DRN-3710855

The complaint

Mr H, through his representative, a claims management company ('CMC'), complains that Zurich Assurance Ltd gave him insufficient information when it advised him to take out a freestanding additional voluntary contribution ('FSAVC') pension policy.

What happened

In 1991 Mr H was advised by an adviser from Company A to take out a FSAVC with it. Zurich Assurance Ltd now has responsibility for Company A's actions in relation to this advice, so for ease I will refer to Zurich from now on.

At the time Mr H was advised to take out the FSAVC he was 23 years old, married, and an officer in the British armed forces. The fact-find completed indicated that:

- He was a member of his employer's occupational pension scheme and had been since late 1988 with a selected retirement age of 55.
- His preferred retirement age (presumably for the FSAVC) was also 55.

In September 2020 Mr H's representative complained to Zurich that Mr H had been mis-sold the FSAVC. The CMC said that:

- The adviser failed to accurately assess the level of risk Mr H was willing to take.
- There was no justifiable reason for Mr H to have a portable FSAVC as he was likely to remain in the same employment until retirement.
- The adviser failed to establish if Mr H's occupational pension scheme had an added years or any other enhanced benefit additional voluntary contribution ('AVC') arrangement that Mr H would have chosen if properly advised.
- There is no evidence that the adviser compared the benefits of the FSAVC with additional contributions to the occupational pension AVC scheme.
- The adviser should have referred Mr H to the company scheme for the full details of charges in order to make an informed choice.
- There is no evidence that the adviser made Mr H fully aware of the comparison of charges with the FSAVC recommended and the in-house AVC scheme.
- There is no evidence that more suitable retirement alternatives were discussed with Mr H in a fair and balanced way.

The CMC concluded that if the Zurich adviser had advised Mr H correctly, he would've contributed to the most suitable in-house AVC arrangement.

In November 2020 Zurich responded to the complaint. It said it wouldn't address every point raised but would address the overall suitability of the advice. It said that at the time Mr H met with the adviser he was eligible to retire at 38 but that he was unsure whether he would do so, and pursue another career, or remain in the armed forces and retire at 55. Zurich said it was clear from the information on its files that Mr H understood his armed forces pension scheme and the FSAVC and he wanted the flexibility the FSAVC gave him. Zurich referred to a letter Mr H had sent it in November 1994 in which he explains his understanding that he wouldn't have to take the FSAVC benefits at the same time as his armed forces pension. Zurich said this was important to him given the uncertainty about his retirement plans. It said that if Mr H had contributed to the armed forces AVC then he would've had to take it at the same time as the armed forces pension. So it concluded Mr H had made an informed choice after discussion with his adviser and it didn't uphold the complaint.

Mr H brought his complaint to our service. Our investigator looked into it. She didn't think that Zurich had met its regulatory responsibilities when its adviser recommended the FSAVC to Mr H. She didn't think the November 1994 letter was enough to show that Mr H had been told of the (potential difference in) charges and the in-house options. She thought Mr H would've made in-house AVCs if properly advised. She set out how she thought compensation should be calculated.

Mr H accepted our investigator's view. But Zurich said she hadn't given sufficient consideration to Mr H's circumstances which showed that he wanted the flexibility of being able to take the FSAVC separately to his armed forces pension. It provided some further correspondence between Zurich and Mr H in late 1994 and early 1995.

Our investigator didn't change her view. She thought that if the main objective was such flexibility it should've been noted somewhere. And there was still no evidence Mr H was made aware of charges and in-house options, so she wasn't persuaded Zurich had met its regulatory obligations.

Zurich asked for a decision from an ombudsman. It said that our investigator hadn't addressed its point that it seemed clear that the FSAVC represented the most suitable choice to meet Mr H's requirements. It said the evidence showed that Mr H clearly wanted to keep his pensions separate.

On 30 August 2022 I issued a provisional decision. My provisional findings were as follows:

Mr H met with the Zurich adviser concerning his pension options some 31 years ago. So I need to consider what the regulatory requirements were at that time, which are different to today. The requirements also differ whether an adviser is independent (can recommend financial products across the whole market) or is 'tied' and can only recommend products provided by one company. The adviser is this case could only recommend products offered by Zurich. They couldn't actively recommend any other products from any other product providers including any in-house options such as AVCs or added years offered by the armed forces pension scheme.

However, a tied adviser was required to follow rules set in 1988 by the regulator at that time - the Life Assurance and Unit Trust Regulatory Organisation ('LAUTRO'). The LAUTRO Code said advisers should maintain high standards of integrity and fair dealing, exercise due skill, care and diligence in providing any services, and generally take proper account of the interests of investors. It added that businesses should:

- *Have regard to the consumer's financial position generally and to any rights they may have under an occupational scheme, and*
- *Give the consumer all information relevant to their dealings with the representative in question.*

So, this means that tied advisers should have known that 'in-house' AVC options would most likely be available to consumers like Mr H. And in addition to highlighting the benefits of the FSAVC, a tied advisor needed to mention the generic benefits of the 'in-house options', including that:

- *Money purchase 'in house' AVCs could potentially offer lower charges than the FSAVCs.*
- *'Added years' might be available under a defined benefit OPS.*

- *The consumer's employer might match or top-up the amount the consumer paid into either in-house option.*

As our investigator said, there's no evidence that the Zurich adviser discussed these matters with M H. And although at the time the advice was given there was no requirement to issue a 'suitability letter' setting out the recommendation, I still would've expected to see some evidence. So I'm not persuaded that the regulatory requirements were met.

But Zurich says Mr H had a clear motivation to favour a FSAVC over any in-house option such as added years or an AVC. Zurich says this was because Mr H wasn't sure if he would leave the armed forces at 38 or 55. If he retired at 38, he would have to take his armed forces pension and any in-house further pension provision at that time. But at the time of the FSAVC sale, it was possible for Mr H to convert his FSAVC to a personal pension and not take it at the same time as the armed forces pension if he did decide to retire at 38.

I've thought carefully about this, but I'm not persuaded this makes the advice suitable, even if I agree that Mr H was undecided about his retirement age at the time he sought advice. I'll explain why.

At the time of the advice in 1991, an FSAVC did normally have to be taken at the same time as the main occupational pension. But it appears that at the time of the advice, Zurich did inform him that he could convert his FSAVC into a personal pension when taking retirement from the armed forces. I say this because of Mr H's recollection in the November 1994 letter. It may well be that this was the motivating factor in Mr H taking out the FSAVC, given his indication in 1994 that he had been undecided when he would retire from the armed forces. But this doesn't mean that I must be persuaded, as Zurich argues, that the FSAVC was the most suitable option given Mr H's circumstances. I've looked carefully at the other correspondence Zurich have provided between it and Mr H in late 1994/early 1995. Its February 1995 letter to Mr H indicated as follows:

> *"In the early 90's there was an Inland Revenue loophole which some members of the Armed Forces were using which allowed them to convert their (FS)AVC at retirement into a PPP. It was always pointed out that this was a loophole and there was no guarantee that it would remain available. The inland revenue has in fact closed the door and therefore benefits now have to be taken (at the same time benefits are taken from the occupational pension scheme)". (initials and words in brackets added by me for context)*

At the time of the advice in 1991, Mr H still had some 15 years until his earliest possible armed forces retirement age of 38. This is a very long period of time in which to expect any such 'loophole' to remain available, given the normal position at the time of the advice that such benefits had to be taken at retirement with the OPS benefits. So I'm not persuaded that pointing out the loophole, even with the warning, was consistent with Zurich's adviser's duties under the LAUTRO code of conduct to advisers should maintain high standards of integrity and fair dealing, exercise due skill, care and diligence in providing any services, and to generally take proper account of the interests of investors. The use of the word 'loophole' suggests to me that this was a position the Inland Revenue hadn't intended and therefore it would be prudent to think it would be closed at some time.

In this context, the lack of any evidence that Mr H was informed of his in-house options, and in particular the possibility of lower fees from an in-house arrangement, assumes even more significance. In my view, if Mr H had been properly advised, I think it very unlikely that he would've opted to pay potentially higher fees for a product which provided flexibility that could be removed at any time. Of course, legislative change can occur at any time in the future, but it is the element of the flexibility being dependent on a known loophole that is of *concern here.*

I am reinforced in my view that the advice was unsuitable in any event by other elements of the February 1995 letter in which it is plain that the FSAVC was provided on the basis that Mr H's retirement age for that product was 55 and early retirement charges would apply if he took retirement at 38. This exposed Mr H to an investment loss if the loophole was closed, and he chose to retire at 38 and had to take the FSAVC. In these circumstances I'm not persuaded that Mr H would've taken out the FSAVC if he'd been properly advised as to the existence of an in-house option and its potentially lower fees.

Having concluded that Mr H wasn't suitably advised in relation to the sale of the FSAVC, I now need to consider what I think it is most likely he would've done if he had been properly advised. I think it's likely Mr H still would've wanted to supplement his armed forces pension scheme provision as he was clearly focussed on planning for his long-term financial future. So I don't think he would've done nothing if he'd been properly advised and informed.

Although the Zurich adviser didn't have to provide the detail of Mr H's in-house options the adviser did need to give the basic information that I've set out earlier, namely that the charges for in-house AVCs could be lower and the employer may make or match contributions, and that it could be possible to buy added years.

I don't think Mr H would've bought added years, as this was an expensive and fairly inflexible option and if he'd stayed until 55, he would've had a good many years of service anyway. I think it most likely that Mr H would've made AVCs – the other option available to him. I set out below my provisional view as to how compensation should be calculated.

I then set out how I thought compensation should be calculated and included an assumption that Mr H's likely income tax rate in retirement was 20%. I invited the parties to tell me if they didn't think that assumption was reasonable.

Mr H's representatives accepted the PD. Zurich indicated it was disappointed with the decision but thanked me for considering its objections and providing my rationale. Neither party challenged my assumption concerning Mr H's likely income tax rate in retirement.

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.

Having done so,I see no reason to change my provisional findings and decision and so I adopt them as my final findings and decision.

Putting things right

Zurich Assurance Ltd should undertake a redress calculation in accordance with the regulator's FSAVC review guidance, incorporating the amendment below to take into account that data for the CAPS 'mixed with property' index isn't available for periods after 1 January 2005.

The FSAVC review guidance wasn't intended to compensate consumers for losses arising solely from poor investment returns in the FSAVC funds, which is why a benchmark index is used to calculate the difference in charges and (if applicable) any loss of employer matching contributions or subsidised benefits.

In our view the FTSE UK Private Investor Growth Total Return Index provides the closest correlation to the CAPS ‘mixed with property’ index. So, where the calculation requires ongoing charges in an investment based FSAVC and AVC to be compared after 1 January 2005, Zurich should use the CAPS ‘mixed with property’ index up to 1 January 2005 and the FTSE UK Private Investor Growth Total Return Index thereafter.

If the calculation demonstrates a loss, the compensation amount should if possible be paid into Mr H’s pension plan. The payment should allow for the effect of charges and any available tax relief. The compensation shouldn’t be paid into the pension plan if it would conflict with any existing protection or allowance.

If a payment into the pension isn’t possible or has protection or allowance implications, it should be paid directly to Mr H as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid in retirement. 25% of the loss would be tax-free and 75% would have been taxed according to his likely income tax rate in retirement – presumed to be 20%. So, making a notional deduction of 15% overall from the loss adequately reflects this.

My final decision

My final decision is that Zurich Assurance Ltd should calculate any compensation due to Mr H in accordance with the method above and pay it to him.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr H to accept or reject my decision before 24 October 2022.

Helen Wheatley
Ombudsman