DRN-3043093

The complaint

Mr C complained about the advice he received from Wesleyan Assurance Society ("Wesleyan") to take out a free-standing additional voluntary contribution (FSAVC) plan. He says if he'd been given adequate information during the sale about his options, he would have bought added years in his employer's occupational pension scheme (OPS).

Mr C is being assisted with his complaint by a claims management company (CMC). And both Wesleyan and the CMC have actuaries working with them to resolve this matter. However, for ease of reading the decision, I'll refer to all representations and arguments as being raised by either Wesleyan or Mr C.

What happened

In December 1994, Mr C was advised by Wesleyan to start contributing to an FSAVC plan. At the time, Mr C was a member of his employer's OPS. The FSAVC plan commenced with Mr C making a monthly contribution of £50 (gross). The last contribution was paid to the FSAVC plan in October 2016.

In 2004, while still making contributions to the FSAVC plan, Mr C contracted to buy added years through his employer's OPS. Mr C paid a total of 3.27% to buy 3 years 63 days, which was the maximum number of added years he was able to purchase, taking him up to the 40 year service limit.

In 2017, Mr C complained to Wesleyan about the sale of the FSAVC plan. In summary, he complained that:

- The FSAVC plan was not suitable for his needs and as a result of being mis-sold, he's suffered a financial loss;
- The full risks, implications, and alternatives in respect of the FSAVC plan were not fully and properly explained. And he wasn't provided with a full or descriptive comparison of benefits between his in-house scheme and the FSAVC plan;
- He was unaware that the FSAVC plan had higher charges and he should've been advised to purchase added years through his employer's scheme.

Wesleyan reviewed the complaint. In its final response it explained that, having considered the sales paperwork and the information Mr C had provided in his FSAVC questionnaire, it wasn't satisfied that he'd been given adequate information during the sale. So it was upholding the complaint. And it said that it would be forwarding Mr C's file to its actuaries for a loss assessment to be completed on an added years basis.

A further letter was issued in 2018 after the loss assessment had been completed. The letter confirmed the following:

- Over the period of liability (up to May 2004), the total contributions paid to the FSAVC plan represented 1.37% of pensionable pay. If 1.37% of pensionable pay had instead been directed to added years, Mr C could have purchased added years of 1 year 348 days up to age 60 if working full time throughout.

- In June 2004, Mr C started an added years contract of 3 years 63 days for a contribution rate of 3.27% of pensionable pay. This was the maximum that he was permitted, taking his total pensionable service at age 60 up to the maximum of 40 years.
- Had an added years contract for 1 year 348 days been in place since 1995, Mr C would have been limited in 2004 (because of the maximum allowable) to additional added years of 1 years 80 days at a cost of 1.25% of pensionable pay. The total cost would therefore have been 2.62% from 2004 for the maximum added years of 3 years 63 days. Mr C paid a higher cost of 3.27% - 2.62% = 0.65% of pensionable pay over the period from June 2004.
- Mr C has not lost the opportunity to purchase additional years of service up to the maximum allowable. However, the delay in contracting to purchase additional years of pensionable service has caused him to pay a higher contribution rate than he would otherwise have done since June 2004.
- Contributions that Mr C could have directed to an added years contract from June 1995 until June 2004 have instead been paid into the FSAVC policy. The part of the FSAVC fund value that is attributable to contributions that he could have paid to an added years contract is a gain that offsets the loss due to the additional added years contributions that he is paying subsequently.

Calculations completed as at 1 July 2018 determined a loss of £6,030. This was adjusted to reflect tax that Mr C is expected to pay in retirement. Wesleyan offered Mr C a cash sum of £4,284.61.

Mr C didn't agree with the methodology Wesleyan had used in its loss assessment so he referred the complaint to our service for review.

In summary Mr C has said that Wesleyan's actuaries have used the value of his own contributions in the purchase of added years to offset the loss caused by the advice to purchase the FSAVC. On another case - where the actuaries are assisting Mr C's CMC - the actuaries have said that that this is not allowed under the FSAVC Guidance.

The loss calculation period is clearly set out in guidance and is stated to be:

> "*The period for loss assessment will end on the earlier of:*
> *1) the 6th April after the investor stopped paying into the FSA VC policy, and*
> *2) the date the investor started paying into the in-house A VC scheme.*
>
> *Starting to buy added years counts as joining the in-house A VC scheme and so will end the period of loss assessment.*
>
> *If the investor starts to buy added years but also continues to pay into the FSAVC policy, I believe that the period of loss assessment would end when the investor starts to buy added years (unless the investor can show that the insurer/adviser gave some subsequent advice, e.g. in connection with a subsequent FSA VC premium increment).*"

Mr C says the value of the benefit is outside the loss calculation period and should not be applied. Wesleyan is incorrect to state that the loss is simply the differential in the cost of purchase caused by deferring the start date of the added years. In reality it's effectively deducting the added years purchased.

My provisional findings

I reviewed the complaint and issued a provisional decision in February 2022. My provisional findings are set out below.

"*I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint. Before explaining my provisional findings, I'd like to take this opportunity to apologise to both Mr C and Wesleyan for the delay in the complaint being reviewed.*

Wesleyan has upheld the complaint on the basis that the FSAVC plan was mis-sold. And it considers that, had he been given adequate information during the sale, Mr C would've chosen to buy added years in the OPS in 1994 (albeit from his next birthday in June 1995), rather than taking out the FSAVC plan. As both Wesleyan and Mr C are in agreement on this matter, my decision focuses on what Wesleyan needs to do to put matters right; I don't intend to comment on the sale of the FSAVC plan and whether I agree that Mr C would've chosen added years in 1994 as these matters no longer seem to be in dispute.

In considering what needs to be done to put matters right, I've taken into account the law, any relevant regulatory rules, guidance and good industry practice.

This service doesn't have the resource to check the actual calculation that is in dispute. Instead, I've considered the calculation methodology Wesleyan has used. Having done this, I'm currently of the view that Wesleyan's calculation methodology is unfair and so I'm minded to uphold the complaint in part. I'll explain why.

<u>The FSAVC Review Model Guidance and Review Bulletin 3</u>

Following concerns about mis-selling, the regulator at that time, told businesses to carry out a review of some FSAVC plans sold between 29 April 1988 and 15 August 1999. The main aim was to review the FSAVC plans of consumers who might have lost matching contributions or subsidies that the employer would've paid, had an in-house AVC plan been started instead. The sale of Mr C's plan didn't fall within the review because the OPS didn't match or subsidise payments to its in-house AVC arrangement.

However, when we uphold a consumer's complaint that they should've been advised to take out the in-house AVCs instead of FSAVCs, we do generally tell the business to pay compensation in accordance with the FSAVC review guidance, even if the FSAVC plan didn't fall within the scope of the review.

It should be noted that, in terms of calculating loss, this guidance was predominately focused on consumers that would've joined their employer's in-house defined contribution AVC scheme. The guidance provided limit information for calculating loss for consumers where it had been decided that they would've bought added years.

An additional bulletin was issued in January 2001 – FSAVC Review Bulletin 3. In this the regulator said that:

> ***"****TREATMENT OF POTENTIAL DEFINED BENEFIT CASES*
> *(…)(Model Guidance, Section 6 – Loss assessment) The response paper to Consultation Paper 27 (published May 2000) explained the use of benchmark indices for simplified redress calculations but recognised that firms should be allowed to use actual performance to establish whether a loss has been suffered.*

This will avoid redress being paid where no loss has been suffered. (Response Paper 27, paragraph 73).

*This principle applies to defined benefit cases as to all others, and firms may test to see if there is any actual or potential financial loss. ('Defined benefit case means one where the case has failed compliance, or the firm has conceded compliance, **and** the firm has established that the investor would have chosen the defined benefit option).*

Firms should:

- *establish the fund value to be used for loss assessment;*
- *consider whether any other firms are involved; and*
- *determine the relevant period for loss assessment in accordance with the Model Guidance*

*Then, in assessing whether there is any actual or potential loss, the calculation should mirror that required for the Pensions Review with the exception that the assumption for future annual salary increases should be RPI + 2% (except where firms can demonstrate that this assumption is inappropriate). For details see paragraphs 6.18.5 and 6.18.6. It is **not** possible to conduct a simplified loss assessment for defined benefit cases. Firms should conduct a full loss assessment, in almost exactly the same way as they would for the Pensions Review. That is, in defined benefit cases firms have the option either:*

- *to concede loss; or*
- *to use actual performance in the loss calculation.*

Firms cannot use benchmark indices in the calculation. Where, in defined benefit cases, the loss calculation indicates that there is an actual or prospective financial loss, or the firm concedes loss, firms should proceed either to causation assessment or to redress and settlement"

While acknowledging that the model guidance and subsequent bulletin are useful, I don't believe strictly applying them is appropriate in the particular circumstances of this case.

Mr C's FSAVC plan didn't fall within the initial scope of the review for which the guidance was intended. And the guidance wasn't written to address every potential scenario, particularly those arising over 20 years after the guidance was issued, where action taken to mitigate loss was taken many years before the complaint was made. And crucially, there's nothing in the Dispute Resolution rules (DISP) – the rules in the FCA handbook that set out how complaints are to be dealt with by firms and the ombudsman service – which stipulates that this guidance must be applied to all FSAVC complaints being raised now, that didn't fall within the initial scope of the review.

That's not to say the guidance and bulletin aren't relevant at all; they do still provide a useful guide, particularly when we consider complaints about mis-sold FSAVC cases where it's been determined that the consumer would've joined their employer's in-house defined contribution AVC scheme. However, in this case I consider departing from a strict interpretation of the guidance is necessary in order to provide Mr C with fair compensation.

I think it's important to explain that when a consumer has lost out financially as a result of something the business has done wrong, I'd generally expect the consumer to be put back *into the position they would have been in, had the business not made the error. This is also the case when considering Mr C's complaint.*

The bulletin referenced above states that after establishing the fund value, considering causation and determining the relevant period for loss assessment, the calculation should mirror that required for the Pensions Review. The Pension Review Guidance has been updated since it was initially issued. The Finalised Guidance issued by 2017 and updated in March 2021 – commonly referred to as FG17/9, states that:

"Guidance for firms on how to calculate redress for unsuitable defined benefit pension transfers (…)

The standard approach to calculating redress

> *2. Where a firm or adviser has failed to give compliant and proper advice, or has committed some other breach of the relevant requirements,* ***the basic objective of redress is to put the customer, so far as possible, into the position they would have been in if the non-compliant or unsuitable advice had not been given or the breach had not occurred {my emphasis}"***

So while I've considered the above model guidance and bulletin when thinking about fair compensation, my main focus has been to put Mr C, as far as possible, in the position he would now be in, had he bought added years in 1994 instead of taking out the FSAVC plan; he shouldn't be placed in better position and equally, he shouldn't be worse off.

<u>How many added years should the calculation be based on?</u>

Wesleyan has calculated that Mr C paid the equivalent of 1.37% of his pensionable pay to his FSAVC plan between 1995 and 2004, when he joined the added years arrangement.

When the FSAVC plan started, if Mr C had paid 1.37% of his salary to the added years arrangement , this would have secured him 1 year and 348 days added years at a rate of 0.70% per year if he'd maintained payments until age 60.

Mr C is due to receive 3 years and 63 days as a result of the added years he purchased in the OPS. This was the maximum Mr C could have purchased to take him to 40 years' service. So he's not lost the opportunity to buy added years. However, as explained in Wesleyan's letter, over the course of the added years contract, Mr C will pay £19,309 more for the 1 year and 348 days added years he could have bought if he'd not taken out his FSVAC plan.

I understand that Mr C has concerns that Wesleyan has used the value of the added years the above excess contributions secured, to offset the loss caused by the advice to purchase the FSAVC. And he says that Wesleyan is incorrect to state that the loss is simply the difference in the cost of purchase caused by deferring the start date of the added years. Mr C says that, in reality, Wesleyan is effectively deducting the added years purchased.

However, if Wesleyan fails to take account in its calculation of the full added years Mr C bought, it will likely leave him with a benefit equivalent of more than the maximum level of service he could have had. This is a position that Mr C couldn't ever have found himself in, had he taken added years initially. And the fact that Mr C has taken action to mitigate his loss by contracting to buy added years from 2004, needs to be taken into account.

The FSAVC model guidance wasn't written with the intention that it would address every scenario that arises. And for the reasons explained, I don't believe strictly applying the *guidance in this case is appropriate, all the added years Mr C purchased need to be factored into the redress correctly.*

I don't think Wesleyan's approach is unreasonable. I'm satisfied that this approach places Mr C in the position he'd be in now but for Wesleyan's error. It's ensuring he hasn't paid more for the 1 year and 348 days his FSAVC contributions between 1995 and 2004 could have secured.

<u>Should the calculation be bought up to date?</u>

I've thought about whether this calculation should be rerun to bring it up to date. It's not unusual for us to do this where a significant time has passed since the calculation was run and the complaint hasn't been settled. Or we may ask a business to pay interest on any loss identified to account for the consumer having been without access to these fund.

In the case of Mr C, although the calculation was run on an added years basis, it was only to determine the difference between the cost of deferring the purchase of added years. The purpose of the calculation wasn't to determine the cost of replacing any added years that Mr C had lost the opportunity to purchase as he's has purchased the maximum. So I believe any changes to the FCA assumptions that have happened since the calculation was completed, in particular the changes in March 2021, regarding CPI index assumptions, are unlikely to have a significant impact on the calculation. So I'm currently minded to say that, because I don't think the methodology Wesleyan has used here is unfair, there is no need for the calculation to be rerun.

However, the calculation had determined that, when adjusted for tax, Mr C had suffered a loss of £4221. As Mr C has been without the use of these funds, I'm minded to ask Wesleyan to bring this amount up to date using 8% simple interest. This seems to be in line with what it had suggested in its offer letter when is said that "Interest should be added to the above redress, calculated at Court rate to settlement date".

<u>FSAVC contributions from December 1994 to June 1995 and 2004 to 2016</u>

Although, I'm minded to say that, other than adding interest to the above loss, Wesleyan doesn't need to take any further action in respect of the added years aspect of this complaint, I'm conscious that it hasn't taken account of the contributions Mr C paid to his FSAVC plan after he joined the added years arrangement in 2004.

Mr C couldn't have joined the added years arrangement until his birthday in 1995 so there were a few months before this when he was making contributions to his FSAVC plan. And he continued making contributions of £50 per month after he joined the added years arrangement.

Wesleyan acknowledges that it mis-sold the FSAVC plan and that Mr C wasn't given adequate information during the sale. It's satisfied that he would have opted for added years had he been given the correct information. However, had Mr C been made aware he could also contribute to the in house AVC plan – with likely lower charges than the FSAVC - as well as purchasing the maximum number added years, I think it's likely that he would have opted to direct the contributions paid before June 1995 and after 2004 to the inhouse AVC. I've not seen any evidence that Mr C wouldn't have had the headroom to make these payments to the in-house AVC. My understanding is that Mr C could have contributed a maximum of 9% of his salary to both in the in-house AVC and added years arrangements.

I do acknowledge that Wesleyan has previously said, on another case, that when the *maximum number of added years is being purchased, the cap for in-house AVC contributions is around 2% or 3%. The information I've seen suggests that Mr C's contribution of £50 per month would have been around 2.5% of his salary in 1994/95 and less than 1% after 2002. So I think it's likely that Mr C would have had the headroom to direct these contributions to the in-house AVC. As such, in my final decision, I intend to direct Wesleyan to carry out a charges only calculation on these contributions."*

Responses to my provisional findings

Wesleyan responded to my provisional decision and confirmed that it had no further comments.

Mr C's representative provided further submissions which I've summarised below.

- Wesleyan is using Mr C's own purchase of added years to offset its liability. Mr C's representative does not believe this compensates Mr C fairly and it considers it breaks the guidance issued by the regulator. No other firm adopts this approach and nor has the FSCS. This is a change in approach by Wesleyan as it hasn't always used this methodology. Wesleyan is wrong to say that the use of Mr C's own purchase of added years, even if this is "outside of the loss calculation period", can be taken into account as "*a client cannot be compensated to a higher degree than they would have been in, had they purchased added years from outset*". Mr C completely agrees that a client cannot and should not be over-compensated, but this is not the case.
- There are two sets of contributions to the pensions – the FSAVC and the added years contributions, however, Wesleyan's methodology shows zero difference in outcome. This is clearly wrong and Wesleyan should not deduct the value of the FSAVC, and so its loss is understated. It appears that, *for benefits*, Wesleyan is modelling the 'Notional Scenario' against the 'Actual Scenario'. However, *for contributions*, it's modelling the same 'Notional Scenario' to added years, but against the 'Actual Scenario'. Consequently, the difference in *benefits* is the value of the FSAVC, but the difference in *contributions* is actually *higher* than Wesleyan calculates so its loss is understated.
- Wesleyan is mis-using the information to manipulate a no loss scenario – and the most obvious error is the deduction of the value of the FSAVC to produce the zero difference in output.
- Mr C is worse off, compared to buying added years from 1994 (1995), because all of the added years (3 years and 63 days) cost more from June 2004 than they would have cost from June 1995 – and Wesleyan's calculations only seek to compensate Mr C for the higher cost of just 1 year and 348 days out of those 3 years and 63 days. So "*all the added years Mr C purchased*" are not being "*factored into the redress correctly.*" And 3 years and 63 days of added years, if purchased from June 1995, would've cost only 2.22% of salary – i.e. initially £44.80 per month, which is actually less than the FSAVC contributions that were set up at that time of £50 per month.

- Even if it is decided to restrict the level of contributions being considered paid to added years to only 1.37%, then although those contributions would buy 1 year 348 days of added years if paid from June 1995, they would only buy 1 year 120 days of added years if paid from June 2004. So the redress calculations should then allow for the benefit value of the missing 228 days of added years (i.e., the missing pension & missing lump sum from only receiving 1 year 120 days of added years instead of from 1 year and 348 days of added years) – and Wesleyan's calculations do not include any valuation of the benefit value of added years (they only calculate the cost of added years).
- In any case, the 1.37% contribution rate is too low, because it excludes the FSAVC premiums paid before June 1995, even though the FSA's FSAVC Review Model Guidance requires that "*Firms should normally carry out a loss assessment in respect of the period from the date at which they gave the advice to purchase the FSAVC ... firms may use the FSAVC policy date or date of first premium instead where they are satisfied that these dates are normally a reasonable proxy for the date of advice."*

My side letter to both parties updating redress

After reviewing the responses to my provisional decision, I issued a further letter to both parties explaining that I was minded to make a change to the redress. I also clarified why I wasn't asking Wesleyan to calculate the benefit value that Mr C considers should be included in the calculation. My letter is set out below.

"*I think it's important to explain that while I have taken account of the FSAVC review guidance, I don't believe that it's useful in this case when trying to put Mr C back in the position he would be in now if he had taken added years in 1995.*

I acknowledge what the FCA has said about the period for loss assessment, which is set out in the FSAVC review guidance. But I would also highlight that it has said that it doesn't get involved in individual disputes; that's a matter for the Financial Ombudsman Service if things can't be resolved between the parties involved.
There is nothing in the Financial Ombudsman Service's rules that states that the FSAVC review guidance must be applied to all complaints that are upheld regarding mis-sold FSAVC plans.

Our rules state that I must award fair redress and in order to that in this case, I consider departing from the above guidance is appropriate.

I also note what Mr C has said about the methodology used by the FSCS. However, the FSCS and our service operate under a different set of rules. The FSCS's rules stipulate that the guidance must be applied, unless it considers departing from it is appropriate in the circumstances of the complaint. However, no corresponding rule exists for the Financial Ombudsman Service. I also think it's important to note that the FSCS would need to consider the relevant time limits and the merits of the complaint, before considering what redress, if any, is due. And even in those circumstances, the FSCS can depart from the FSAVC guidance if it feels it's necessary in order to provide fair redress.

I think what I'm proposing below, puts Mr C in the position he would be in now, if he hadn't taken the FSAVC plan out and instead had bought added years in 1995.

<u>*How many added years should the calculation be based on?*</u>

At the moment, Wesleyan has calculated that Mr C paid the equivalent of 1.37% of his pensionable pay to his FSAVC plan between 1995 and 2004, when he joined the added *years arrangement. It's calculated that this would have secured him 1 year 348 days added years, at a rate 1995 and maintained payments until age 60.*

When Mr C started his FSAVC plan, he contributed £50 pm. The plan started in December 1994. However, if Mr C had taken an added years contract instead of the FSAVC, he wouldn't have been able to start the added years contract until his next birthday in June 1995. For this reason, I'm satisfied that this is when the added years part of the calculation should start. The contributions paid before this date, are accounted for in the charges only calculation.

Based on the information set out in Wesleyan's calculation, it looks like Mr C was earning £24,211.26 that this time. So £50 pm, would have been around 2.47% of his salary. At the rate of 0.70% per added years, this would have secured over three and half years added years at the point of sale days, which he says would have cost 2.22% in 1995.

Had Mr C joined the added years arrangement in 1995 as opposed to taking out the FSAVC plan, this £50 pm would have increased in line with any changes to Mr C's salary as contributions would have need to be maintained at 2.22% to secure the added years.

Both parties are in agreement that Mr C would have bought added years so it follows that he would have been prepared for his contributions to increase above the initial £50pm. This is more than the 1.37% of salary that Wesleyan has based its calculation on. So to ensure Mr C is put back in the position he would have been in, had the FSAVC plan not been taken out, I believe the calculation needs to be rerun on the basis of the number of years the initial £50pm contribution could have secured.

I can understand why Wesleyan has used the 1.37% as this does reflect what Mr C paid to the FSAVC plan between 1995 and 2004. And basing its calculation on this higher initial number of added years, as I've proposed above, will mean that there is a contribution shortfall. Mr C will have paid less to his FSAVC than he would have paid to the added years arrangement between 1995 and 2004. So the value of the contribution shortfall will need to be factored in to the calculation. But in turn this will also mean that Mr C will have paid more between 2004 and when he retires for all of his added years rather than the 1y 348 days Wesleyan has based its calculation on. So the calculation will also need to determine how much extra he has paid since 2004.

<u>Should the calculation be rerun?</u>

I was previously of the view that it wasn't necessary for the calculation to be rerun but instead Wesleyan should bring the calculation up to date using 8% simple interest. However, given that there has now been a change to the number of added years Mr C would have purchased at the point of sale, in my final decision I intend to direct Wesleyan to rerun on the basis I've set out above.

And for the reasons explained in my provisional decision, I intend to direct Wesleyan to carry out a charges only calculation on the contributions Mr C paid to the FSAVC before June 1995 and after 2004.

<u>Value of benefits</u>

Mr C still maintains that Wesleyan is using the value of the added years benefit he secured to offset its liability.

Although above I've suggested the calculation is rerun using the number of added years the initial £50 pm contribution would have secured, to avoid confusion when addressing the

‘value of benefits’ issue, I think it makes sense to refer to the 1.37% contribution rate, which would have secured 1 year 348 days in 1995 as this is what was set out in my provisional decision and it’s on this basis that Mr C has presented his counter argument.
I accept that in 2004 when Mr C started to purchase added years, 1.37% would have secured less added years than in 1995 because the cost of each year had increased. Mr C believes this difference to be 228 days (1y 348 days – 1y 120 days). And he considers Wesleyan is using the added years he purchased to offset its liability.

I’ve acknowledged in previous correspondence that different actuaries will have their own method of determining what they considered to be correct redress and some of these may be more generous than others. And I accept that the value of this 228 days benefit is greater than the contributions made to purchase it. But Mr C hasn’t lost this benefit. He will still receive his full added years entitlement from his OPS.

So while Mr C’s actuary may have dealt with these added years differently, I don’t think Wesleyan is being unfair. I’m satisfied that if Wesleyan completes the calculation as I’ve set out above, it will be placing Mr C in the position he would have been in, had he bought added years in 1995. He will receive 3y 63 days added years benefit from his OPS scheme, and he won’t have paid any more for the number of years his initial £50pm contribution could have secured.

Mr C has concerns because he says the calculation only considers the cost of buying the added years, it takes no account of the value of the benefit provided by the added years. But in this case, where a member has secured the full added years they were entitled to, albeit at an increased cost, no benefit has been lost and so I’m not going to be asking Wesleyan do any more in this regard. And contrary to what Mr C has suggested, in this case, the value of the FSVAC plan is not being used to replace any added years. There are no lost added years as Mr C will receive his full entitlement from the scheme.

Mr C also says that the value of the FSAVC should not be deducted as this understates the loss. But I don’t agree.

The value of the plan (in respect of the proportion representing contributions paid between 1995 and 2004) needs to be taken into account in order to put Mr C back in the position he would have been in. Any value in excess of the contributions paid during this period is a gain and it’s not unreasonable for Wesleyan to use this gain to offset against any loss Mr C may have suffered as a result of the extra he has paid to secure the added years.

If Mr C is redressed as I’ve set out above, he will receive the full added years entitlement from his OPS and he won’t have paid any more for the years his initial contribution would have secured. This puts him back in the position he would have been in had he not taken the FSAVC plan out and had instead started the added years contract in 1994. If he also received the value of any investment gain made on the FSAVC contributions, he’d be a in better position.”

Final submissions from Mr C

Mr C believes he would have paid for added years for a term of 30 years from June 1995, but instead he is actually paying for a term of 21 years from June 2004. So currently he has only paid for around 17.77 years of the 21 years, and so only 84.6% of the added years have been purchased so far. If he had started in 1995, then by now he would have already paid for around 26.77 years of the 30 years, or 89.2% of the added years would have been purchased so far. So he believes that if he had to stop the added years contract now e.g. because he left NHS employment, or because he wanted to stop paying for added years, then he will have accrued around 5% fewer added years than if he had started buying added years in June 1995 – and so the “benefit” value of the lower added years would need to be brought into the calculation of redress.

Final submissions from Wesleyan

Wesleyan understands that it’s being asked to rerun the calculation of “difference in cost” to allow for a notional scenario in which Mr C would have contracted to purchase 3 years 63 days “Notional” added years from June 1995 rather than the 1 year 348 days which it has used in it calculation.

The 3 years 63 days added years has been determined by considering the initial FSAVC contribution and comparing this to Mr C’s earnings in the tax year commencing 1 April 1998. As Mr C would have been constrained by the 40 year service limit, the notional added years have been capped at 3 years 63 days. The impact of the proposed adjustment will be relatively low because it is only making a comparison of cost of contributions rather than the value of added years. Making the proposed adjustment would however introduce complexity into the calculation because as noted there would be a contribution shortfall to value.

Furthermore, calculating the notional added years in the way suggested would not be consistent with the way that Wesleyan has calculated loss for other investors. Whilst it understands the proposal is specific to a scenario where an investor has subsequently entered into an added years arrangement, Wesleyan has a strong preference to use the same calculation methodology on all cases.

The FSAVC model review guidance does not provide any instruction as to how the notional added years should be determined and it is therefore necessary to use a sensible and reasonable method.

Wesleyan is strongly of the view that calculating the notional added years based on the total contribution paid over the term of the FSAVC is appropriate. It considers that using the starting FSAVC rate could result in unfair and unintuitive outcomes. In particular, redress could be higher for an investor who has paid less to their FSAVC overall (but have paid flat contributions), than for someone who has paid more (but started on a lower rate and raised it gradually over time). As such Wesleyan considers that its methodology is more robust and fair between investors.

Wesleyan appreciates that other firms may take a different view on the way that the notional added years are calculated. However, it’s very uncomfortable with moving away from its long standing calculation approach. Therefore, from both a practical and consistency perspective, Wesleyan would strongly prefer not to rework the calculation as it has been suggested

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 reviewed the case afresh and considered the further submissions provided by both parties, I’m partially upholding this complaint. I’ve explained why below.

<u>FSAVC contributions from December 1994 to June 1995 and 2004 to 2016</u>

I explained in my provisional decision why I was minded to ask Wesleyan to complete a charges only calculation on the contributions Mr C paid to his FSAVC plan, both before he could have joined the added years arrangement, and after he did actually join in 2004.

Neither party provided any comments in relation to this aspect of my provisional decision so I see no reason to depart from my findings in this regard. Therefore, if Mr C accepts my final decision, Wesleyan should carry out a charges only calculation on the FSAVC contributions Mr C paid between December 1994 to June 1995 and 2004 to 2016.

<u>How many added years should the calculation be based on?</u>

In terms of the added years calculation, I remain of the view that the redress should be as set out in my most recent side letter. I appreciate that Wesleyan believes calculating the number of added years based on what Mr C's initial contribution could have purchased, brings a complexity to the calculation because any contribution shortfall needs to be factored into the calculation. It also considers the impact of the proposed adjustment would be relatively low. However, as Wesleyan is satisfied that Mr C would have bought added years at the start, if he's been given adequate information about his options, I'm of the view that this method of calculation provides fair redress to Mr C.

It may not be consistent with the way Wesleyan has calculated loss for other investors. But when Wesleyan upholds a complaint on the basis that the consumer would have bought added years, it follows that must be satisfied that the consumer would have been prepared for their contributions to mirror any changes to their salary as this is what would have happened if they had bought added years. While I'm only making a finding specific to Mr C's complaint, I see no reason why this approach should be different for a consumer that doesn't then go on to buy added years.

I accept that this could result in investors that opt to pay a flat rate of contributions receiving more redress, than if they had paid less initially and increased contributions gradually throughout the duration of the plan. But if an investor had joined the added years arrangement, the number of added years secured would have been set at the outset of the contract. And so I consider this approach more accurately reflects the position the investor would have found themselves in, had they taken added years rather than an FSAVC.

I think it's important to highlight that whether a consumer choses to increase contributions, or not, is a factor that could impact the merits of a complaint in terms of whether it is ultimately upheld on an added years basis or a charges only basis. This is because, as I've said above, to uphold on an added years basis would suggest that Wesleyan is satisfied the consumer would have been prepared to increase their contributions in line with their salary.

In the case of Mr C, despite paying a flat rate of contributions throughout the duration of the FSAVC plan, both parties are in agreement that he would have bought added years and so I believe the redress I've set out above is fair.

<u>Value of benefit</u>

I appreciate that Mr C's representative doesn't agree but I remain of the view that Wesleyan only needs to calculate the difference in the cost of buying added years; I don't believe it needs to calculate the value of the benefit Mr C's excess contributions to the added years arrangement have secured. I don't intend to repeat my reasons for reaching this decision here as they are clearly set out in both my provisional decision and side letter.

In its most recent submissions, Mr C's representative has argued that if Mr C stopped his added years contract now - because he left NHS employment or he simply wanted to stop paying for added years - then he would have accrued around 5% fewer added years than if he'd started buying added years in June 1995.

I agree that this may well be the case. But it’s not been suggested that Mr C intends to stop paying for added years before the contract is due to end. And so, on balance, I think it’s likely that Mr C will continue his added years contract until the age of 60 and he will receive the full 3 years 63 days added years he contracted to buy. So, if I was to ask Wesleyan to provide redress on the basis that Mr C has currently secured less added years, and Mr C continues with his added years contract as I believe is most likely, this will effectively leave Mr C with a benefit equivalent of around 5% more than 3 years 63 days he was entitled to buy under the added years arrangement. So for this reason, I won’t be asking Wesleyan to factor this benefit value into its calculations.

Putting things right

In assessing what would be fair compensation, I consider that my aim should be to put Mr C as close to the position he would probably be in if he had purchased added years in 1995 rather than taking out the FSAVC plan.

Calculation in respect of added years

In order to determine how much extra Mr C has paid as a result of the delay in purchasing added years, Wesleyan should rerun its calculation on the basis of the number of years the initial monthly contribution of £50 could have secured Mr C in 1995, presumed to be 3 years and 63 days. Wesleyan will need to take account of any shortfall in the contributions Mr C paid to his FSAVC plan between 1995 and 2004. Any loss identified should be adjusted to reflect tax that Mr C is expected to pay in retirement.

FSAVC contributions between December 1994 to June 1995 and 2004 to 2016

Wesleyan 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, Wesleyan 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 C'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 C 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 40%. So making a notional deduction of 30% overall from the loss adequately reflects this.

Wesleyan should complete the above calculations as at the date of my final decision. And it should pay 8% simple per year from the date of the final decision to the date of settlement if the matter is not settled within 28 days of the it being notified of Mr C's acceptance.

My final decision

For the reasons explained above, I partially uphold this complaint. I require Wesleyan Assurance Society pay redress as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr C to accept or reject my decision before 27 April 2022.

Lorna Goulding
Ombudsman