DRN-4154968

The complaint

Mrs A complains that she was mis-sold a free standing additional voluntary contribution (FSVAC) pension plan by The Royal London Mutual Insurance Society Limited. She complained that she would instead have purchased her occupational pension scheme's (OPS) added years option if she'd been made aware of that.

What happened

Mrs A was advised by Royal London to take out a FSAVC in 1990 when she was 34 years old.

Earning £13,776 a year and contributing 6% into OPS. Agreed to make FSAVC contributions of £67 a month which were made until 2007.

Mrs A had joined her OPS at age 26 and the scheme had a normal retirement age of 60. By which time she would have been six years short of her maximum OPS benefits. So could have purchased 6 additional years in the scheme.

Mrs A complained to Royal London that her FSAVC was mis-sold. Royal London explained that it had little evidence from the time of the sale but accepted that Mrs A ought to have been advised about the option of in-house AVC's with her employer. And that it was likely she wasn't. So went ahead with a loss calculation, that it said showed Mrs A was better off by taking out the FSAVC.

Mrs A referred her complaint to us via her representative because she was dissatisfied with Royal London's attempt to resolve it. This matter remained unresolved after our investigator had considered it and the case was passed to me for an ombudsman's decision. I issued a provisional decision to allow both parties the opportunity to consider my view.

In my provisional decision I said

The event complained about happened in 1990. So it is understandable after such a passage of time that evidence and recollections of what occurred may not be complete. Still, Royal London have consented to our looking into this complaint. So I've not considered whether this complaint has been made too late under our rules.

We haven't been provided with evidence of any recommendation that Mrs A was given by Royal London that led to her decision to take out the FSAVC policy. But Royal London haven't defended the suitability of any recommendation that Mrs A was given. Rather, it has accepted that the advice was likely to have been incorrect. Following the regulatory guidance that existed at the time when policy sales such as this were subject to a review.

The starting point in deciding a fair resolution for this complaint is therefore that both Royal London and Mrs A agree that she wasn't treated fairly in 1990. So, like Royal London did, I also uphold Mrs A's complaint

Royal London was advising on a FSAVC. This was only available to Mrs A if she was a contributing member of an OPS. Which Mrs A was. Prior to recommending the FSAVC, the regulatory framework at the time meant that Royal London had to make Mrs A aware of the alternatives that were available to her through her scheme. These options were an in-house AVC or an option to purchase added years of her defined benefits.

Royal London wasn't expected to advise on the suitability of the options provided by her employer. But was expected to highlight that the AVC was likely to have lower charges than a FSAVC. It would be expected that Mrs A would then contact her scheme to explore that. Purchasing added years was an entirely different proposition. Once highlighted to Mrs A, again it would be down to her to explore whether she considered that to be more suitable for her.

The issue of disagreement in resolving this complaint is the question of what Mrs A would have done if she'd been made aware of the options available to her. That is, what would she have done faced with the choice in 1990, rather than with the benefit of hindsight looking back. I make this point because the financial landscape in 1990 was different than it is today.

It appears that Mrs A was single at the time and had no dependants. Although it is explained that she expected to marry soon and then start a family. She was in an occupation that it was very likely she would remain in. And one that would continue to receive annual pay increments and offer opportunities for career advancement. So purchasing added years may well have offered attractive benefits had Mrs A known to look into that option.

It would have given her the opportunity to bring her pension up to the maximum amount. The benefits were guaranteed as a percentage of any final salary she retired on, rather than being dependant on investment performance. But a key factor here is what those investment returns may have looked like in 1990.

The industry projections for investment returns that were introduced in July 1988 were 8.5%; 10.75%; 13% for low; medium; high annual returns respectively. These are the projections that would likely have been used in pension illustrations. And reflected the industry view of expected returns at that time. In contrast by 2014 the industry projected rates had reduced to 2%; 5%; 8%. Which the industry considers more accurately reflects likely future investment returns now.

What this means is that the performance of money purchase pension arrangements like Mrs A's FSAVC haven't performed anything like as well as was anticipated in 1990. And today, it looks like purchasing added years, with the guaranteed defined benefits, would give more valuable benefits. But Mrs A would not have known these things in 1990.

In 1990 she had 26 years until her normal retirement age. With her existing OPS benefits, I think that she had the capacity for loss for such an investment product. It would be adding to her pension rather than being the sole pension provision. And I've seen no evidence that it was invested in a way that would have been incompatible with most consumers' attitude to risk at that time.

The added years option required an up-front decision to purchase a set number of additional years of pension. The cost would be a percentage of annual salary for the remainder of Mrs A's career. As her salary increased, so too would the cost. It wouldn't afford the flexibility to adjust the amount paid in response to life events like an AVC or FSAVC might.

I've considered the amount of Mrs A's contributions into her FSAVC. They were set at quite a high level. £67 a month equated to about 5.8% of Mrs A's salary in 1990. She was contributing about the same level again as she contributed to her OPS.

I've seen that Mrs A's representative has shown that the level of her contributions was higher than the cost of purchasing six additional years at that time. The figures provided indicated an annual cost of 0.78% of salary for each added year purchased. Which meant that six added years would equate to a contribution of 4.7% of Mrs A's salary each year. So I agree that Mrs A could have afforded the cost initially.

But I need to be convinced that, in 1990, Mrs A would have thought that contributing a further 4.7% of her salary would remain affordable for the whole of her career. She was yet to marry or start a family. It seems likely that she would have anticipated fluctuations in her disposable income in the future because of these life events.

Mrs A's pay was subject to annual reviews through pay negotiations and had increased by an amount most years. Mrs A was likely to expect that to continue to be the case. Her pay was also calculated on an incremental scale. Mrs A had been in her occupation for around eight years by 1990, so was not yet at the top of the pay increments at that time. But there's no evidence that Mrs A intended to increase the contributions that she made as her salary was reviewed. Rather, the evidence shows that no annual increases to her FSAVC premiums were ever made. Long before Mrs A stopped paying the premiums into her FSAVC in 2007, the amount she was paying would have been lower than the sum she would still have been tied into had she purchased added years in 1990.

I have to reach a conclusion, based on the evidence, as to what I think would most likely have happened if Royal London had done what it was supposed to. For the reasons I've given above, I can't say that it's more likely that Mrs A would have opted to purchase added years rather than taking out an AVC. I do however agree with our investigator's conclusion that Mrs A would more likely than not have opted for the AVC over Royal London's FSAVC if she'd been made aware that it was likely to be the cheaper option.

Royal London have always accepted this position. Although I can see that there has been further disagreement about the assumptions that Royal London used in making its calculation from the outset. Royal London didn't find out what charges would have been applied to Mrs A's AVC had she instead chosen that option. Instead it made an assumption. Which placed those charges as higher than its own FSAVC. Which, in line with the regulator's methodology for calculating redress in such cases, showed no loss.

Mrs A's representative has since provided evidence that the assumptions used in Royal London's calculation were incorrect. Our investigator proposed using the figure of 1% for the AVC charges. Which Royal London agreed to do.

Response to my provisional decision

I've received no further comments or evidence from Royal London.

Mrs A's representative didn't agree with my finding. He still thought that Mrs A would have purchased added years in her OPS for the reasons that he'd already given. But he additionally suggested that Royal London should pay £500 as a gesture of goodwill and as an apology for its failings in dealing with the case.

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 considered everything again my final decision is the same as the finding I reached in my provisional decision. And for the same reasons, that I've included above. I think that, but for Royal London's mistake, Mrs A would most likely have opted for her employer's AVC instead.

I've considered again how Royal London should put things right. The rules that our service operate under allow me to direct a business to compensate a customer for financial loss that they may have suffered. Which is what my following direction does. I'm also allowed to award compensation where a businesses mistake has caused distress or inconvenience, or pain and suffering. Whilst it may be the case that businesses may offer payments as goodwill gestures, this isn't something that our rules allow me to direct a business to do.

Any award I make has to be as a consequence of the impact on the customer of a business's mistake. In this case, the mistake in 1990 may have resulted in Mrs A being in a less suitable product. But this didn't have any immediate impact on her. She wasn't aware of the issue or caused distress or inconvenience by it for around thirty years. It has only recently come to light. Overall in this case I think that putting right any financial impact is sufficient compensation for the mistake that was made.

Putting things right

Royal London have now made the offer to put things right taking into account the actual fee structure that existed for Mrs A's AVC. I think this is now fair. For the avoidance of further doubt though, I will set out how I think Royal London must calculate whether Mrs A suffered a loss.

Royal London 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, Royal London 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 Mrs A'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 Mrs A 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 her 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

For the above reasons, I uphold Mrs A's complaint and direct The Royal London Mutual

Insurance Society Limited to compensate her in the manner I’ve set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mrs A to accept or reject my decision before 23 June 2023.

Gary Lane
Ombudsman