DRN-3775130

The complaint

Mr W complains about the sale of a Free Standing Additional Voluntary Contributions plan (FSAVC) by Scottish Widows Limited (Scottish Widows) in 1998.

He is represented by a claims management company (CMC). It says the plan was unsuitable for Mr W and he has lost out financially as a result.

The CMC says that the adviser didn't fully discuss the differences in charges between the FSAVC and an in-house Additional Voluntary Contributions (AVC) plan. The CMC said there was no reason why Mr W would've chosen to incur the higher charges posed by the FSAVC.

The CMC also says there was no discussion about, what it describes as, the greater tax efficiency of the in-house AVC.

What happened

Mr W met with an adviser in 1998**.** He was recommended a FSAVC plan with a net monthly contribution of £30. He took out the plan and made the monthly payments and he was still making them at the time of the complaint.

In 2020 a CMC representing Mr W complained to Scottish Widows about the recommendation it made to Mr W to take out a FSAVC plan.

Scottish Widows didn't uphold Mr W's complaint. It said that its adviser had met with Mr W and suggested he explore his in-house scheme. It said the adviser had provided Mr W with a leaflet setting out the generic differences between the in-house options and the FSAVC plan.

Scottish Widows said that once Mr W had had an opportunity to consider both pension options, he had expressed a preference for the FSAVC because of the mobility it offered. It said that Mr W was provided with an illustration together with the generic differences leaflet before taking out the FSAVC plan, enabling him to make an informed choice.

Scottish Widows said the adviser had considered Mr W's attitude to risk and assessed it as low to medium. It said Mr W had been recommended the maximum contribution, but he had chosen a smaller contribution to keep within his budget.

Scottish Widows said it was satisfied that Mr W had been provided with all the necessary information to make an informed choice and that Mr W had started his plan to provide additional income at retirement.

The CMC disagreed and referred Mr W's complaint to our service. It said at the time, Mr W was employed and intending to stay in the same profession. The CMC said he wanted to increase his pension provision as much as possible.

The CMC said the recommendation to take out a FSAVC was unsuitable for Mr W and there was no evidence that the adviser had followed the applicable rules at the time. It also said that there had been no explanation as to why Mr W would've chosen to incur higher charges by taking out the FSAVC. The CMC said it was implausible that he would have done so.

The CMC said it was clear that Mr W had lost out financially as a result.

Our investigator considered the complaint but didn't think it should be upheld. She said Mr W met with a tied adviser for Scottish Widows in April 1998. The investigator said the role of tied advisers was to highlight the generic differences between AVCs and FSAVCs and explain the difference in charges between those options.

The investigator noted that the adviser had produced a suitability report, provided a leaflet outlining the generic differences and advised Mr W to investigate his in-house scheme. She referred to the illustration which set out the impact of the charges on the return and the terms and conditions which explained how the charges worked.

The investigator was satisfied that the leaflet provided explained that the charges for an in-house scheme were usually lower than the FSAVC.

The investigator noted that Mr W had a job that was considered to be secure and he wanted to enhance his retirement provision. She also noted that the suitability letter indicated that the main factor for choosing the FSAVC was its mobility.

The CMC disagreed with the investigator's conclusions and said:

- The tied adviser should have compared the merits of the FSAVC with the probably better value for money in-house AVC.
- There were several things the adviser was obliged to do before selling the FSAVC but ultimately the most important was making sure the consumer was aware of the difference in charges between the two products.
- It noted that we believed it was simply sufficient to provide a generic leaflet and an illustration showing the effect of charges on the FSAVC. But the CMC said it didn't believe there was anything within the file that actually showed the 'difference' in charges and what effect that would have on the consumer's retirement planning.
- There could be no justification for a consumer choosing the FSAVC over the in-house AVC when the CMC said it was, and is well known, that the in-house option gave better value for money. The CMC said it was simply implausible to think that anyone with any understanding or knowledge of the two products would choose the more expensive option.
- It didn't believe that the adviser had made Mr W sufficiently aware of the alternatives in a way that he would have fully understood. Therefore, it said Mr W was not given enough information to make an informed choice.
- It strongly believed that Mr W had been disadvantaged by the poor advice he had received.

As no agreement could be reached the complaint was referred to me for review.

I issued a provisional decision which I concluded that the complaint should be upheld and redress should be calculated on the basis of a comparison with the lower costs that would have been incurred, if Mr W had taken out an AVC plan, and that it should be carried out in accordance with the regulator's FSAVC review guidance.

The following is an extract from my provisional decision, and forms part of this final decision.

"I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Mr W met with an adviser on 27 April 1998 and a fact find was completed recording his circumstances and objectives. He was in his late twenties and employed as a teacher. He was already a member of an occupational pension scheme. It was recorded that he wished to enhance his retirement benefits by contributing to a plan.

Mr W was earning around £18,500 per year and paying about 6% of his income in pension contributions. His employer was also contributing to his occupational pension and Mr W was intending to retire at 60.

Mr W had recently taken out a mortgage and was making monthly repayments.

The fact find recorded that Mr W had a pension need and that he had been advised to consider details of his in-house scheme before comparing those with the FSAVC benefits.

A recommendations report was issued by the adviser and signed by Mr W, and the adviser, on 28 April 1998.

In that report it was recorded that Mr W had been recommended a FSAVC plan and that the recommendation had been made as an alternative to the in-house AVC.

It was also recorded that:

"The client has been advised to investigate the company arrangements, has been given an AVC comparison leaflet and will advise of the decision. The client reviewed the In-House arrangements.

Mr WXXX(redacted) is able to commit £30 per month to satisfy the above need. My recommendation is therefore that Mr WXXX has decided to make net contributions of this amount into his new FSAVC plan on an increasing basis (5% per annum).

The client was made aware of the generic benefits of both In-House and Black Horse Free Standing AVC's. The client preferred to purchase benefits using the Free-Standing Plan because of the mobility it allows him and the potential for enhanced benefits above his IN- HOUSE scheme."

I note the adviser who recommended the plan was a tied adviser so he couldn't recommend an in-house AVC or added years. The adviser could only recommend the pension products provided by the firm he worked for.

So, I think it is important to look at what was required from a tied adviser at that time.

<u>Requirements of a tied adviser</u>

The tied adviser couldn't recommend products from other providers but was required to:

1. *Draw Mr W's attention to the in-house alternative*
2. *Discuss the generic differences between the two routes*
3. *Direct Mr W to his employer or the OPS for more information on the in-house option.*

Mr W's representative says the adviser didn't do this and if the adviser had explained the differences, including the difference in charges between the options and the impact of those charges, Mr W would have chosen the in-house AVC as it would've had lower charges.

I consider the recommendations letter represents a summary of what was discussed between Mr W and the adviser and it makes several references to the in-house options. So, I am satisfied on balance that the adviser drew Mr W's attention to in-house alternatives.

I am also satisfied that the adviser directed Mr W to his employer for more information, as it is recorded that he was advised to investigate his company arrangements and that Mr W would advise of the decision. And then it is subsequently recorded, that Mr W had reviewed the in-house arrangements. So, I think the tied adviser would have met two of the requirements.

I also note it is recorded that Mr W was made aware of the generic benefits of both options and the recommendations report refers to the reasons why he preferred the FSAVC plan, namely the mobility and the potential enhanced benefits. However, I don't think that, of itself, demonstrates that the generic differences between the different options were discussed, with Mr W being made aware, of the advantages of the in-house AVC plan, in particular the difference in costs. And I have to consider whether sufficient information was provided by the adviser to explain the key differences between the options, in particular the differences in costs.

Were the generic differences between the two routes discussed?

Scottish Widows has provided a copy of a AVC comparison leaflet it says was provided to Mr W at the time and it is recorded in the summary and recommendations report that Mr W was provided with a AVC comparison leaflet.

Mr W's representative says the differences between the in-house and free-standing option weren't explained to him at the time and in particular the difference in costs wasn't explained.

I am satisfied from the contents of the document and the way that it was laid out that it was designed to be used by the adviser to assist in explaining the generic differences between the FSAVC and the in-house options.

Comparison of options leaflet

I can see at the top of the first page of the "comparison" document it notes that

"Most employers bear part or perhaps all of the expenses of the AVC"

and it makes it clear that the charges of in-house AVCs are "usually lower than for Free Standing AVCs and that is the main reason for some customers choosing the in-house option."

The document also explains what AVCs and added years are, in the glossary of terms on the first page of the leaflet.

It also refers to the tax treatment of the different plans and explains that with the in-house option, the plan holder receives tax relief immediately up to their highest marginal rate. Whereas with the FSAVC, the immediate relief rate only applied up to basic rate, and higher rate taxpayers would have to receive relief by assessment or through their tax code.

In addition, I don't think the document over-stated the portability benefit of the FSAVC because on the in-house side, it also explained that if the plan holder changed employer, they may be able to start a new in-house AVC with their new employer.

So, I consider that the "comparison" document did provide information about the differences between the options and I also think it made express reference to several advantages of the in-house AVC option, including the charges usually being lower and referred to the corresponding negative aspects of the FSAVC. I therefore consider it set out the differences in a balanced way and I also note it gave a broad explanation as to how in-house AVCs and added years worked.

Were the contents of the "comparison" document explained to Mr W?

I note the recommendations report was a fairly brief document with the note of Mr W being provided with the AVC comparison leaflet appearing on page two, and the signed declaration on page four of the report.

The declaration stated:

"I understand that the advice has been given to me based on the information provided, and that I am under no obligation to act upon any recommendation that may be made."

And

"I confirm that a key features document and schedule was supplied/received in respect of each of the above accepted products prior to completing the corresponding application form.

There is no specific reference in that declaration to Mr W being provided with the comparison document and its contents being explained to him. So, Mr W didn't confirm there, or elsewhere in the point of sale documentation, that he had received that document and its contents had been explained to him.

I also note there was no specific reference in the recommendations document, or in the fact find to the difference in costs between the in-house AVC and the FSAVC plan. I think this was an important factor and if there had been some meaningful discussion, where the adviser had highlighted the likelihood of lower costs with the in-house AVC , I would've expected some specific reference in the documentation.

So, overall, I'm not satisfied on balance that the available evidence supports the position that the generic differences were properly discussed so that Mr W was made aware of important differences between the FSAVC and the in-house options - in particular, the difference in costs.

<u>What would Mr W have otherwise done if the generic differences had been discussed?</u>

I have to consider what would have happened here if the generic differences between the FSAVC policy and in-house options had been properly explained to Mr W. Would Mr W still have elected to take out a FSAVC policy, or would he have chosen an AVC plan which generally had lower charges than the FSAVC policy and the potential to build up a retirement fund? Alternatively, would he have elected the added years option which tended to be more expensive, but gave a more certain level of benefit?

As I have said, the tied adviser couldn't recommend an in-house option, but Mr W could have pursued this himself with his scheme.

I think that budget considerations were important as Mr W didn't take out the full amount available as an FSAVC contribution (which was £140 gross) but chose to limit his contribution to £30 with a regular increase of 5%. So, I think keeping contribution costs low was an objective for Mr W. And higher costs would've had a greater impact on the return he would receive from those contributions.

Mr W was relatively young at the time of the advice so portability may well have been an attractive feature. However, Mr W was employed in a profession where people do remain for their whole career and indeed, as Mr W has explained, he is still in that profession, so I'm not persuaded that portability was a deciding factor for him.

I think that the potential returns shown on the FSAVC illustration and the flexibility of retirement age would have been attractive but ultimately, I think the difference in costs is likely to have meant he would have preferred the in-house AVC option.

<u>Added years</u>

Although this aspect hasn't been specifically raised by Mr W's representative, I've nevertheless considered the option of buying added years within the in-house arrangements. As with the in house AVC, I think it's more likely than not that, when directed to investigate the in-house options, this is something of which Mr W would have been aware.

I also think it's more likely than not that if Mr W had investigated the added years option with his scheme, it would have appeared expensive in comparison with the FSAVC, in relation to the returns that might be achieved.

That is because his Occupational Pension Scheme would have offered the buying of added years at a fixed cost. When deciding the cost, it would have wanted to make sure the scheme could cope with how many people wanted to buy added years. So, it would have used conservative assumptions when working out the cost. I think it is likely therefore that it would have appeared expensive.

When comparing the cost of added years against the projected returns on the FSAVC at that time, for example, it meant that with the FSAVC a relatively low contribution could potentially achieve a higher return. And as I have said, I consider budgetary considerations were a significant factor for Mr W.

I also take into account that the purchase of added years was based on the assumption that the contributions would be paid until retirement age, with increases linked to salary, and that *generally there was less flexibility to stop and restart. So, I consider these aspects may well have been less attractive to Mr W, who was relatively young at the time of the advice.*

I also consider added years would have been more of a fixed commitment for Mr W with increasing contributions linked to his salary for a fixed term. Whereas with an AVC plan Mr W would have been able to make increases over time – when he felt ready to do so. So, I think that was a potential benefit for Mr W. Overall, I'm not persuaded on balance that he would have taken out added years.

<u>Attitude to risk</u>

Mr W's attitude to risk was recorded as low to medium which appears to be in line with his circumstances and objectives at the time. This plan was intended to be held until retirement and he was in his late twenties. I consider he was able to take some risk over the long term with a relatively small monthly contribution. And, I consider on balance that he wished to do so, in order to try to achieve the sort of level of return shown on the illustration.

I also take into account that this was a top-up plan rather than Mr W' s main pension. He already had an occupational pension scheme which represented the majority of his contributions and where any investment risk was borne by the scheme. So, I think it's likely that Mr W was willing to take more risk with this plan in the hope of achieving something like the level of return set out in the FSAVC illustration.

On that basis I consider Mr W was willing to take this level of risk – and notably a risk which would also have been present within an in house AVC arrangement - over the long term to try to achieve a reasonable return on his contributions and top up his pension.

So, I don't think the risk posed by the plan made it unsuitable for Mr W. However, as I have explained, I think if the difference in costs had been explained to Mr W, it is more likely than not that he would have opted for an in-house AVC instead.

<u>Summary</u>

Accordingly, I propose to uphold the complaint and I think compensation should be calculated on the basis of a comparison with the lower costs that would have been incurred if Mr W had taken out an AVC plan. I have set out the details later on in this provisional decision.

<u>Putting things right</u>

Scottish Widows 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, Scottish Widows 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 W'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 W 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."*

Both parties acknowledged and accepted my provisional decision and made no further representations.

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, and noting that both parties have accepted my provisional findings, my decision remains the same as set out in my provisional decision, an extract of which is reproduced above and forms part of this decision.

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My final decision

My final decision is that I uphold Mr W's complaint against Scottish Widows Limited and it should pay compensation calculated as 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 7 December 2022.

Julia Chittenden
Ombudsman