DRN-5096733

The complaint

Mrs S has complained about the advice provided in 1998 by Canada Life to commence a Free-Standing Additional Voluntary Contribution ('FSAVC') scheme.

Mrs S has stated that the advice was unsuitable as insufficient consideration was given to the availability of the in-house pension options provided by her employer. Mrs S believes these in-house options would have been more appropriate and as such the FSAVC scheme should not have been recommended.

Canada Life has since become part of Scottish Friendly Assurance Society Limited ('Scottish Friendly') and as such it is Scottish Friendly who are now responsible for answering Mrs S's complaint.

What happened

The FSAVC scheme was recommended in January 1998. The original contribution was set at £80 per month gross (£61.60 per month net). The premium was to rise each year by 5% or the increase in National Average Earnings index, whichever was higher.

The premiums were to be split equally between the Managed Pension Fund and the Equity Pension Fund, with the policy being set up using a selected retirement age of 60.

A report completed by Canada Life on 13 January 1998 recorded Mrs S's circumstances and objectives and formed the basis for the advice provided.

This recorded:

- Mrs S was aged 28, had a desired retirement age of 55, had income of £18,000 per year and disposable income of £160 per month.
- Using assumptions about future income needs Mrs S was projected to have an income shortfall in retirement of at least £4,000 a year.
- Mrs S's attitude to risk ('ATR') was recorded as being Balanced.
- Mrs S was employed as a teacher and had been a member of her occupational final salary scheme since 1993.

The general notes section of the document confirmed that Mrs S would have completed 36 years' service within her occupational scheme at her desired retirement age of 55, however Mrs S intended to marry and have children in future which would cause a break in her teaching years. The FSAVC contributions were intended to build a fund in her early years of teaching however this may be reduced in future based on possible future changes to circumstances.

The notes also record the fact that the FSAVC scheme would be stopped as and when there was any break in Mrs S's teaching.

The application form for the FSAVC scheme was also completed on 13 January 1998. This form contained three tick boxes which asked Mrs S to confirm that her adviser had:

1. "Drew my attention to the alternative option of investing in my employer's in-house additional voluntary contribution arrangement.

2. Discussed with me the differences between a free-standing additional voluntary contribution plan and an in-house additional voluntary contribution arrangement in generic terms (covering issues which include basic product/scheme information and taxation/Inland Revenue rules).

3. Directed me to my employer or to the scheme trustees for additional information concerning the in-house additional voluntary contribution arrangement."

The internal advice checklist completed by Canada Life in 1998 noted that the reason for choosing the FSAVC scheme over the other options as being "privacy".

A further checklist was completed by the adviser on 13 January 1998 (and checked internally on 20 January 1998). This was entitled a Decisions Document and said:

"Other products considered to address immediate needs: scheme AVC + buying extra years"

And

"Give reasons why product selected is the most suitable for immediate needs: provides portability, privacy, possible to get benefit if retires + does not get teachers pension"

The full advice provided to Mrs S was documented in Canada Life's suitability letter dated 20 January 1998.

This stated:

"The report has shown a projected shortfall of £4,000 but you wish to create a projected fund of £23,400 per annum in your retirement income at your preferred retirement age of 55. You are an employee who is a member of an occupational pension scheme run by your employer and are aware of the facilities provided by this scheme to make Additional Voluntary Contributions. You are interested in providing additional benefits for your retirement through another source."

And

"You will have already received a Key Features Document and Personal Example for the proposed plan. These contain full details of the features, benefits, charges and any risks."

The charges of the policy were included in a Product Summary document. This was not a personalised document and covered the recommended product in general.

The document confirmed that for the first two years of the policy premiums would be used to buy Capital units which incurred a 4.75% annual management charge ('AMC'). Premiums paid after this initial two years would purchase Accumulation units with a 1.25% AMC. The policy also had a monthly administration charge of £1.94. In addition, the policy bore a management charge which was reflected in the Bid – Offer prices of the investment units held by Mrs S. This Bid – Offer spread was confirmed as 5%.

In May 2001, having changed jobs, Mrs S was informed by her Canada Life adviser that the FSAVC scheme was no longer appropriate. As such the premiums were ceased and a new policy was commenced. The suitability of this second policy is not the subject of complaint and has not been considered further.

Having become aware that there may have been an issue with the advice received, Mrs S registered her complaint with Scottish Friendly in November 2023.

Scottish Friendly issued their response on 23 April 2024. This stated that they believed the documentation produced at in 1998 met the standards required at that time. Scottish Friendly noted that the documentation did state that other products (including the in-house AVC scheme and the added years option) had been considered and that the file recorded Mrs S's future plans with the expectation that there would be a change in income / work circumstances with marriage / children being expected in future.

Unhappy with the complaint response Mrs S referred her case to this service in May 2024.

Our investigator looked into things and concluded that the advice to purchase the FSAVC scheme was unsuitable. The investigator did not consider the 1998 documentation demonstrated the differences between Mrs S's in-house options and the FSAVC scheme were discussed in sufficient detail and concluded that had such discussions taken place Mrs S would have instead chosen to contribute to her in-house AVC scheme.

Scottish Friendly did not agree, stating their belief that 1998 paperwork sufficiently detailed what discussion took place and confirmed that Mrs S was given all the required information.

As our investigator was not minded to change their opinion, and as no agreement could be reached the case was passed to me for a final decision.

I originally issued a provisional decision which said:

"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 agree with the investigator's assessment and for largely the same reasons.

Firstly, I would like to note that Scottish Friendly have consented to this service considering the merits of this complaint. As such I have not considered our jurisdiction in this case, and have focussed solely on the merits of the complaint – the suitability of the 1998 advice provided to Mrs S.

As our investigator explained, the first step in assessing the suitability of advice given in relation to an FSAVC pension is to establish the status of the adviser involved. The documentation on file in this case confirmed that Mrs S's adviser "represents only Canada Life". As such, it is the rules and expectation placed upon tied advisers in 1998 which I must consider when assessing the suitability of the advice in this case.

Prior to May 1996 company representatives were required to exercise due skill, care, and diligence in dealing fairly with investors.

In relation to FSVAC sales this meant knowing that in-house AVC options existed and mentioning the generic benefits of these options as well as highlighting the benefits of their FSAVC plan.

The generic benefits included that:

- *AVCs potentially offered lower charges.*
- *'Added years' might be another option.*
- *The employer might potentially match or top up the amount a consumer contributed to*

either in-house option.

In May 1996 the regulator issued an update called "RU20" which set out the procedures it expected product providers to follow. This wasn't new guidance but restated what was already in place.

The update said that a tied adviser shouldn't recommend their own company's FSAVC until they had:

- *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).*
- *Direct the client to his / her employer, or to the scheme trustees, for more information on the in-scheme option.*

Those generic differences which were part of the discussions should include, among a number of topics, the difference between charges and expense deductions.

I have carefully considered the content of the advice documentation and more specifically the excerpts of these I have included above.

The suitability letter dated 20 January 1998 confirmed that Mrs S had been issued with a key features document and a personal illustration which included details of the charges applicable to the FSAVC. The decision document stated that in-house AVC's and added years had been considered, and the application form containing the three declaration points (detailed above) was signed by Mrs S.

However, in line with what our investigator has already said, I have concluded that further detail is needed, specifically I think there should have been specific reference to the fact that the charges applicable to in-house AVC schemes are usually significantly lower than those on an FSAVC.

As explained by our investigator, whilst I accept that the 1998 documentation does indicate that Mrs S was made aware of the charges applicable to the FSAVC scheme, and was referred to her employer in relation to the in-house options, there is, in my opinion, insufficient detail to confirm what was discussed around the differences between Mrs S's options and why she was prepared to pay higher charges for the FSAVC.

Scottish Friendly have noted that the fact that such additional detail is not documented within the 1998 paperwork does not mean that such discussions did not take place at that time. I do appreciate that not everything that was said will be recorded within the paperwork, and as I was not present at the time, I cannot state for certain what was, or was not, discussed.

As such I need to base my decision on the evidence available, what I consider most likely to have occurred, and on the principles of fairness and reasonableness. In this case, given the regulatory guidance in place at the time, the likely significant difference in charges levied on the available options, and the limited detail about this issue in the contemporaneous evidence available, the charges issue remains a significant concern.

This issue is compounded by the fact that, in my opinion, the reasons given in support of the FSAVC are weak.

Privacy was noted as a reason in support of taking the FSAVC however, as per our investigator's findings privacy is not strictly maintained with the FSAVC as in all cases the product provider must notify the consumer's occupational pension scheme that its scheme *member has an FSAVC. Whilst the in-house AVC scheme would have provided Mrs S's employer with more information than the FSAVC scheme, there is no information on file confirming why Mrs S valued the additional privacy provided in comparison to the (likely) higher fees required to pay for it.*

Portability and / or convenience have also been noted as justification for the FSAVC recommendation. However, this is contradicted by the point of advice documentation which noted that upon any changes to Mrs S's status as a teacher the FSAVC scheme would be stopped "as and when" there was a break in Mrs S's teaching career. This would have similarly been the case with either of the in-house options (AVC or added years) which were available to Mrs S in 1998 and is therefore not considered a strong argument in support of the more expensive FSAVC.

Overall, I have reached the same conclusion as our investigator. I believe that had a full discussion taken place around the charges levied on the FSAVC in comparison to those applicable to the in-house options, Mrs S would ultimately have decided to contribute to an in-house option rather than the FSAVC scheme.

Having reached this conclusion, and in order to establish what redress would be appropriate, I have gone on to consider whether Mrs S would have opted for the in-house money purchase AVC scheme or whether she would have opted to purchase added years within her final salary scheme.

Mrs S did have adequate headroom within her occupational defined benefit scheme to purchase added years and did opt for her FSAVC premiums to increase each year, both of which support the conclusion that the added years option would have been appropriate. In addition, added years would have provided spousal benefits to Mrs S's potential future husband.

However, whilst there is no information on file about the cost of purchasing added years, it is likely that this would have been a more expensive option. This is because the cost of any additional year purchased would have fallen entirely to Mrs S, with no further contributions from her employer.

Additionally, Mrs S was detailed as a medium risk investor. Whilst in more recent times the guaranteed benefits provided by a final salary pension have been considered desirable, I must consider the circumstances in 1998. At that time projected investment returns were much higher than they are now with low, medium, and high projected growth rates being 6%, 9%, and 12% respectively. It is these growth rates which Mrs S would have used to make her decision.

Given this, in addition to the likely higher costs associated with the added years option, I have concluded that Mrs S would most likely have opted for her in-house money purchase AVC scheme.

The redress below reflects this outcome."

In addition to the commentary above I asked both parties to provide any additional commentary or evidence they wanted me to take into consideration before a final decision was issued.

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.

In response to the provisional decision Mrs S simply confirmed she was willing to accept the outcome documented.

Scottish Friendly did not provide any additional evidence but did specifically question whether the additional commentary they had provided in response to our investigators findings had been taken into consideration.

I have already confirmed that all the evidence provided by both parties had been fully considered in the provisional decision above.

However, in order to provide both parties with this reassurance I have specifically covered these additional points in more detail here.

Scottish Friendly noted the RU20 guidance which states:

“Charges under in-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”

However, it was noted that this does not specifically state that the difference in charges (and likely lower charges associated with the in-house options) should be documented in the suitability letter.

Scottish Friendly also said that the content of the suitability letter, the decision document, and the three declarations on the application form could be considered, on the balance of probabilities, to confirm that the difference in charges was discussed and understood by Mrs S at the time of advice.

I accept that the RU20 does not give specific guidance in relation to where Scottish Friendly should document their discussions with customers.

In addition, I accept that the decision document and the tick boxes on the application form confirm that Mrs S had been made aware of the in-house options and “basic product / scheme information” had been discussed.

However, the RU20 document notes that charges are likely to have the “greatest impact” on which choice a consumer may make, with the only reference to charges in the point-of-sale documentation relating to those which applied to the FSAVC scheme.

Scottish Friendly have concluded that, based on the balance of probabilities, the documentation shows that charges were discussed with Mrs S at the time of advice.

To decide whether I agree with this conclusion, I have to look at the reasons given in the advice documentation stating why Mrs S chose the FSAVC plan over the in-house options and consider whether, in my opinion, these are sufficiently robust to justify the higher charges.

As I have documented above, I do not consider the two reasons given in support of the FSAVC scheme to be sufficiently strong.

Whilst privacy has been noted as a reason in support of transfer, both the in-house options and the FSAVC scheme would require some disclosures to Mrs S’s employer / pension scheme administrators. In either case, it is unlikely that Mrs S's day to day work colleagues would be aware of any changes to her pension arrangements.

Portability and/or convenience of the FSAVC scheme has also been noted as a benefit. Again, as above, I accept the FSAVC scheme would allow Mrs S to continue contributions should she move employer. However, the advice documentation notes that the FSAVC scheme would be stopped "as and when" there was a break in Mrs S's teaching career and as such I do not believe portability or convenience of the plan was a key consideration at the point of advice.

Overall, I do not consider the reasons given for choosing the FSAVC scheme over the in-house options to be strong.

As such, given the lack of any reference to the discussions had around the difference in charges applicable to Mrs S's options, I have concluded that, based on the evidence available and in my opinion, it is more likely than not that charges were not fully discussed at the point of sale. If charges had been fully discussed, based on the weak arguments documented in support of the FSAVC scheme, I have concluded that Mrs S would most likely have opted for the in-house options available to her.

As such I am not changing the outcome or redress originally outlined in the provisional decision.

Putting things right

The aim of any redress I award is intended to place a consumer as closely as possible to the position they would most likely be in were it not for a business's error.

The redress instructions below have been provided with this principle in mind.

Scottish Friendly 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 Friendly 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 S'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 S 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

As per the rationale above I am upholding this complaint and require Scottish Friendly Assurance Society Limited to calculate and pay redress in line with the methodology provided.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs S to accept or reject my decision before 2 January 2025.

John Rogowski
Ombudsman