DRN-3558645

The complaint

Ms K has complained to Wesleyan Assurance Society (Wesleyan) about the sale of her freestanding additional contribution (FSAVC) plan. Wesleyan has upheld the complaint but Ms K doesn't agree with the redress methodology it's used to calculate the loss she's suffered as a result of the FSAVC plan being mis-sold.

Ms K is being represented in her complaint by a claims management company. And both Ms K's representative and Wesleyan have actuaries assisting them with this matter.

What happened

In 1997, Ms K was advised by Wesleyan to take out a FSAVC plan, making contributions of £150 per month. At the time, Ms K was a member of her employer's occupational pension scheme (OPS).

In 2019, Ms K's representative complained to Wesleyan about the sale of the FSAVC plan. Wesleyan upheld the complaint as it wasn't satisfied that the adviser explained the in-house options Ms K had for topping up her pension through her OPS. And although Ms K had indicated in her complaint letter that she would have bought added years, Wesleyan said that the paperwork from the time of the sale indicated that Ms K wanted to retire at the age of 57. And so it said it would be completing a calculation on a charges only basis as it was satisfied that Ms K would have gone into the in-house additional voluntary contribution (AVC) scheme and not the added years arrangement. Wesleyan instructed its actuary to carry-out the calculation on a charges only basis.

In March 2020, Wesleyan wrote to Ms K's representative. It said that having completed its review and calculations it had determined that Ms K had not suffered a loss as a result of the advice she received to take the FSAVC instead of being a member of the in-house AVC scheme between July 1997 and July 2013. Its letter said:

> *"At the time of the advice to effect (FSAVC plan) you were a member of the NHS Pension Scheme. A gross level monthly contribution of £150.00 was paid from July 1997 to July 2013.*
>
> *The contributions were invested in the With Profit fund and the Plan was written to run to age 55. You retired from the Scheme on 15 March 2017 aged 65. You have yet to vest your FSAVC Plan.*
>
> *The value of the charges is calculated by accumulation of the fund with zero investment charges less the value of the funds accumulated subject to the individual Plan charges. For the purposes of comparison, the investment return used is the CAPS mixed with property fund (Annual) until 1 January 2005 and thereafter the FTSE UK Private Investor Growth Total Return Index.*
>
> *On this basis, up to 1 January 2020, the value of the investment charges incurred within the FSAVC Plans were higher than those under the AVC option by **£10,136.52.***

Your Plan benefited from a valuable Guaranteed Annuity Option (GAO) which provided for a much-enhanced annuity at retirement by comparison with a competitive annuity expected to be available in the annuity market. The enhancement in value due to the GAO is included in our loss assessment. The GAO valuation is based on the FCA calculation methodology for defined benefits, assuming retirement at age 67 (your age at date of calculation) and is carried out at the appropriate FCA quarter date of 1 January 2020. Under the GAO, at age 67, there is a guarantee of £7.593 per £100.00 (of the fund value) payable monthly in advance guaranteed 5 years and with no increases. The Plan had a fund value as at 1 January 2020 of £111,341.05. To use the funds to purchase an equivalent annuity based on the FCA calculation methodology for defined benefits would require an amount now of £154,441.11, a notional fund enhancement of £43,100.06.

The adjustment for the GAO described above is restricted to 75% of the fund, the balance being the maximum 25% of the fund which may be taken as tax free cash. It is assumed that you are in good health and do not have a health impairment that would qualify for an annuity on enhanced terms.

Comparing the charges redress of £10,136.52. with the notional fund enhancement of £43,100.06, due to the GAO, there is a gain of £32,963.54.

Therefore, there is no loss and no redress due."

Ms K's representative had concerns about Wesleyan's methodology. It didn't think the approach Wesleyan was taking by including the value of the GAO in its charges only calculation was fair. So it referred the matter to our service for consideration.

One of our investigators reviewed matters and didn't uphold the complaint. In summary, our investigator said:

"…the overarching dispute is about the interpretation of the regulator's guidance for assessing losses related to FSAVCs. Specifically, in this case, where a 'cost only' assessment has been carried out, whether taking account of the guaranteed annuity rate is appropriate.

The Financial Service Authority's 'FSAVC Review Model Guidance' has been referred to by both parties.

In an email with comments from [Ms K's actuary], which related to another case, I note the points raised about tables in page 62, 63 and 65 of the model guidance. For clarity there are four tables through pages 62 to 65.

The relevant table in this case appears to relate to charges only:

> *6.27.4 Where there are no employer matching contributions or other subsidised benefits available if the investor had contributed to the in-house AVC arrangement then the loss assessment should be carried out following the principle in the following table.*
>
> *Table 4 – Actual and prospective loss assessment*
>
> *The loss is:*
>
> *• The value of the charges incurred on the FSAVC fund up to the Calculation Date allowing for accumulation at the benchmark index; less*

• The value of the charges that would have been incurred by the investor on the inhouse AVC arrangement up to the Calculation Date allowing for accumulation at the benchmark index.

6.27.5 Where the 'loss' calculated as above is negative, or positive only due to an immaterial difference in charges, then firms may conclude that no loss has been suffered.

Ms K has said that with no reference to guarantees within this table, it's incorrect to take into account a guaranteed annuity rate.

Looking at the above guidance in isolation would indicate that a guarantee wouldn't be taken into account. But I think it needs to be considered in the context of other guidance.

Prior to the four tables, used for different categories of investors, the guidance stated:

'6.24.2 These tables are for guidance only. They may not cover all situations and should not be taken to exclude other elements that may be appropriate in particular circumstances.'

'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 inhouse 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.'

Firstly, 6.24.2 appears to suggest a degree or flexibility in carrying out loss assessments. It allows for the consideration of 'elements that may be appropriate in particular circumstances'. Arguably, a valuable guaranteed annuity, which when lost are common causes for complaint at this service, could be considered appropriate.

Secondly, 6.25 and 6.25.1 need to be considered in combination. 6.25 refers to all of the categories of investors including those which would've benefited from 'lower level or charges in the in-house AVC arrangement'. Such an investor would typically expect a loss assessment under 'charges only' (table 4).
It goes on to further clarify in 6.25.1, that whilst for investors who lost out on employer matching contributions or other subsidised benefits, there was an expectation a loss occurred. It did allow a business to take into account 'some kind of value guarantee of benefits in retirement', which I think a guaranteed annuity rate would qualify as. I don't interpret 6.25.1 as meaning the value of a guarantee can only be taken into account for those who lost out on matching employer contributions or other subsidised benefits. I think the initial comment was simply highlighting the high probability of a loss in those particular investor categories.

I interpret the guidance as allowing for guarantees which might be taken into account across various investor categories. I'm not persuaded that whilst very detailed, the guidance excludes the consideration of guaranteed benefits for a 'charges only' calculation when the above guidance is taken into account.

Furthermore, on a fair and reasonable basis, I think it is appropriate to take into account the value of a guaranteed annuity. Whilst Ms K now has wider options for taking pension benefits, compared to the rules when the FSAVC was established, I don't think it's fair to ignore the value of the benefits which are reasonably attributable to a guaranteed annuity. For the reasons given, I think Wesleyan Assurance Society's loss assess was carried out on a fair and reasonable basis."

Ms K's representative didn't accept the investigator's opinion. In summary it said that the loss calculation is a "charges only" calculation which does not involve a final value. The GAO should never be used in a charges only calculation as it adds an element of value which is inappropriate. It believes Wesleyan is mixing the two types of loss calculation (added years and charges only) together to work in its favour. By including the GAO it ceases to be a 'charges only ' loss calculation. Ms K's representative has also said that when it questioned Wesleyan regarding its stance on another case where it had initially included the value of the GAO, it subsequently reran the calculation without it and a loss of over £18,000 was determined. It believes this evidences doubt as the to method Wesleyan is adopting.

The actuaries assisting Ms K's representative have said that it's clear from the FSAVC review model guidance that GAO's on FSAVCs should not be included in charges cases. The calculation tables on pages 62, 63 & 65 of the guidance only include the following wording for the FSAVC side of the calculation "the value of the charges incurred on the FSAVC fund up to the calculation date allowing for accumulation at the benchmark index" i.e., only the charges in the FSAVC should be modelled". And it would seem unfair to a consumer that, due to the vagaries of which actuarial firm makes the calculation, this determines a large difference in the outcome.

Ms K's actuaries have also said that if a GAO were to be allowed, the type of annuity would accordingly need to match the benefits of the occupational pension with the NHS. The GAO that Wesleyan uses in its calculation is a single life non escalating, whereas the alternative NHS benefits for an annuity are CPI linked 50% spouse survivor. Not only is the GAO use inappropriate but plays no part in a "charges only" loss calculation; if it were a true comparison of value, a "charges only" calculation does not take account of value.

As no agreement could be reached on this matter, the complaint has been passed to me to decide.

<u>My provisional findings</u>

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

"*Wesleyan has upheld this complaint and it considers Ms K would have joined her in-house AVC arrangement had the FSAVC plan not been mis-sold. Ms K initially complained that she would have bought added years but she no longer seems to be arguing this. And she hasn't disputed the basis on which Wesleyan has upheld her complaint. So, all that's left for me to decide is how Wesleyan needs to put matters right. However, for completeness, I should add that I agree that, given what was noted in the sales paperwork about Ms K's desire to retire at 57, the in-house AVC does seem to have been a more appropriate option for her than added years.*

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 Ms K'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 and it's determined that they should've been advised to take 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.

While acknowledging that the model guidance is useful, it's simply that, guidance. It doesn't set out rules that all businesses must follow. And, in some circumstances, it's not appropriate to apply the guidance if it will result in unfair redress for a consumer that has been mis-sold an FSAVC plan.

Like our investigator explained, I do think that the FSAVC review model guidance allows firms to consider whether no loss has been suffered by a consumer. And I also agree that one of the situations where it can do this is when the FSAVC has a GAO. I don't think there is much more I can add to what the investigator has said in this regard. However, I don't think it necessarily follows that it will always be fair for a firm to apply this approach just because an FSAVC plan has a GAO.

I think it's important to highlight that the pensions' environment has changed significantly since the guidance was published in May 2000. The options a consumer had when taking their benefits at that time were fairly limited. And I think it's likely that it would generally have been envisaged that the majority of consumers would take an annuity when they took the benefits of their FSAVC plans. So, in those circumstances, I don't think it would have necessarily been unreasonable to suggest that many consumers would have utilised their GAOs at retirement, had that been an option on their plan. So in those circumstances, it might not have been considered unreasonable for a firm to consider whether the inclusion of the GAO meant that the consumer may not have suffered a loss.

However, there have been several changes over the years to the rules for consumers accessing their pension via drawdown, along with major changes introduced in April 2015, widely known as pension freedoms. These changes have given consumers more flexibility in the way they can access their pension benefits. And these "freedoms" apply not only to the FSAVC plans but would also have been accessible under the in-house AVC arrangement. The result of this is that there has been a considerable decline in the number of consumers taking annuities.

I note that on another case we have considered here Wesleyan has said that where a valuable GAO exists, it would normally expect an investor to take it. I do accept that those that do opt to take an annuity, may well utilise any guarantees available on their plans because current annuity rates on the open market have dropped considerably. But ultimately these "freedoms" mean that not all consumers with FSAVCs are taking an annuity – and in turn they aren't utilising the GAOs - when they take their FSAVC benefits.

In the case of Ms K, the GAO adds an additional £43,100.06 to the value of the FSAVC. However, the GAO is only valuable if taken. If the consumer opts to take their benefits via any other means, the value of the GAO is irrelevant. Had Ms K been a member of her inhouse AVC, she would also have had the option to take her benefits flexibly – but, as at 1 January 2020, she would have paid £10,136.52 less in charges to the AVC. For this reason, I'm currently minded to say that, where the complaint has been upheld on the basis that the consumer would have opted to *contribute to the in-house AVC, it's not appropriate for Wesleyan to take account of the value the GAO adds to the plan.*

However, just because Ms K would have paid less in charges, it doesn't necessarily mean that she has suffered a loss as a result of taking the FSAVC. And I'm aware that Wesleyan has raised this issue as it considers its FSAVC funds have performed particularly well.

As I've said above, I'm satisfied the regulator's FSAVC review guidance allows a firm to consider if no loss has been suffered and one of the instances where it can do so "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." So, in my final decision I intend to direct Wesleyan to carry out a comparison between the FSAVC and the in-house AVC. If it can demonstrate that the FSAVC's performance has exceeded the in-house AVC by more than the higher charges Ms K has paid, then it may conclude that she has not suffered a loss as a result of taking the FSAVC. However, if a loss is identified Wesleyan should pay Ms K the value of the excess charges.

I'm aware that, despite several attempts, Wesleyan has been unable to obtain notional values from the in-house AVC scheme. This isn't surprising given that the firm operating the scheme has changed over the years. So I have set out below, in the putting things right section, details of the benchmark that Wesleyan should use to run the comparison.

<u>What if Ms K uses the GAO when she takes her benefits?</u>

As I understand it, Ms K is yet to take the benefits of her FSAVC plan. So I do accept that there is a possibility that when she comes to take her benefits, she may opt to take an annuity with Wesleyan and utilise the GAO. If Ms K has also received a payment to reflect the higher charges she has paid to the FSAVC arrangement, this could leave her in a better position than she would have been in, had she joined her in-house AVC. She will effectively have received a refund of the higher charges and she'll also be benefitting from the increased value the GAO adds to her FSAVC fund. In these circumstances, I don't think it would be unreasonable for Wesleyan to take account of any payment it makes now as a result to the higher charges when the benefits are taken, should Ms K use the GAO."

<u>Responses to my provisional findings</u>

Ms K's representative responded and said it had no further comments.

Wesleyan responded and said that, whilst it maintained the view that the guaranteed benefits provided by the FSAVC plan are valuable and should be included in the loss assessment, it accepted the redress approach put forward in the provisional decision.

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.

I explained in my provisional decision why I intended to uphold the complaint. I appreciate Wesleyan still considers the GAO is valuable and should be included. However, I remain of the view that it's not appropriate for it to be included in this type of calculation.

As both parties accepted my provisional findings, I see no reason to depart from these. So I've set out below what Wesleyan needs to do to put matters right.

Putting things right

As at the date of my final decision:

If Wesleyan wishes to consider whether no loss has been suffered, it should calculate a notional value for the in-house AVC scheme as if it had performed in line with the FTSE UK Private Investors Income Total Return Index for half of the investment, and for the other half, the average rate from fixed rate bonds index. I've chosen this benchmark because this would have achieved capital growth with a small risk to the capital. The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to her capital. The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It's a fair measure for someone who was prepared to take a small degree of risk to get a higher return.

So, the 50/50 combination would reasonably put Ms K into that position. It does not mean that Ms K would have invested 50% of her money in a fixed rate bond and 50% in some kind of index tracker investment. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Ms K could have obtained from investments suited to her objective and risk attitude.

Wesleyan should then compare the actual value of the FSAVC with this notional value. If the actual value exceeds the notional value no financial loss has been suffered and it need not take any further action.

The Financial Ombudsman Service uses benchmarks like this as a proxy for the typical growth that would have been achieved in investments that performed similarly to the benchmark. The aim of any benchmark used in this way is for the investment provider to achieve returns broadly in line with the benchmark, despite the charges that would ordinarily be incurred. For that reason, Wesleyan should not deduct charges when taking this particular step to calculate a notional value. This is consistent with the approach the Financial Ombudsman Service takes with such benchmarks.

If Wesleyan doesn't carry out the above comparison, or the comparison produces a loss, it must run a charges only calculation to establish the difference in charges between the FSAVC and in-house AVC. This should be run 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 a loss is identified Wesleyan should pay Ms K the value of the excess charges as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid in retirement. 25% of the loss would be tax-free and 75% would have been taxed according to her likely income tax rate in retirement – presumed to be 40%. So making a notional deduction of 30% overall from the loss adequately reflects this.

My final decision

For the reasons explained, I uphold this complaint and direct Wesleyan Assurance Society to complete the calculations as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms K to accept or reject my decision before 21 July 2022.

Lorna Goulding
Ombudsman