I've considered all the evidence afresh including Mr W's and Merlin's comments in response to our investigator's assessment. I'd like to clarify that the purpose of this decision isn't to repeat or address every single point raised by the parties to this complaint. So if I haven't commented on any specific point, it's because I don't believe it's affected what I think is the right outcome.

The FCA's BSPS DBAAT

As noted above, the redress scheme rules require firms to use the FCA's BSPS DBAAT. In summary, the tool helps firms assess the suitability of pension transfer advice by considering whether, based on the evidence on the consumer's file, any of 12 examples of unsuitability are present. For each example, the firm, in its role as assessor, should simply answer "yes" or "no" to indicate whether or not the example is present considering the consumer's circumstances and FCA guidance at the time of the advice.

If an example is present on the consumer's file it may indicate failure to comply with the FCA's suitability requirements for pension transfer advice. Once all 12 suitability questions are answered, the tool suggests a rating. If one or more examples are present, the tool will

suggest that the advice is “potentially unsuitable” and the pension transfer isn’t likely to be in the consumer’s best interests. If no examples are present, the tool will suggest that the advice is “potentially suitable”. But the tool only provides a suggested rating. It’s for the assessor to make a final judgment, taking account of the available evidence, whether it considers the advice is suitable or not. In all cases the assessor must explain its reasoning for the final judgment.

Merlin’s review of the advice it gave Mr W

In its role as assessor, Merlin answered that none of the 12 examples of unsuitability applied to Mr W’s case. This generated a suggested rating of “potentially suitable”. Merlin finalised the advice rating as “suitable” based on the following rationale:

“The client has rental properties and a state pension which will cover required outgoings in retirement. His wife also has 20 years in a final salary scheme along with her state pension. Therefore [sic] the guaranteed benefits along with rental income will easily cover their essential living costs. The client has worked in financial services so undestands [sic] risks. Client wished to access his British Steel pension early in order to obtain tax-free cash with which he stated he would purchase a third buy to let property.

After taking his tax-free cash he would have a personal pension fund of £134,928.61 at the time to help provide additional income in retirement. He was already a landlord with two properties providing £1,800 per month in rent. Income from this third property along with his wife’s state pensions [sic] plus a final salary pension scheme that his wife had at the time with over 20 years membership would easily cover the required expenditure in retirement.

He also wanted more suitable death benefits for his family. He understood the risks of transferring away from the British Steel scheme for which he signed a short letter to confirm this. In addition, he also made the adviser aware that he had knowledge of Financial Services, having worked in the industry. He also held personal pensions and was currently paying into his employer’s auto-enrolment pension scheme at a rate of 15% of his salary of £66,000 which was an annual contribution of £9,900 per annum to his retirement plans. He had experienced and understood the risks of investment-based plans and the fact that the values could rise and fall. With this in mind it helped him achieve his wants and needs and therefore I find the advice suitable”.

I’ve reviewed the answers on the completed DBAAT. For largely the same reasons, I agree with our investigator’s view that Merlin didn’t follow the redress scheme rules when it assessed Mr W’s case. In particular, based on the contemporaneous evidence and the redress scheme instructions in CONRED 4 Annex 21, I think Merlin, in its role as assessor, should’ve answered “yes” to the following examples of unsuitability:

Example 1: The client is, or will be, reliant on income from the comparator scheme

Under reference 10.3 E (3) in CONRED 4 Annex 21, the assessor is directed to answer “yes” to Example 1 when the available evidence demonstrates that the firm hasn’t obtained the necessary information in all of the Information Areas 5, 6 and 7 of the Information Section. The direction to answer “yes” is because the absence of that necessary information means the firm hasn’t demonstrated it has a reasonable basis for believing the consumer is able to bear the risk of the pension transfer to achieve their income objective. I think this question is relevant to Mr W’s case, as I will explain.

Mr W was then aged 55. Merlin recorded that he and his wife required joint gross annual income of around £24,000 from all sources when they retired. His safeguarded benefits in the BPS, accounting for 12 years and 3 months' pensionable service, had a transfer value of £177,176.55 and, based on the available evidence, represented his main private retirement provision built up by that time.

Merlin recorded that Mr W had a DC workplace pension plan offered by his then employer into which 15% of his annual salary of around £66,000 was being contributed. But it didn't record the fund value or obtain a projection of the benefits payable by that plan. And I cannot see that it recorded Mr W's planned retirement age. In addition, in meeting the target income figure, Merlin were relying on Mrs W's DB pension based on around 20 years' pension service. But it didn't record further details about this such as the annual pension at the date of leaving or the projected benefits available at the scheme normal retirement age. And it didn't record the age at which she wanted to retire which I think was necessary given there was a reliance on her pension income to meet the target figure of £24,000. So it's my view that Merlin didn't record the necessary information on these points.

Furthermore, it appears that the figure of £24,000 was a notional figure suggested by Mr W based on his own analysis. This concerns me. As the professional party in the transaction, I'd have expected Merlin to have adopted a thorough approach in establishing Mr W's target retirement age and income needs taking into account his expected basic cost of living, lifestyle expenditure, discretionary expenditure and saving. But it doesn't appear to have done this and instead relied on Mr W's own analysis of the situation without scrutinising the notional target income figure. So it's my view that Mr W's needs weren't properly scrutinised. This wasn't addressed by the assessor when it completed the DBAAT.

Based on the above, I don't agree with Merlin's rationale that "*the guaranteed benefits along with rental income will easily cover their essential living costs*". It's my view that it didn't collect enough information at the time of the advice to support this conclusion.

In addition, one of Mr W's main objectives was to take an immediate tax-free lump sum from the PPP to buy an investment property. But I cannot see that Merlin established any further details on this such as the expected cost of the property and the costs associated with buying it – and therefore whether transferring would enable Mr W to achieve the objective.

As a result, it's my view that Merlin didn't obtain the necessary information to demonstrate it had a reasonable basis for believing Mr W was able to bear the risk of the pension transfer to achieve his income and lump sum objectives.

In absence of evidence to the contrary, I think it's fair to say that Mr W, then aged 55, would be reliant on the income from the comparator scheme by the time he came to retire bearing in mind that these benefits – based on the available evidence – represented his main private retirement provision built up by that time and he had limited timeframe to build up additional benefits before he retired (whenever that occurred).

Given the above points, it's my opinion that the assessor should've answered "yes" to Example 1.

Example 2: The aim of the transfer is to pass the value of the pension to beneficiaries on the member's death, but the firm has not demonstrated that the consumer can bear the risk of the transfer that would be needed to achieve this objective

Under this question the assessor is required to consider whether the pension transfer was required to achieve Mr W's death benefit objective and – if so – whether he was able to bear the risk of the transfer. Under reference 10.5R (3), the assessor is required to identify

whether there was an alternative way to meet the objective without giving up comparator scheme benefits.

In the suitability report it was stated in reference to Mr W's objectives, "...you would also like more suitable death benefits applicable to your circumstances". So it's not disputed that passing on the value of his DB pension upon his death was important to Mr W. However, the question here is whether the pension transfer was required to achieve the objective.

In the supplementary fact find document, Merlin ticked a box to indicate that "alternative life cover" had been considered by Merlin and discounted. In its research notes I can see that Merlin obtained whole of life quotes with a sum assured mirroring the transfer value of £177,176.55. However, I cannot see any reference to this quote in the suitability report and why it had been discounted by Merlin in favour of the pension transfer. It's unclear how the alternative whole of life cover was presented and considered in discussions with Mr W, if at all. But even if it was, I'm concerned that Merlin limited its research to whole of life cover.

There's no contemporaneous evidence that any or a combination of the following ways to meet the death benefit objective were adequately considered and discounted by Merlin as an alternative way to meet the objective:

- using some of Mr W's surplus disposable income of around £2,500 available every month to obtain level or decreasing term assurance which may have been more appropriate than whole of life cover. Level or decreasing term life cover is cheaper than whole of life cover where Mr W would be charged for benefits he might not need, such as a surrender value or longer-term life cover. Furthermore, decreasing term life cover may more closely match the shape of a decreasing fund value, once accessed; and/or
- using Mr W's personal contributions of £21,584.10 paid into the BPS which would be refunded plus interest by the BPS/BSPS2 to any nominated beneficiary on his death including his wife; and/or
- using the value of any death benefits available under Mr W's existing DC workplace pension plan and any death in service lump sum benefit offered by his then employer.

This wasn't addressed by the assessor when completing the DBAAT. With reference to 10.5R (4), the assessor is required to decide whether the firm has a reasonable basis for believing that the recommendation to transfer in order to pass the value of the pension to beneficiaries on death met the consumer's investment objectives.

I think it's clear that lower risk suitable alternative options were available to achieve Mr W's death benefit objective but it's my view that Merlin failed to adequately consider these, as noted above.

Since Mr W was aged 55 and in good health at the time, he could reasonably expect to live well into his 80s based on average life expectancy. It's fair to say that immediately following the transfer to the PPP and for the period until Mr W started to withdraw retirement benefits, the death benefits available would be significant (subject to investment performance) until such time as he accessed and depleted the fund value. But once he started withdrawing money from the PPP to meet his income and lump sum needs, it would mean that the size of the fund remaining in later years – when death is more likely – could be much smaller than expected. This doesn't appear to have been considered by Merlin and explained to Mr W.

As noted above, the age at which Mr W wanted to retire wasn't recorded. Shortly after the

pension transfer was completed Mr W, at age 55, withdrew the maximum tax-free lump sum of £45,756.36 from the PPP and left the residual fund invested in line with his recorded objective. The TVAS report obtained by Merlin showed the critical yield was 9.7% based on Mr W retiring at age 65. In my view, taking the tax-free cash earlier than age 65 increased the risk that the PPP fund value would be depleted during Mr W's lifetime bearing in mind the critical yield figure of 9.7%. In addition, I cannot see any evidence that Merlin carried out any meaningful cashflow modelling to indicate the sustainability of income from the proposed PPP to achieve Mr W's income target.

Overall, given Mr W's level of reliance on these benefits, I think it's unclear what level of death benefits, if any, would likely be available from the PPP, particularly if Mr W lived beyond average life expectancy which of course is a possibility.

Taking into account the above, it's my view that Merlin didn't have a reasonable basis for believing that the recommendation to transfer in order to pass the value of the pension to beneficiaries on Mr W's death met his objective.

Under reference 10.6E (1), (2) and (3), the assessor is directed to answer "yes" to Example 2 when the available evidence demonstrates that:

- a lower risk suitable alternative was available to achieve this objective; and/or
- it was likely that the consumer would exhaust their pension savings during their lifetime and so there will be minimal death benefits available.

Given the above points, it's my opinion that the assessor should've answered "yes" to Example 2.

Example 3: The aim of the transfer is to access income-related benefits flexibly but the firm has not demonstrated that the consumer can bear the risk of the transfer that would be needed to achieve this objective

Under reference 10.9E, the assessor is required to answer "yes" to this question where the following apply:

- (2) there is an alternative way for the consumer to meet their objectives using other assets instead of transferring their BPS scheme.

It was recorded that Mr W wanted to transfer so that he could have flexibility regarding how and when he withdrew his pension benefits. It was noted that he wanted an immediate tax-free lump sum of around £45,000 to buy an investment property and, when he retired, an annual income of around £24,000 from all sources.

Flexibility of income might sound attractive, but I cannot see that Mr W had any concrete need for it specifically in connection with his DB pension in the BPS. There's no real evidence that Mr W required the flexibility of irregular or variable income during retirement from this money. Rather, the evidence indicates that he required a steady and reliable source of income when he retired to achieve his stated income need when he retired. If he did require flexibility, there were alternative, lower risk options available:

- saving some of Mr W's surplus disposable income of around £2,500 available every month while he was still working in either a pension, investment or savings account to provide flexible income or lump sums rather than transferring and losing benefit guarantees; and/or

- using the value of Mr W's existing DC workplace pension (into which 15% of his annual salary was being invested) to meet any flexible needs; and/or
- using the rental income generated from Mr W's existing investment properties to meet any flexible needs.

This wasn't addressed by the assessor when completing the DBAAT. Overall, it's my view that Merlin failed to adequately consider and discount alternative, lower risk options to achieve any flexible needs rather than relinquishing a guaranteed lifetime income under the BPS.

Given the above points, it's my opinion that the assessor should've answered "yes" to Example 3.

Example 4: the aim of the transfer is to maximise PCLS but the firm has not demonstrated that the consumer can bear the risk of the transfer that would be needed to achieve this objective

Under reference 10.13E (1), (2) and (4), the assessor is directed to answer "yes" to Example 4 when the available evidence demonstrates that:

- the consumer didn't have the requisite capacity for loss because they were unable to forego scheme benefits to achieve this objective; and/or
- there was an alternative way for the consumer to access income-related benefits flexibly without transferring their pension benefits; and or
- the firm hasn't collected the necessary information regarding the consumer's estimated expenditure and financial situation.

As noted above, Mr W wanted to take the maximum tax-free lump sum immediately to buy an investment property.

As I've concluded in Example 1, I don't think Merlin obtained the necessary information to demonstrate it had a reasonable basis for believing Mr W was able to bear the risk of the pension transfer to achieve his objectives. Furthermore, while Merlin recorded that Mr W wanted the maximum tax-free lump sum to enable him to buy an investment property, it didn't record further details such as the expected cost of the property and the costs associated with buying it. I think this information was critical to support the case for a pension transfer and to demonstrate suitability. Without this information it's my view that it wasn't possible to advise whether transferring was the most suitable option to achieve this objective.

Lower risk and alternative options may have been available but Merlin appears not to have considered and discounted these. For example, Mr W was contributing to his DC workplace pension but Merlin didn't record the then fund value or whether it was possible under the scheme rules to withdraw a tax-free lump sum at that time to use towards the property purchase rather than transferring his DB pension and losing benefit guarantees. In addition, Mr W may have been able to obtain a mortgage or re-mortgage his two existing investment properties to release money to facilitate the purchase of the third investment property. Again, I cannot see that Merlin considered this as an alternative to transferring.

Given the above points, it's my opinion that the assessor should've answered "yes" to

Example 4.

Example 9: The firm's transfer analysis does not support a recommendation to transfer

Under reference 10.27E (1) (a), the assessor is required to answer “yes” to this question when the firm hasn’t demonstrated that the transfer analysis supports the recommendation to transfer, for example because: (i) the critical yield indicated in the transfer value analysis is likely to be unattainable, factoring in the term to retirement and the consumer’s attitude to investment risk; or (ii) the capitalised value of death benefits (where this is a priority objective) is significantly higher under the comparator scheme(s) than that available from the proposed arrangement.

In Mr W’s case, I cannot see that Merlin recorded the age at which he wanted to retire. But the TVAS calculation was based on retiring at age 65. The critical yield figure at age 65 calculated by Merlin was 9.7%. Merlin recommended that Mr W invest the value of his PPP into a fund that aligned with his ‘*Low medium*’ risk profile. The key features illustration for the PPP showed that the assumed growth rates were 8.00%% for the upper projection rate, 5.00% for the middle projection rate and 2.00% for the lower projection rate. I think the critical yield figure of 9.7% was likely to be unobtainable based on the rates of return shown on the illustration and Mr W’s risk profile. Furthermore, it’s my view that Merlin should’ve calculated the critical yield figure at age 55 given that it knew Mr W wanted to access benefits in the PPP earlier than age 65. The critical yield figure at age 55 would’ve been greater than at age 65 due to the shorter investment timeframe and impact of the initial advice charge on the required growth rate, further undermining the case for a pension transfer.

Furthermore, according to the TVAS report, the capitalised value of death benefits under the BPS were significantly higher at £218,678.25 compared to the PPP at £175,404.78. I acknowledge that the TVAS report indicates that the capitalised value of the death benefit under the PPP was higher after five years and beyond – but this was misleading because it didn’t take into account that Mr W was looking to take the maximum tax-free lump sum from the PPP once the transfer had been completed.

It’s my view that the transfer analysis showed it was likely Mr W would be financially worse off as a result of the pension transfer.

Given the above points, it’s my opinion that the assessor should’ve answered “yes” to Example 9, particularly given my view that lower risk alternative options were available to meet Mr W’s death benefit objective (Example 2) and that he didn’t require flexibility with these benefits (Example 3).

Conclusion

Based on the above considerations, it’s my opinion that Merlin failed to follow the FCA’s redress scheme rules when it assessed Mr W’s case. Specifically, for the reasons explained above, it’s my view that had it followed the guidance correctly, it would’ve answered “yes” to unsuitability examples 1, 2, 3, 4 and 9 in the DBAAT. The tool would’ve then generated a suggested rating of “potentially unsuitable”. Considering the evidence in the round, I cannot see any compelling reason why a suggested rating of “potentially unsuitable” should be overturned to “suitable”.

Causation

I've considered the points under reference 11.7G (1) to (9) in the Causation Section under the redress scheme rules to decide whether I think it's more likely than not that Merlin's non-compliant conduct was the effective cause of Mr W's decision to transfer. This was a complex transaction involving many factors. In my view, Mr W was reliant on Merlin, as the professional party in the transaction, to take those factors into account and provide balanced and suitable advice regardless of his own views about what was right for him.

Overall, it's my view that Merlin's conduct is more likely than not to have caused Mr W to transfer to the PPP when this wasn't in his best interests. Given Mr W's reliance on Merlin to provide suitable advice, I think it's unlikely he would've still decided to transfer to the PPP against its advice had it advised him not to transfer.

Putting things right

Merlin must do the following:

1. Amend the DBAAT so that unsuitability Examples 1, 2, 3, 4 and 9 are marked as 'yes' on the relevant tab and the '*Assessor's suitability rating*' is marked as "unsuitable" – and then update the section covering rationale with appropriate comments to support the conclusion;
2. Calculate and pay any redress due in line with the redress scheme rules; and
3. Ensure that any relevant records and reporting to the FCA are updated accordingly to reflect the change in outcome on Mr W's case.

My final decision

I uphold this complaint. I direct Merlin Financial Services Limited to follow the steps set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 18 June 2024.

Clint Penfold
Ombudsman