DRN-3292346

The complaint

Mr W complained about the advice he received from Wesleyan Assurance Society to take out two free-standing additional voluntary contribution (FSAVC) plans.

Mr W 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 ready the decision, I'll referred to all representations and arguments as being raised by either Wesleyan or Mr W.

What happened

In May 1992, Mr W was advised by Wesleyan to start contributing to an FSAVC plan. At the time, Mr W was a member of the NHS Pension Scheme. The FSAVC plan (plan No. *0003) commenced with Mr W making a monthly contribution of £120 (gross). In September 1993 another FSVAC plan was established (plan No. *0005) with Mr W contributing a gross amount of £80 each month. Mr W's contributions to both plans ceased in June and July 2002 when he decided to start contributing to the in-house added years arrangement through the NHS Pension Scheme.

In 2018, Mr W complained to Wesleyan about the sale of the FSAVC plans. In summary, he complained that:

- The FSAVC plans were not suitable for his needs and as a result of them being mis-sold, he's lost money,
- The full risks, implications, and alternatives in respect of the FSAVC plans 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 plans,
- He was unaware that the FSAVC plans had higher charges,
- He should've been advised to purchase added years through his employer's scheme.

6

Wesleyan reviewed the complaint. In its final response it explained that it had been unable to locate the sales paperwork for the FSVAC plan so it had upheld the complaint. And it said that it had forwarded Mr W's file to its actuaries for a loss assessment to be completed on an added years basis.

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

- Mr W had suffered a financial loss as a result of the advice received to take out the FSAVC Plan instead of being a member of the NHS Pension Scheme 'added years' years arrangement from June 1992 to June 2002. The calculation had been based on the assumption that Mr W would've bought added years from June 1992, the earliest date possible after receiving advice from Wesleyan, and was based on a retirement age of 60.

- In June 1992, Mr W could've purchased 1 year additional pensionable service at a cost of 0.78% of pensionable pay payable for a term of 27 years to Normal Retirement Age (60). Between 1992 and 2002 the FSAVC contributions were equivalent to 8.849% of pay. If contributions at this level had continued to age 60, they would have bought 11 years 126 days added years. However, Mr W would've been restricted on the amount of contribution he could pay for additional service within the Scheme's overall maximum of 40 years pensionable service. The "headroom" available for Added years was 11 years 35 days and the percentage of pay to purchase these Added years would have been 8.655% through to age 60. The contribution rate of 8.655% represents 97.81% of the total FSAVCs paid.

- In June 2002 Mr W maximised his contributions to added years and purchased 6 years 337 days with contributions of 9% of pay. If, instead of starting the added years contract in 2002, Mr W had started in 1992, he would've continued paying 8.655% for the maximum permitted added years. This means that since June 2002, his contributions have been too much by (9% - 8.655% =) 0.345 % of pay. The overpayment of contributions to date is calculated to be £4,930, accumulating the over payment at Bank Base Rates. The discounted value of the overpayment between now and age 60 is £283. The total value for the overpayment is £5,213.

- The total added years Mr W could've contracted if he had been correctly advised in 1992 was 11 years and 35 days. The difference between 6 years 337 days (what he actually contracted for in 2002) and 11 years 35 days (what he could have contracted for in total) is 4 years and 63 days.

- Plan *0003 fund value at 1 October 2018 was £91,046.22. Plan *0005 fund value at 1 October 2018 was £56,868.69. Both Plans benefitted from a valuable Guaranteed Annuity Option. At age 60, there was a Guaranteed Annuity Rate (GAR) of £7.016 per £100 fund value payable monthly in advance guaranteed for 5 years and with no escalation. To use the funds to purchase an equivalent annuity based on the FCA calculation methodology (to be consistent with the valuation of the lost Scheme benefits) would require an amount now of £134,963.77 for Plan *0003 and £84,300.18 for Plan *0005, a total of £219,263.95. Therefore, the fund values on which the calculations are based is these higher figures. The GAR adjustment only applies to 75% of the fund, the balance being the maximum 25% which may be taken as tax free cash.

- 97.81% of the FSAVC Plan contributions would've been needed to purchase a contract for the maximum added years and this is reflected in the value of the Plans given credit for in the loss assessment below, which is reduced to £214,462.07.

- Calculations have been completed as at 1 October 2018 and are based on the financial assumptions at that date determined in accordance with FCA guidance.

The prospective value of the lost Added years	£209,998.91
Plus the value of the over contribution	£5,213.00
Less the value of the Plans	£214,462.07
The loss is therefore:	£749.84

  When factoring in the tax deduction and the fact that 25% of the fund would've been tax-free, the total redress payable is £524.89.

Mr W's CMC instructed a firm of actuaries to review the loss assessment. It didn't agree with the calculation methodology that Wesleyan had used. And after raising a number of queries with Wesleyan the matter was referred to this service to review. In referring this matter, Mr W provided detailed arguments to support its stance. In summary, Mr W said he was concerned about Wesleyan's use of the GAR in the loss assessment. And he considered Wesleyan has 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.

I issued my provisional decision in October 2021, explaining why I thought the calculation methodology Wesleyan had used was fair. My provisional findings are set out below.

Provisional findings dated 11 October 2021

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 W would've chosen to buy added years in the NHS Pension Scheme in 1992, rather than taking out the FSAVC plan. As both Wesleyan and Mr W 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 W would've chosen added years in 1992 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 fair and I'm not minded to uphold the complaint. 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 W's plan didn't fall within the review because the NHS Pension Scheme 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.

However, 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 W's FSAVC plans 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 some 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 W 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 W'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 the FCA in 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 W, as far as possible, in the position he would now be in, had he bought added years in 1992 instead of taking out the FSVAC plan; he shouldn't be placed in better position and equally, he shouldn't be worse off.

Use of GAR in calculating fund value for loss assessment

The model guidance and calculation tables contained within it aren't useful when considering Added Years complaints. Both parties have referenced section 6.25 as the only part of the guidance that mentions FSAVCs which have a valuable guarantee of benefits in retirement.

> "*6.25 Firms may wish to investigate whether there has in fact been no financial loss suffered despite the possible loss of employer matching contributions, subsidised benefits or lower level of charges in the in-house AVC arrangement.*
>
> *6.25.1 If the investor has lost out on employer matching contributions or other subsidised benefits, it is almost certain that a loss will have occurred. However, an example of circumstances when a loss will not have occurred is where the investment performance of the FSAVC has exceeded that of the in- house AVC arrangement by more than the cumulative value of the*

lost employer contributions and any difference in charges. ***A further example might be where the FSAVC offers some kind of valuable guarantee of benefits in retirement {my emphasis}.***

6.25.2 *If a firm finds an investor for whom circumstances such as those in paragraph*
6.25.1 apply they may conclude that no loss has been suffered"

Wesleyan has argued that "*some kind of valuable guarantee of benefits in retirement"* would include a GAR. Like Wesleyan, I don't think when the guidance was written that it would've been envisaged that a GAR could provide such a valuable benefit but, as things stand today, GARs are considered very valuable, given how much annuity rates fallen over the years. In this case the GAR provides £7.016 per £100. So I do agree it's a valuable benefit when compared with today's annuity rates. And I also agree with Wesleyan's arguments that it is only logical that if a GAR can be used to exclude a case from the loss assessment process then a GAR can also be used in the loss assessment calculation. I think the reason GARs aren't specifically included in the subsequent sections of the guidance, which set out how the fund value is determined for loss assessment, is most likely because the guidance was written with in-house AVC's in mind, where fund values and guarantees aren't taken into consideration as the relevant comparison is between the charges of the FSAVC and the in-house AVC option.

Like Mr W, I'm not aware of the use of GARs being mentioned in the initial pension review guidance. However, when discussing fund values, the pension review guidance does state that it isn't "*intended to cover all situations nor to exclude other elements, which may be appropriate in particular circumstances*"

So while there is nothing that specifically states that the value of a GAR should be included when determining the fund value for loss assessment, I don't think it's unreasonable to do so, if it's appropriate in the circumstances of the complaint.

In this case, Wesleyan has confirmed that the GAR is based on a single life and is guaranteed for 5 years. This isn't consistent with the benefits that would've been payable under the Added Years arrangement. So on the face of it, it doesn't seem reasonable to include the value of the GAR when determining the fund value for loss assessment. I've asked Wesleyan if it provides a blended GAR or a GAR on another basis and it doesn't appear that it does. However, I'm conscious that Wesleyan has confirmed that if the investor chooses to take their pension on another basis – so they don't make use of the GAR – the fund value is uplifted to reflect the value of the GAR.

This means that Mr W will benefit from the uplift in fund value, even if he opts not to utilise the GAR when he takes his benefits. For this reason, I don't agree with Mr W's argument that Wesleyan is using the GAR in order to potentially deprive him of compensation.

Given the value this benefit adds to the fund, and as Wesleyan has said that the fund will be uplifted to reflect the value of the GAR, even if it's not utilised, I don't think it's unreasonable in the circumstances of this complaint for the value of the GAR to be included in the fund value.

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

Wesleyan has confirmed that, at the time of advice, Mr W was eligible to buy added years of 11 years and 35 days. This was the maximum he would've been able to contract for under the NHS Pension Scheme as this, alongside his expected scheme membership, would've taken him to the maximum of 40 years' service.

However, instead of purchasing added years in the NHS Pension Scheme, Mr W commenced two FSVAC plans. The plans started in May 1992, with Mr W contributing £120 pm gross, and September 1993, with an additional £80 pm gross contribution. From this point on Mr W continued to make total monthly contributions of £200 per month (gross) to these plans until 2002.

Wesleyan has confirmed that if Mr W had continued contributing to the FSAVC plan at the same rate, until the age of 60, his contributions would've actually purchased added years of 11 years and 126 days, which would've taken him over the maximum of 40 years' service. In 2002, Mr W decided to start buying added years and he stopped contributing to his FSVAC plans. However, at this point Mr W was only able to contract to buy 6 years and 337 days. This was the maximum he was able to buy at that time, given the 9% of salary contribution limit that applied.

Wesleyan has based its loss assessment on the difference between these two amounts (11 years 35 days minus 6 years 337 days), that being added years of 4 years and 63 days. The value of the 4 years 63 days has been calculated by Wesleyan to be £209,998.91.

Having thought about the approach Wesleyan has taken, I don't think it seems unreasonable as it does put Mr W back in the position he would've been in, had he contracted for the maximum number of years – 11 years and 35 days - in 1992 (6 years 337 days plus 4 years 63 days). However, although I'm minded to say that the number of years Wesleyan has based its calculation doesn't seem unreasonable, it doesn't automatically follow that the calculation is fair. So I've considered this further.

Is the calculation methodology fair?

In contracting to buy added years from 2002, Mr W wasn't only unable to purchase the full 11 years and 35 days shortfall he had, he also had to contribute 9% of his salary, which was more than he would've needed to contribute had he purchased 11 years and 35 days added years in 1992.

Wesleyan has confirmed that in order to purchase 11 years and 35 days added years, from 1992, Mr W would've needed to contribute 8.655% of his salary through to age 60. Wesleyan's calculations show that this contribution rate of 8.655% represents 97.81% of the total contributions paid to FSAVC plans between 1992 and 2002.

From 2002 onwards, Mr W has been paying 9% of his salary to buy added years but this is 0.345% more than he would've been paying, had he started added years in 1992. These over contributions need to be taken into consideration. And having reviewed the calculation, it does appear that Wesleyan has made an allowance for them.

At the time Wesleyan ran its calculation both funds had a combined value of £219,263.95 (this has been uplifted to take account of the GAR). However, in determining the fund value for the loss assessment, Wesleyan has only used 97.8% of this combined value, that being £214,462.07. This additional £4,801.88 was excluded from the calculation to reflect the excess contributions Mr W paid between 1992 and 2002.

These additional contributions benefitted from tax relief when they were paid and the value of the fund itself has been uplifted to reflect the value of the GAR attached to the FSAVC plans. When Mr W takes the benefits of these plans, he will likely be entitled to tax free cash. So this doesn't seem an unreasonable way to deal with the over contributions held within the FSAVC plans. And although this scenario isn't specifically addressed in the pension review or model guidance, I am aware that under paragraph 1208 of the original pension review guidance – which explains how ‘overpayments’ are dealt with during reinstatement - the percentage of the fund that relates to the ‘overpayment’ is excluded from the reinstatement costs. So it does seem that what Wesleyan has done here is in the spirit of the guidance.

In terms of the excess contributions Mr W has paid since contracting to buy added years, I can see that the total value of the 0.345% extra he’s been paying has been calculated to be worth £5,213.00, this included contributions that were yet to be made at the date of calculating but have since been paid. And these contributions have been brought up to date using bank base rates. This is how I’d expect the over contributions, that fall outside of the FSAVC plan, to be dealt with and is consistent with how businesses dealt with over contributions during the pension review.

However, Mr W doesn’t agree with the methodology used here as he believes Wesleyan is valuing benefits accrued, and contributions made, outside of the loss calculation period. The model guidance states that the period for loss assessment will end on the earlier of:

> *“1) the 6th April after the investor stopped paying into the FSAVC policy, and*
> *2) the date the investor started paying into the in-house AVC scheme”*

Mr W believes that the period of loss ends at June 2002 so Wesleyan should model the same contribution rate for both the "actual" and "notional" scenarios after this point. He says modelling a contribution rate of 8.655% for both the actual and notional scenarios after 2002, as opposed to 9% in the actual scenario, would result in the net added years increasing from 4 years and 63 days to 4 years 160 days. This in turn increases the loss by £13,375.

However, excluding these additional added years from the calculation (the years the 0.345% secured) would leave Mr W with a benefit equivalent of over 40 years’ service, a position that he couldn’t ever have found himself in, had he taken added years initially. And the fact that Mr W has taken action to mitigate his loss by contracting to buy added years from 2002, needs to be taken into account. As I’ve said above, the 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 for the loss assessment period in this case is appropriate.

Mr W believes that Wesleyan’s methodology simply calculates the differential in the cost of deferring the purchase of added years. But I don’t think this is an unreasonable approach. I’m satisfied that this approach places Mr W in the position he’d be in now but for Wesleyan’s error. It’s ensuring he has a benefit equivalent of 11 years and 35 day added years. And that he has the benefit of any excess contributions.

I appreciate that the value of the added years the extra 0.345% contributions secured exceeds the value of those contributions. But giving Mr W the value of the added years puts him in a better position than he would’ve been in, had he not taken the FSAVC plans. Mr W doesn’t agree with this approach. He believes by doing this, Wesleyan is using the value of his own contributions in the purchase of added years to offset the loss caused by the advice to purchase the FSAVC. But the methodology he’s proposed would mean that he exceeded the number of added years he would’ve been permitted to purchase, had he joined the added years arrangement in 1992. I note from the submissions provided that Mr W’s actuaries do acknowledge that this approach is generous and that other approaches might be reasonable.

To conclude, as I've said my aim is for Mr W, as far as possible, to be put in the position he would be in now but for the business's error. It's difficult to do this where it's no longer possible to secure the missing added years within the NHS Pension Scheme. And I do acknowledge that there may be alternative ways to calculate the redress but I don't think Wesleyan's method is unfair or means that Mr W has lost out as a result of the advice he received. So I'm currently minded to say that Wesleyan's calculation methodology is fair. However, given the time since the calculation was completed, and upon receiving confirmation of Mr W's acceptance, I would expect Wesleyan to rerun the loss assessment, using the most recent financial assumptions at the date of my final decision.

Responses to my provisional decision

Since issuing my provisional findings, both parties have provided further arguments and it's come to light that Mr W has taken the benefits of his FSAVC plans. In doing so, he opted to take an annuity and utilised the GAR.

Having considered the further submissions, I wrote to both parties to explain that I was minded to uphold the complaint in part. My letter explained that while I remained of the view that the calculation methodology Wesleyan had used wasn't unfair in terms of the added years, I thought Wesleyan needed to do more in terms of the excess contributions. Initially I thought that a charges only calculation should be run to compare the difference between the charges of the FSAVC and the in-house AVC. But after considering the comments provided, I issued a further letter, on 13 January 2022, explaining the revised redress. Any additional arguments that didn't relate to the excess contributions have been summarised below under 'final submissions' and, where relevant, have been addressed in my findings.

Letter dated 13 January 2022 confirming updated redress

"I've now had the opportunity to consider the additional arguments and I've revisited what I consider to be fair redress in the circumstances of this complaint. I remain of the view that Mr W's complaint should be partially upheld but my thoughts around how matters should be put right - in terms of the excess contributions - have changed slightly from the position set out in my above mentioned letter. So I'm writing to set these out before issuing my final decision on this matter.

I've firstly considered Wesleyan's comments regarding whether Mr W would have had the "headroom" to make additional contributions to the in-house AVC if he'd also contracted to buy the maximum number of added years.

In my previous letter I said that I thought Mr W could have contributed a maximum of 9% of his salary to both in the in-house AVC and added years arrangements. Wesleyan doesn't believe this is necessarily the case. It's confirmed that Mr W would've been restricted under the in-house AVC arrangement to contributions of 8%. It's explained that normally the cap is more like 2% or 3% but as Mr W joined the scheme relatively late, he had a high cap. However, given there were restrictions on the added years maximum service which were designed to avoid a member exceeding Inland Revenue limits, Wesleyan considers it very unlikely that an individual would have been permitted to contribute at the maximum level to both added years and the in-house AVC. So, it considers that a charges only calculation on the excess contributions would overstate redress. As such, Wesleyan's standard approach is not to assess a charges only loss on excess contributions that could not have been directed to added years.

I appreciate what Wesleyan is saying but I don't think it's done enough here to show that Mr W definitely couldn't have directed these excess contributions to the in-house AVC. We know that he could have contributed up to 8% to the in-house AVC. But this figure was *based on Mr W not having bought the maximum number of added years. Wesleyan has therefore concluded that this limit would have been reduced to zero, meaning he couldn't have directed anything to the in-house AVC. This may well have been the case but Wesleyan has made an assumption here, it's not been able to provide evidence to support this. So, I don't know for sure that Mr W couldn't have redirected these contributions and for this reason, I'm still minded to say that I think on balance Mr W had leeway to contribute up to 9% to both arrangements.*

I said in my letter that a charges only calculation would be an appropriate way to deal with the over contributions that Mr W has paid to his FSAVC plans as this would be in line with the FSAVC guidance. However, having reconsidered matters, I don't think strictly applying the guidance in the case of Mr W's complaint is appropriate here. The guidance provides exactly that, guidance; it doesn't set rules that must be applied in all circumstances and so where appropriate, the guidance can be departed from.

In the case of Mr W, he's taken his benefits and has benefitted from the GAR that was attached to his plans. So rather than calculating the difference in the charges between the FSAVC and the in-house AVC, I think instead a fairer and more accurate way to determine any loss Mr W has suffered by paying these excess contributions to the FSAVC plans, would be to compare the value of FSAVC plans with the notional value of the in-house AVC plan.

I did state in my previous letter that I thought Wesleyan could complete a calculation of this nature if it wished to consider whether Mr W has suffered a loss. However, I was previously of the view that if any loss was identified, then a charges only calculation would be required. However, as explained above, having thought about matters again, I don't think this second calculation – on a charges only basis – is necessary as it has the potential to place Mr W in a better position if the difference between the charges is greater than any loss identified when comparing the fund values. So if a loss is identified when comparing the FSAVC fund value with the notional value of the in-house AVC, then Mr W should receive redress based on the loss identified at this stage.

Therefore, I'm minded to ask Wesleyan to run calculation comparing the value of the over contributions in the FSAVC plan (including any uplift provided by the GAR) and the notional value of the over contributions, had they been paid to the in house AVC scheme. This calculation should be run as at the date Mr W took his benefits and any loss identified should be bought up to date using 8% per year simple interest.

<u>What if a notional value can't be obtained for the in-house AVC scheme?</u>

Wesleyan thinks it's unlikely it will be able to obtain a notional value for the in-house AVC option. However, it doesn't appear that it requested this information as yet. So this should be done. If it can show that it's not been able to obtain a notional value then an appropriate benchmark, based on Mr W's attitude to risk, should be used to model how the in-house AVC would have performed.

In the case of Mr W, both Wesleyan and Mr W are satisfied that he would have bought added years instead of directing all of his contributions to the in-house AVC plan. This suggests that he's a more cautious investor when it comes to his pension arrangements. So I think the calculation should be based on a 50/50 benchmark (50% FTSE UK Private Investors Income Total Return Index and 50% average rate from fixed rate bonds).

<u>What about the excess contributions Mr W has paid to the added years arrangement?</u>

I also said in my previous letter that a charges calculation should be run on the 0.345% extra Mr W has been paying for added years since 2002. However, this was an error. The way Wesleyan has already dealt with these contributions in its calculation is appropriate. So, other than to bring the loss on these over contributions up to date when it reruns its loss assessment using bank base rate, it's not necessary for Wesleyan to take any further action with regards to these excess contributions.

I hope the above clarifies my position with regards to the additional contributions. Both parties have raised additional points in response to my provisional decision and previous side letter and I'll be addressing these additional points in my final decisions."

Mr W's final submissions

Although Mr W didn't have anything further to add in respect of the updated redress for the excess contributions, he has previously provided additional points for consideration on other aspects of the complaint. In summary he's said that:

<u>The GAR</u>

The main argument by Wesleyan is that the use of a GAR is mentioned in the FSA's FSAVC Mis-Selling Review Guidance, and therefore can be used to mitigate its losses. But Mr W's representative doesn't believe Wesleyan has always included the GAR in its calculations and it's provided a statement from a former employee in support of this. Mr W is concerned that some Wesleyan customers are being treated differently from others.

Wesleyan has now said that if the GAR isn't utilised, it still uplifts the plan value to reflect the GAR when the investor takes the benefits. However, Mr W has questioned if this is the case where a plan has been moved to another provider.

Mr W remains of the view that including the GAR in the loss assessment is unfair. He's referenced what I've said in my provisional findings about the guidance allowing a GAR to be used to exclude a case from the loss assessment process, and so, a GAR can also be used in the loss assessment calculation. However, Mr W says that if this argument was valid then it would also be valid to argue that investment performance can also be used in the loss assessment calculation. However, while paragraph 6.25 of the guidance does explicitly allow actual investment performance to be used to exclude a case from loss assessment, paragraph 6.8 does not allow the use of actual investment returns in the final loss assessment. In other words, the final loss assessment cannot always use all factors that can be used to exclude a case under paragraph 6.25 of the guidance.

The provisional decision said that where the FSAVC plan has vested, the value placed on the plan for the purpose of an added years loss calculation would be the value of the annuity in payment and the loss assessment should compare the lost income stream from the occupational scheme to the lost income from the FSAVC. However, this is not true – paragraph 6.23.2 of the Guidance says that "*The fund that is to be used for actual loss cases is the fund immediately prior to the purchase of benefits at the date of crystallisation*". So for actual loss cases, where the FSAVC has vested, the actual amount of the annuity in payment or future income stream is not used in the loss assessment, and the value to be used is the fund value immediately prior to vesting.

<u>The maximum benefit that was able to be purchased</u>

Mr W said that once the 40 year ceiling had been reached, he would still have had headroom to make contributions to the in house AVC for the balance of any premiums that took him over the 40 year threshold. So a loss calculation for the balance of the FSAVC premium would trigger a charges only loss calculation for that balance premium.

<u>The contribution rates modelled</u>

The provisional decision said that if the "actual scenario" contribution rate was reduced from 9% to 8.655% then "*excluding these additional added years from the calculation (the years the 0.345% secured) would leave Mr W with a benefit equivalent of over 40 years' service*". This isn't true – the "*notional scenario*" would **still** be modelling the 11y 35d added years to give 40 years maximum total service (so still allowed), and the "*actual scenario*" would be modelling just 6y 240d added years (instead of 6y 337d), which is still well within the 40 years maximum service. In other words, both the actual and the notional scenarios would be within the 40 years maximum service limit.

The provisional decision does not address the fact that two different firms of consulting actuaries can make loss calculations using exactly the same data, and result in a £100,000+ difference in the compensation amount due to a customer.

Mr W is concerned that Wesleyan's actuary is adopting an alternative strategy, that it has confirmed it instigated and suggested to Wesleyan, potentially as a means of substantially mitigating Wesleyan's financial losses. Mr W believes that this patently goes against the industry standards of excellence and treating customers fairly.

Wesleyan's final submissions

<u>The GAR</u>

Wesleyan says that the value of the plan is uplifted even if the Investor doesn't utilise the GAR. But it considers that even without such uplift, it is reasonable to make allowance in the loss calculation of the GAR. This is because it believes that the value attributed to the plan should be the value of the future income stream available from the plan. It doesn't consider the fact that the form of the benefits from the GAR is different to that offered by the occupational scheme is a reason for the GAR to be ignored. If the issue is that the Investor should not be made to receive benefits in a different form to the Added Years then it may be worth noting that most investors use defined contribution pots to purchase a non increasing pension (irrespective of whether a GAR is in place) because the pricing for inflation linked annuities is typically unfavourable. Therefore, in practice, where a valuable GAR exists Wesleyan would normally expect an investor to take it.

Wesleyan also said that the form of benefits from an FSAVC is fundamentally different to that from a defined benefit scheme and if anything the GAR, which would result in annuitisation mirrors the pension from a defined benefit scheme far better than full commutation or income drawdown. Importantly, as previously noted, where the FSAVC plan has vested, the value placed on the plan for the purpose of an added years loss calculation would be the value of the annuity in payment (calculated using the FG17/9 assumptions). This means that for an investor who has a GAR, once this option has been taken up, and assuming they take it, the value of the FSAVC plan would reflect it automatically. Therefore, in order to avoid a substantial step change in the value of the FSAVC plan benefits at the point of vesting, it is appropriate that the GAR is allowed for in prospective loss calculations.

Wesleyan does not agree with the premise that if the Investor has transferred out their plan then no allowance should be made for the GAR. This is because any such transfer would have been implemented on the back of subsequent financial advice and a separate claim should be made to that advisor in relation to the loss of the value offered by the GAR. Wesleyan considers it unreasonable and inconsistent with the principles of the pensions review for Wesleyan to be required to compensate an investor for losses incurred as a result of financial advice from a different firm.

In terms of whether there is an inconsistency in the treatment of investors, Wesleyan does not agree with the comments made by Mr W's CMC. Its explained that there was a change in approach some time ago at which point it was determined that the GAR should be reflected in loss assessment. Subsequent to this decision, GARs have been reflected in all calculations in a consistent manner.

The excess contributions

Wesleyan is pleased with the conclusion I've reached that it is not appropriate to offer redress which would place the Investor in a better position than they would have been had they not taken the advice from Wesleyan.

Wesleyan noted that, in order to avoid infringement of overall Revenue limits on total pension, the NHS had a stated policy of imposing a restriction on the percentage of earnings allowed to be paid to the NHS money purchase AVC scheme. The caps applying reflected a member's service to date and their age as set out in the table below. Given these limits Wesleyan doesn't believe that it is strictly true to say that Mr W had leeway to contribute 9% of his salary to the AVC arrangements. He would have been restricted under the money purchase AVC arrangement to contributions of 8% (normally the cap is more like 2% or 3% but as Mr W joined the scheme relatively late he has a high cap). However, more importantly, given that the restrictions on the Added Years maximum service were, like the money purchase AVCs, designed to avoid a member exceeding Inland Revenue limits, it considers it very unlikely that an individual would have been permitted to contribute at the maximum level to both Added Years and money purchase AVCs. So it consider that the approach outlined would overstate redress. As such its standard approach is not to assess a charges only loss on excess contributions that could not have been directed to Added Years (although Wesleyan will do this if the ombudsman wants it to).

The calculation being bought up to date

Wesleyan also considers that it's unfair it's being asked to update the main part of the calculation (the Added Years part) for current market conditions as the redress will have increased since the original calculation date - in part due to the change to redress guidance introduced in March 2021. The ombudsman has effectively concluded that the approach Wesleyan used was correct and normally it wouldn't go back and recalculate loss unless there was an error. Here there is a judgement about the "excess contributions" but that doesn't affect the added years calculation, and it's not really an error in any event. So Wesleyan is concerned this will set a precedent and it doesn't want to be in a position where recalculation on a more generous basis is required just because the CMC has raised what turned out to be an invalid argument.

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.

Since issuing my provisional decision and side letters, both parties have provided additional submissions and having carefully considered these, I remain of the view that the complaint should be upheld in part. In reaching my decision, I've taken account of the relevant rules and guidance issued by the regulator.

It’s important to first explain that I will only be making a finding to matters that directly impact Mr W’s complaint. So I won’t be addressing any concerns raised by the parties regarding consumers that have transferred their FSAVC’s away from Wesleyan. Nor will I be making a final determination regarding the inclusion of the GAR on prospective loss cases.

<u>Use of GAR in calculating fund value for added years loss assessment</u>

In both my provisional decision and my first side letter, I explained why I didn’t think it was unreasonable for Wesleyan to include the value of the GAR when determining the fund value for an added years loss assessment. This was because Wesleyan had confirmed that the value of the plan is uplifted to reflect the value of the GAR, even if the pension is taken on a different basis.

Mr W is concerned that Wesleyan has not been applying this approach consistently. But Wesleyan has confirmed that this is a fairly recent change in policy and since the change, it’s been applying the approach consistently.

I can only comment on the cases I’ve seen and so far, the approach taken by Wesleyan has been consistent. But in any event, I have previously clarified that if the investor didn’t receive the uplifted value – or if they didn’t make use of the GAR – then I’d likely conclude that it wouldn’t be reasonable to take the value of the GAR into account when determining the fund value for an added years loss assessment. Wesleyan has provided further comments to dispute this stance but as I’ve said above, I don’t need to make a final determination on this particular aspect as Mr W has now taken his benefits and utilised the GAR. So any arguments raised regarding prospective loss cases, where the loss is expected to be suffered at some point in the future and the basis on which the benefits are taken is not yet known, are not relevant to Mr W’s case.

In the case of Mr W, it’s recently been confirmed that he’s taken his benefits. So, although my thoughts on the use of the GAR haven’t changed, I don’t need to make a finding on this.

Mr W has confirmed that when he took his benefits he took an annuity and made use of the GAR. So, in these circumstances, it’s appropriate that Wesleyan takes the value of the GAR into account when determining the value for loss assessment.

In terms of the GAR, what still remains in dispute is how the fund value for loss assessment is calculated. So I’ve considered this aspect further.

The FSAVC guidance states:

> *“6.23.2 The fund that is to be used for actual loss cases is the fund immediately prior to the purchase of benefits at the date of crystallisation and before any refund of surplus that may have been made to the investor”*

However, this isn’t how Wesleyan has calculated the fund value that it’s used in Mr W’s added years calculation. Wesleyan has explained that where the FSAVC plan has vested, as Mr W’s has, the value it places on the plan for the purpose of an added years loss calculation is the value of the annuity in payment (calculated using the FG17/9 assumptions).

I’ve thought carefully about whether what Wesleyan has done here is fair. In doing so, I’ve also taken account of FSAVC Review Bulletin 3. This was issued in January 2001 and provided additional *guidance* for defined benefit loss assessment cases. Of relevance here is that, after establishing the fund value for loss assessment, the guidance says that the calculation should follow the Pension Review Guidance. The bulletin doesn't specifically state that the fund value should be calculated as per the guidance in 6.23.2, although I think it could be argued that this is implied. However, this is only guidance, which a firm may opt not to follow if it doesn't consider it's appropriate in the circumstances of the complaint.

In this case, Mr W's case didn't fall within the review for which the guidance was produced. And I don't think that by following a different approach – the one set out in FG17/9 - Wesleyan is being unfair. It's essentially comparing the value of the pension Mr W is receiving against what he would have received from the added years arrangement. This is how a fund value for loss assessment would be determined for a vested personal pension plan when it's been determined that the consumer has lost out on defined benefits within an occupational pension scheme (OPS). I don't think it's unreasonable to value the annuity provided by the FSAVC in the same way.

I appreciate that the Actuaries representing the parties involved in this complaint have reached substantially different amounts in terms of the loss suffered by Mr W. This is in the main due the inclusion of the GAR in Wesleyan's calculation. As explained above, Mr W has benefited from the GAR and so it's appropriate that this is taken into consideration when calculating any loss he may have suffered.

<u>Calculation methodology</u>

Mr W says that Wesleyan's methodology simply calculates the difference in the cost of deferring the purchase of added years. And he believes Wesleyan is offsetting losses by gains, outside the loss calculation period, to reduce its liability.

The method Mr W has suggested, essentially disregards the added years bought by the 0.345% excess contributions Mr W paid to the added years arrangement. But Mr W will receive the benefit equivalent 6 years and 337 days from his OPS when he takes his OPS benefits, if he hasn't done so already. So these added years need to be factored into the redress correctly. Mr W's method suggests modelling a lower contribution rate in the 'actual' scenario than the rate Mr W actually paid, 8.655% instead of the 9%. I appreciate that technically anything after 2002 is outside of the period for loss assessment if you apply the FSAVC guidance. But I explained in my provisional findings why I didn't think it was appropriate to apply the guidance in Mr W's case and my thoughts on that haven't changed.

Mr W says that his method doesn't mean that his benefits will exceed the 40 year service cap that he has on his OPS scheme. But I think it does. The shortfall he has, or had, in his OPS was 11 years 35 days. He's due to receive 6 years 337 days as a result of the added years he purchased. This amount won't change, even if they are excluded from the calculation. So, Mr W only requires a further 4 years and 63 days to top this up to 11 years 35 days. I accept that if Mr W's method is used then the *calculation* won't necessarily show that he has exceeded the 40 year service cap. But as he will receive this extra service bought by the 0.345%, in reality – the actual scenario - he will exceed it by 97 days.

I remain of the view that calculating the difference between the cost of Mr W buying added years in 1992 and when he actually bought them in 2002 is not unreasonable. By refunding the excess contributions Mr W paid to the added years arrangement, Mr W hasn't paid any more than he would have paid for the same number of added years in 1992.

I do acknowledge that not all actuaries use the same methodology. So there is likely to be variations in the loss identified by these different methods. Mr W's actuary has acknowledged that its approach is generous. However, this doesn't mean that Wesleyan's methodology is unfair or that Wesleyan isn't treating customers unfairly. Wesleyan is required to put Mr W back in the position he'd be in now but for the unsuitable advice and I'm satisfied that the methodology it's used in its calculation does this. It's ensuring Mr W has a benefit equivalent of 11 years and 35 days added years and that he hasn't paid more to have this. So I'm not asking Wesleyan to do any more in this regard.

Excess contributions and the headroom check

In my provisional decision I set out how I thought Wesleyan should treat the excess contributions Mr W had paid to both the FSAVC plan and to the added years arrangement. Both parties subsequently provided further submissions regarding this so I reconsidered this aspect, in light of the new submissions. I set out a revised calculation method for the excess contributions in my letter dated 13 January 2022.

Neither party have disagreed with the methodology so I see no reason to depart from what was set out in my letter. Wesleyan has raised concerns that Mr W may not have had the headroom to make additional contributions to the in-house AVC. But as explained in my letter, I don't think it's done enough to show that he definitely couldn't have done. So I remain of the view that a calculation should be completed.

In summary, in terms of the excess contributions I think Wesleyan should run a calculation comparing the value of the excess contributions in the FSAVC plan (including any uplift provided by the GAR) with the notional value of the excess contributions, had they been paid to the in house AVC scheme. This calculation should be run as at the date Mr W took his benefits and any loss identified should be bought up to date using 8% per year simple interest.

If Wesleyan can demonstrate that it's not possible to obtain a notional value then an appropriate benchmark, based on Mr W' attitude to risk – presumed to be cautious to low risk - should be used to model how the in-house AVC would have performed.

In term of the 0.345% extra Mr W has been paying for added years since 2002, I'm satisfied the way Wesleyan has already dealt with these contributions in its calculation is appropriate. So, other than to bring the loss on these over contributions up to date using bank base rate, it's not necessary for Wesleyan to take any further action with regards to these excess contributions.

Bringing the calculation up to date

In my provisional decision and subsequent letters I said that I was minded to ask Wesleyan to bring the added years calculation up to date, using the most recent assumptions. Wesleyan thinks this is unfair as the redress will have increased since the original calculation date. And it doesn't want to be a in a position where recalculation is required where the CMC has raised an invalid argument.

I think it's important to explain that, even if represented by a CMC, all consumers have the right to refer their complaint to this service, this includes where a complaint has been upheld but there are concerns about the way in which a firm has proposed to settle matters. In this case, while I've not upheld the concerns the Mr W and his CMC raised about the added years calculation, I don't think it means that Mr W should be penalised for querying why Wesleyan's redress differed so much to his own actuary's calculations. Wesleyan's Actuary has explained that it only became aware that some of the FSAVC with profits plans had a GAR in mid-2017 and so it was only after this point that GAR were included in its calculations. So, given the substantial change in calculations issued pre and post this point, I don't think it was unreasonable for Mr W – via his CMC - to raise these concerns.

The pension review guidance states that calculations are only valid for three months and generally when an offer hasn't been accepted in this time frame, the business has always been required to update its calculation to reflect the most recent FCA assumptions. In the past, my understanding is that this could have gone either way, in some instances it would reduce the redress due; it didn't always mean the redress amount would increase.

However, the FCA updated its redress assumptions in March 2021 to take account of changes in the way the Retail Prices Index inflation will be calculated after 2030 and the impact this will have on the Consumer Prices Index inflation assumptions. So Wesleyan is concerned that recalculation using the latest assumptions will be more generous to Mr W. However, it doesn't feel fair not to update the calculation where we know Mr W is likely to be worse off as a result. Ultimately, Wesleyan has admitted that it mis-sold Mr W's FSAVC plans and so it needs to ensure that Mr W is not worse off as a result of its negligent advice.

I'm conscious that Wesleyan, in order to limit its liability for any loss Mr W had suffered, could have arranged to make a payment to him on completion of its calculation; it didn't have to wait until the complaint with our service had been resolved before doing so. Any payments made would have been taken into consideration when ultimately deciding what Wesleyan needs to do to put matters right.

Putting things right

Although I've determined that Wesleyan's added years calculation methodology is fair, given the time since the calculation was completed, and upon receiving confirmation of Mr W's acceptance, I direct Wesleyan to rerun the loss assessment, using the most recent financial assumptions, at the date of my final decision.

The compensation amount must where possible be paid to Mr W within 90 days of the date Wesleyan 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 Wesleyan to pay Mr W.

I also direct Wesleyan to complete a calculation, comparing the value of the excess contributions Mr W paid to his FSAVCs, with the notional value of these contributions if they'd been paid to the in-house AVC arrangement. This calculation should be run at the date Mr W took his FSAVC plan benefits. If the value of the in-house AVC is greater, Mr W should be compensated according, with any loss being bought up to date using 8% simple interest to the date of settlement. If a notional value can't be obtained, Wesleyan should use the appropriate benchmark, as explained above.

Wesleyan has already calculated the value of the excess contributions Mr W paid to his added years arrangement. This value should be bought up to date using bank base rate.

My final decision

I uphold this complaint in part and ask Wesleyan Assurance Society to pay Mr W the compensation as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 9 March 2022.

Lorna Goulding
Ombudsman