

complaint

Mr S complains Prudential Assurance Company Limited about the advice he was given to purchase a Free Standing Additional Voluntary Contributions (FSAVC) pension policy.

background

The advice was given by a representative of a predecessor business, but for ease of reading I'll refer to Prudential in this decision.

Mr S is a lecturer in a further education college and joined his occupational pension scheme, the teachers pension scheme (TPS) in August 1993. In 1996 a personal friend (Mr C) who was a representative of Prudential, recommended he start making FSAVCs to increase his retirement provision. This was apparently because he'd received a letter explaining his occupational scheme benefits wouldn't be guaranteed if he retired after 2000. Mr S started an FSAVC plan making contributions of £25 per month, increasing 5% per year, into the with-profits fund, with the intention of retiring early at age 55. In 1998 Mr S wrote to Prudential to increase his monthly contributions by £10.

Mr S has remained with the same employer, getting promoted over the years. And in 2019 he attended a pension workshop which led him to believe he'd been badly advised, so he complained.

Prudential upheld the complaint as it thought the advisor should have pointed out the higher charges with FSAVCs compared to AVCs in his occupational scheme, and so it made an offer of compensation to Mr S of around £745 on that basis. But Mr S thought he'd have been better off purchasing added years in the TPS, so he brought his complaint to this service. Mr S believes his financial loss is far greater as he's lost out on the contributions his employer would have made to the AVC plan which could be more than 20%, and tax relief on his contributions.

One of our investigators looked into the complaint and asked both parties about the letter which appeared to be the basis for recommending the FSAVC. She couldn't envisage why such a letter would have been issued given the security of a public sector pension. But no copy has been retained. And having reviewed Mr S's circumstances at the time she thought it likely purchasing added years would have appealed to Mr S had he known he could. So she recommended Prudential should resolve the complaint on that basis.

Mr S accepted the outcome she reached, but Prudential objected, saying the absence of a copy of the letter doesn't mean it hadn't existed at the time. After all Mr S signed the advisor's recommendation where this letter was mentioned. And just because Mr S thinks he'd have been better off with added years in hindsight, that doesn't mean he would have chosen them at the time. Purchasing "extra years" was mentioned in the recommendation which shows they and AVCs were discussed with Mr S. And he would have had the scheme booklet which he'd joined only three years previously.

So the complaint's been passed to me to make a decision.

my findings

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'm going to uphold it, for broadly the same reasons as the investigator. But I think it's finely balanced, so I'll explain why.

I agree with the investigator it would be helpful to know more about the letter Mr S apparently received which prompted concerns about the TPS. Mr S can't now recall the letter and there's no copy on Prudential's file. More than 20 years has passed since the advice was given and businesses aren't obliged to keep information forever so it's not unusual for limited evidence to be available. But I can see that before Mr C was permitted to send his "reasons why" letter to Mr S it had to pass Prudential's compliance check. So I'd have expected a copy to have been retained in order for this check to take place. And like the investigator I find it puzzling such a letter would have been issued. The TPS is financially backed by government so it's almost inconceivable that members in 1996 would be warned their benefits wouldn't be guaranteed beyond 2000, only four years later. If such a letter had been issued it presumably would affect a large number of scheme members and I've seen no evidence widespread concerns were raised about the TPS. I can't completely rule out its existence, as Prudential has highlighted, Mr S did sign the advisor's one-page recommendation where this letter is mentioned. So if it wasn't the basis for the discussion Mr S just had with Mr C, it's surprising he signed the letter without querying its contents. But in any case I think the advisor would have known public sector schemes like the TPS are secure, and should have reassured Mr S on this point. I think it's likely Mr S would still have wished to top-up his pension provision in some way, particularly if he was hoping to retire early.

The recommendation refers to Mr S being a friend of the advisor and Mr S says he knew Mr C through a club they both belonged to at the time. He recalls Mr C brought up the subject of Mr S's pension over a drink and mentioned he worked in financial services. Mr S says Mr C described his pension as "*totally inadequate*" and he could do better elsewhere and take advantage of the government topping it up through "PIRAS" (meaning the tax relief on pension contributions). Mr S wouldn't be able to take his occupational scheme benefits before age 60, so the advisor said the FSAVC policy could be written to age 55. Mr S says at the time he hadn't been in the UK for long (he's from another European country) and so didn't understand our financial system. So although he hadn't worried about his pension before, being relatively young, he trusted Mr C and relied on his professional advice and judgement. Although this all happened a long time ago, I'm persuaded by Mr S's recollections.

Even though Mr C approached Mr S as a friend, he was still professionally required to act in his client's best interest. And as the advice was given after May 1996 Mr C was bound to follow guidance from the then regulator, the Personal Investment Authority (PIA), which clarified previous guidance issued by "LAUTRO" (the regulator before PIA) in relation to AVCs and FSAVCs. But Mr C wasn't an independent advisor, he was an appointed representative of the predecessor business of Prudential so could only recommend its own products. As AVCs (and added years) are part of the TPS, he wouldn't have been able to discuss these in any detail. But he was obliged to (among other things) explain the difference in charges between FSAVCs and in-house AVCs and to refer Mr S to his in-house scheme to find out more about the options available to him. But he first needed to carry out an assessment of Mr S's financial circumstances before making a recommendation. So I've looked at the information recorded at the time.

Mr C completed a “personal financial review” for Mr S which showed at the time of the advice he was 25, married and in good health, with one dependent child. And he had three years’ service as a college lecturer, earning £17,000. He gave his chosen retirement age as “50/60” and thought he’d need about 90% of his income to live on in retirement. He was making pension contributions of 6% of his salary with his employer contributing 8.05% and he’d contracted out of SERPS. Mr C calculated that based on the projected benefits of his occupational scheme, Mr S had a pension shortfall of almost £30,000 allowing for inflation. I think this figure was sufficient to alarm Mr S and make him receptive to the advice of a professional advisor he considered to be a trustworthy friend.

The hand-written note records Mr S’s attitude to risk (ATR) as “cautious/balanced” and that he “*wishes his pension provision to be as secure as possible*” which was the basis for recommending the “with-profits” fund. The recommendation letter does mention that Mr S could make in-house AVCs or purchase extra years but doing so was discounted due to “*worries about the main scheme*” and the predecessor of Prudential was recommended as they have “*such a good reputation in this area*”. But I’ve seen nothing to show Mr S was given any information about the comparative charges for FSAVCs compared to the in-house options. The only reference to charges is a section of the suitability letter entitled “*How much will the advice cost*” which shows Mr C’s firm received £231.92 at the start of the policy and £0.82 each month from month 28 to the end of the policy and a proportionate amount each time the premiums increase.

I think it’s unlikely the usual benefits attributed to FSAVCs (portability and fund choice) would have appealed to Mr S, as he could continue his membership of the TPS even if he worked in different learning establishments over his career. And his cautious ATR and desire for a high level of pension security are factors which count against opting for FSAVCs or in-house AVCs as both involve some risk. So I’ve considered whether Mr S would have opted to purchase “added years” in his occupational scheme if the advisor had suggested he explore this route.

As the investigator has explained, Mr C couldn’t have discussed the features of Mr S’s occupational scheme, but he should have advised him to contact the TPS and find out what options were open to him before making a decision. This would also have given Mr S the opportunity to satisfy himself further about the security of his occupational scheme. The cost of added years was set by the government actuary and is based on rather conservative assumptions compared to AVCs or FSAVCs which is why they appear more expensive for the presumed investment growth. Although purchasing added years required Mr S to agree to contribute a fixed percentage of his salary, the certainty may have suited his cautious approach. After all he did commit to the 5% annual increase in contributions, which is similar to the rate he might expect his salary to increase over time. And the spousal benefits available may have appealed, given he already had a wife and small child who depended on him financially. Based on Mr S’s retirement date at age 60 in June 2031, he’d have a potential of 38 years’ pension contributions from 1993. So to complete the maximum 40 years contributions Mr S could have purchased an additional two added years which would have cost him around 20% for each extra year spread over the term. In 1996 Mr S was 35 years away from retirement age, so he’d have had that long to spread the additional cost, although unusually the TPS allowed him to opt for a shorter term if he wished. The higher cost and percentage commitment at quite an early stage in someone’s career is what often dissuades people from opting for added years. But I think it’s likely Mr S would have been interested in the advantages, given his secure employment with the potential for promotion, his family commitments and his desire for pension security. Our investigator calculated that

had Mr S opted to purchase added years in 1996 at the contribution level he was making, he'd have finished paying for them after 16 years (so by 2012) after which time he could have started contributions to the in-house AVC offered by the TPS. And doing so this would balance his desire for a secure pension with the potential for growth based on contributions he found affordable.

Mr C said paying into FSAVCs would increase the amount of TFC available to Mr S, as although FSAVCs themselves don't provide an entitlement to TFC they would enable him to opt for more TFC from his occupational scheme as they would replace the "*pension foregone in the main scheme*". But this is also incorrect as the TPS scheme rules provide for TFC in addition to pension not by way of commutation (surrender). So purchasing added years in the TPS scheme would have increased Mr S's entitlement to TFC at retirement not reduced it.

I can however reassure Mr S about the other ways he feels he's missed out. Firstly at the time his employer would not have intended to make additional contributions to his pension whether he opted for in-house AVCs or added years. The recent information he provided showing the increased level of employer contributions was to the main scheme and only because the employee contribution rate was only 6%. The contribution rate to buy one added year was much higher than this, which is why they would've appeared expensive at the time. And secondly he hasn't missed out on "PIRAS" (tax relief) as any kind of pension contribution is subject to tax relief, so his contributions to his FSAVC would have been "grossed up".

So in summary I uphold this complaint as I think Mr S would have opted to purchase added years in his occupational scheme in 1996 had he been given the right advice and information. The advisor had already identified that Mr S wanted his pension to be as secure as possible, didn't want to take risk, and had dependents. And he was in a position to dispel any confusion about the security of the main pension scheme caused by the letter Mr S received.

A fair and reasonable outcome would be for the business to put Mr S as far as possible, into the position he would now be in but for the unsuitable advice. Prudential must undertake a redress calculation for the maximum number of added years Mr S could have purchased in line with the regulator's pension review guidance as updated by the Financial Conduct Authority in October 2017.

This calculation should be carried out as at the date of this decision using the most recent financial assumptions published at the date of that decision. In accordance with the regulator's expectations, this should be undertaken or submitted to an appropriate provider promptly following receipt of notification of Mr S's acceptance of the decision.

For any further contributions Mr S made to his FSAVC which exceeded the amount he would have been required to pay for the maximum added years (above), Prudential must assume these would have been paid to his employer's in-house AVC scheme and carry out a 'charges only' calculation in line with the FSAVC review guidance.

If the redress calculation demonstrates a loss, the compensation should if possible be paid into Mr 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 Mr S as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid. 25% of the loss would be tax-free and 75% would have been taxed according to his likely income tax rate in retirement. Mr S has confirmed he's currently a standard rate taxpayer, so presumed to be 20%. So making a notional deduction of 15% overall from the loss adequately reflects this.

The compensation resulting from the loss assessment must where possible be paid to Mr S within 90 days of the date Prudential receives notification of his acceptance of my final decision. Further interest must be added to the compensation amount at the rate of 8% per year simple from the date of my final decision to the date of settlement for any time, in excess of 90 days, that it takes Prudential to pay Mr S this compensation

my final decision

I uphold this complaint. Prudential Assurance Company Limited should resolve this complaint as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 4 June 2020.

Sarah Milne
ombudsman