DRN-4938576

The complaint

Mrs F complains that Zurich Assurance Limited (Zurich) then trading as Allied Dunbar misadvised her to take out a Free Standing Additional Voluntary Contribution pension plan (FSAVC), causing her losses. She wants to be put back in the position she should have been in.

Mrs F is represented in her complaint by a claims management company (CMC) but for ease I will just refer to Mrs F except where necessary in this decision.

What happened

Mrs F says Zurich advised her to start the FSAVC in 1998 to make additional pension savings on top of the Teachers' Pension Scheme. She took benefits from the FSAVC in 2009. She says she should have been given more information about the in-house AVC (the TAVC) option. As this was likely to have had lower charges and she may have suffered losses as a result. She says she only realised this during 2022, after contacting the CMC, having seen its advert.

Through the CMC Mrs F complained to Zurich, making a number of points. It didn't accept her complaint. It said there was no evidence the regulations at the time of the advice hadn't been complied with. It said its adviser had met with Mrs F on 29 April 1998 and completed a fact find which contained notes about the TAVC and the further added years option, which suggested these had been discussed. And the *"Reason for Recommendation"* letter dated 20 May 1998 confirmed a booklet called *"Topping Up you Occupational Scheme Benefits – Your Choice"* (the booklet) had been provided. It said this gave details of typical in-house AVC and added years options compared to FSAVC's. And that she should contact her employer for more information before deciding what to do. It said as the plan didn't start until 1 September 1998, she'd had time to do this. It said the recommendation letter confirmed Mrs F had told the adviser she understood the choices available to her. And when the plan started, she was sent further documentation explaining the plan, including its charges.

The CMC said the booklet didn't provide a clear explanation of charges, so was mis-leading and a discussion also needed to have occurred which wasn't evidenced.

Mrs F referred her complaint to our service and our investigator looked into it, but she didn't uphold it.

Our investigator said the financial services regulator had provided guidance about FSAVC sales in May 1996. These said,

> *"A representative should not recommend his own company's FSAVC until he has:*
> *- drawn the client's attention to the in-scheme alternative*
> *- discussed the differences between the two routes in generic terms (taking account, among other things, of the features described in this article); and*
> *- directed the client to his employer, or to the scheme trustees, for more information on the in-scheme option"*

Our investigator said the evidence Zurich had provided in the booklet and the recommendation letter appeared to have met these requirements as Zurich wasn't required to carry out a detailed comparison of the TAVC and its FSAVC. She said the booklet directed Mrs F to her employer for more information and provided general comparison between typical AVCs and Zurich's FSAVC. And she said charging information was provided in the illustrations that Zurich prepared. She said the fact find notes stated Mrs F wanted privacy which was a reason why the FSAVC was preferred over the in-house AVC.

Mrs F's CMC didn't agree. It said the evidence didn't show the process required by the regulator at the time had been adhered too. It said the recommendation letter didn't refer to charges or any discussion that the TAVC's charges were likely to be lower than the FSAVC's.

Our investigator reconsidered the evidence and now felt that Zurich hadn't complied with the regulator's guidance. She issued a second view upholding the complaint. She said the recommendation letter didn't refer to charges or that they were discussed in detail. And that the adviser had relied on information in the booklet. But she didn't consider this adequate as tit didn't highlight that the in-house AVC was likely to have lower charges. She said Zurich was required to tell Mrs F's employer she'd taken out the FSAVC, undermining the purported privacy compared to the in-house option. And given the lack of detail in the recommendation letter she wasn't persuaded secrecy was a key objective for Mrs F, outweighing the higher costs involved.

Our investigator said Mrs F's objective was to increase her income in retirement and the regulator's view was that the critical factor was that in-house AVC charges were usually lower and had she been advised correctly she wouldn't have opted for the FSAVC plan. Our investigator said Zurich should undertake a loss calculation in accordance with the regulator's FAVC review guidance to calculate the difference in charges and if this showed a loss, to compensate Mrs F accordingly.

Zurich disagreed. It said the rules were different between independent financial advisers and a tied adviser like its own in 1998 as tied advisers didn't need to provide a comparison between in-house AVC and FSAVC options. Instead, it's adviser needed to draw Mrs F's attention to the in-house plan, discuss the generic differences and direct her to her employer or pension scheme for more information. Which it said had been done. It said the fact find completed on 29 April 1998 identified Mrs F wanted to pay pension contributions to cover a career break and noted the existence of the in-house options and that her employer wouldn't match contributions. It said the adviser would have gone through the booklet with Mrs F at the meeting, which covered the generic differences and prompted her to seek further information.

Our investigator said our service expected tied advisers to have referred to charges and that in-house AVC's were likely to be lower. But there was no reference to this in the recommendation letter or other notes evidencing it was discussed. She said the information in the booklet about charges was inadequate and misleading. Zurich said the regulator's guidance from 1996 didn't specifically state charges had to be discussed and it considered the advice to be fully compliant. Our investigator said the guidance was that tied advisers should discuss the generic differences and the regulator had highlighted the importance of charges. But said there was no evidence this had been discussed.

As Zurich doesn't agree it has come to me to decide.

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 am upholding the complaint.

I think the key issue here is whether the likely difference in charges between the in-house AVC and the FSAVC were adequately discussed as I think was required by the regulations at the time. Zurich says that no specific need for discussion was set out in the regulator's guidance, and the actual requirement was met by providing the booklet referred to in the recommendation letter. I disagree, because I think a more detailed discussion was needed and the contents of the booklet are inadequate.

When the regulator issued its guidance (Regulatory Update 20) in May 1996 it set out the general requirements I've quoted above. These refer to features described in the *"article",* meaning the rest of Update 20. The article mentions various features, the regulator clearly expected to be discussed. These included, tax treatment, whether employers would match contributions and the ability to provide additional life assurance cover. It also referred to the typically lower charges under in-house AVCs,

> *"Charges under in-house scheme AVCs will usually be lower than those under FSAVCs reflecting economies of scale, rebated commission or a contribution to administration expenses by the employer. Of all the differences between the two routes, this is likely to exert the greatest impact on which route would offer the greater benefits to the client".*

So, whilst Zurich's tied adviser couldn't give advice about the TAVC, I think it's clear the regulator expected tied advisers to discuss the generic differences between any in-house AVC option and the FSAVC alternative, with a specific emphasis required in the area of charges. I think that required the tied adviser to point out that in-house AVC charges were usually lower.

The *"Reasons for Recommendation"* letter provided to Mrs F doesn't discuss the differences between the in-house and FSAVC options or confirm they've been discussed. It says the booklet has been provided. Which *"sets out the benefits and features"* of the FSAVC *"and those typically available under the employers' in-house scheme".* It states Mrs F had said she understood the choices. But the recommendation letter makes no comment at all about charges, which I think it should have done, given the regulators emphasis.

As for the booklet itself the copy Zurich has provided is of poor quality and it isn't possible to make out any date on it, although it says it is from 1997. I'm aware this booklet was updated after then at least once to better reflect the requirements set out in Regulatory Update 20. I think the booklet is very much a sales document emphasising perceived benefits of the Zurich product rather than discussing generic differences.

Importantly I think the short section providing information on charges is misleading, it says:

> *Your employer may have agreed enhanced terms with the insurance company in the form of reduced charges. This may mean that the charges levied on contributions to an in-house AVC are lower than those charged under the Allied Dunbar AVC Pension Account, particularly in the early years, although over the life of the plan these may even out.*
>
> *However, you should not look at charges in isolation."*

If the booklet was provided to Mrs F, I think she would have concluded there was likely to be no real difference in charges at all. That is despite the regulator having flagged charges as having the greatest impact on which type of AVC was likely to offer *"the greater benefit to the client".* Because of that I think Zurich needed to clearly demonstrate it had informed Mrs M that the in-house AVC was likely to be more cost effective, not that it "*may"* be or some similar weaker phrase, which was itself then undermined in the same sentence.

The booklet also stated that an illustration would be provided that would show costs and the effect of charges. Mrs F's retirement age with her employer was 60 and the fact find notes that was her intended retirement age. However, the illustration provided by Zurich dated 20 May 1998 (the same date as the recommendation letter) shows a retirement age of 65. Increasing the investment term generally increased the advisers commission, so this type of anomaly is something of a red flag.

Although here Mrs F's plan does appear to have actually been set up to age 60. But because of the way the charges on the plan worked, the longer the investment term the lower they appeared to be in terms of the reduction of the projected fund, due to the (slowly) diminishing impact of the high initial charges involved. This is opaquely referred to in the booklet as I've quoted above. Perhaps this was an innocent error, but it wouldn't have helped Mrs F fairly compare charges with alternative options, which was likely to be the key difference between in-house and FSAVC alternatives.

In terms of the additional *"privacy"* Zurich has referred to as being a benefit, this isn't mentioned in the recommendation letter. Which had it been important to Mrs F, I'd expect it to be. It is referred to in the booklet in a surprisingly long section and arguing that a FSAVC offered more privacy is a common justification why this route might be more appropriate than an in-house AVC. But I think any advantage was one perceived more by advisers than most consumers. It was often cited where someone was looking to pay extra contributions to fund early retirement, which they might not have wanted their employer to find out about. That seems a fairly remote risk for public sector pension schemes with hundreds of thousands of members. And Mrs F wasn't looking to retire early, and Zurich was still required to inform her employer's pension scheme that she'd taken out a FSAVC with it. So, I think this "advantage" was minimal in reality and didn't reasonably justify incurring the higher costs the FSAVC was likely to entail.

I think the evidence shows that Zurich did rely on the booklet to comply with the requirements of Regulatory Update 20, but the booklet failed to do that as it provided misleading information about charges. So, from the evidence available it doesn't appear that Zurich's advice complied with the regulatory requirements at the time. That means the policy was mis-sold. And if that has resulted in a loss for Mrs F it is fair that Zurich compensate her for that.

Putting things right

My aim in awarding compensation is to put Mrs F as closely as possible back into the position she should have been in but for the poor advice.

Zurich 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 Mrs F’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 F 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

My final decision is that I uphold the complaint against Zurich Assurance Limited.

I direct Zurich Assurance Limited to complete the redress calculation set out above and pay any compensation due accordingly.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mrs F to accept or reject my decision before 8 October 2024.

Nigel Bracken
Ombudsman