DRN-3559466

## The complaint

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

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

## What happened

In 1995, Ms C was advised by Wesleyan to take out a FSAVC plan, making gross contributions of £170.42 per month. At the time, Ms C was a member of her employer's occupational pension scheme (OPS). The paperwork completed at the time of the sale, indicated that Ms C intended to retire at the age of 55. In 1998, Ms C met with Wesleyan again and took out another FSAVC plan, paying gross contributions of £117.68 per month.

Ms C paid into both plans until April 2011. In June 2019 both plans were transferred to an existing SIPP that Ms C held with another provider.

In 2019, Ms C's representative complained to Wesleyan about the sale of the FSAVC plans. Wesleyan upheld the complaint as it wasn't satisfied the adviser explained the in-house options Ms C had for topping up her pension through her OPS. And although Ms C had said in her complaint letter that she would have bought added years, Wesleyan said that the paperwork from the time of the sale showed that Ms C wanted to retire at the age of 55. And so it said it would be completing a calculation on a 'charges only' basis, i.e. a comparison of charges between the FSAVC plan and the in-house additional voluntary contribution (AVC) plan, as it was satisfied Ms C would have gone into the in-house AVC scheme and not the added years arrangement.

Wesleyan instructed its actuaries to carry-out a calculation on a charges only basis. In its final response, Wesleyan only addressed the 1998 sale, however, the redress calculation incorporated the 1995 sale as well.

In September 2019, Wesleyan wrote to Ms C's representative. It said that having completed its review and calculations it had determined that Ms C had not suffered a loss as a result of the advice she received to take the FSAVCs instead of being a member of the in-house AVC scheme from March 1995 onwards. Its letter said:

> *"We have completed the calculation assuming the same level and incidence of contribution to the AVC arrangement available from the NHS Pension Scheme as was made to the FSAVC plans. Contributions were paid from March 1995 to April 2011 to [plan 1] and invested in a With Profits Fund. This Plan has an attaching Guaranteed Annuity Rate.*
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> *From April 1998 to April 2011 further contributions were paid into [plan 2] and invested in a United Linked Fund.*

*Both Plans were cancelled, and the fund values transferred to [new provider] in June 2019. This transfer is disregarded for the purposes of the loss assessment because the transfer was not advised by Wesleyan. That is, the above Plans are treated as having remained with Wesleyan after June 2019 and the values used are those that would have applied had the Plans continued in force.*

*The investment charges levied by the Scheme were obtained as were the investment charges applied to the FSAVC Plans. The comparison assumes that [Ms C] would have invested in the lower cost funds available from Equitable Life and allows for the investment charge differences up to 25 May 2020.*

*Both Plans were written to run to age 55. It is assumed that if the transfer had not occurred [Ms C] would have drawn the benefits from the [plan 1 & 2] at age 56 and would have taken 25% of the fund as tax free cash and the balance of the fund as an annuity on the guaranteed terms.*

*The calculations were carried out as at 1 July 2019. On this basis, up to 1 July 2019, the value of the investment charges incurred within the FSAVC Plans was higher than that under the AVC option by:*

*- £14,294.21 [plan 1] and*
*- £3,093.02 [plan 2].*

*After allowance for the effect of future investment charges up to 25 May 2020, the gross value of the difference in charges is:*

*- £14,986.59 [plan 1] and*
*- £3,192.40 [plan 2]*

*A total of* ***£18,178.99.***

*The Plan [plan 1] 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 fair value for the enhancement is found by applying the calculation methodology established by the Financial Conduct Authority (FCA) for defined benefits.*

*Under the GAO at age 56 there is a guarantee of £5.525 per £100.00 (of the fund value) payable monthly in advance guaranteed 5 years and with no increases. [Plan 1] had a fund value as at 1 July 2019 of £140,251.59. To use the funds to purchase an equivalent annuity based on the FCA calculation methodology for defined benefits, assuming retirement at age 56, would require an amount now of £195,204.83, a notional fund enhancement of £54,953.24.*

*Comparing the total charges loss of £18,178.99 with the notional fund enhancement of £54,953,24 due the GAO there is a gain of £36,774.25. As a result, no compensation is due as our calculations show that [Ms C ] has incurred no financial loss."*

Ms C's representative had concerns about the methodology so it challenged this with Wesleyan. In summary it said that the guidance states that GAO's on FSAVCs should not be included in charges only loss assessments. This is because the calculation tables on pages 62, 63 & 65 of the guidance only include the following wording for the FSAVC side of the loss 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."

Wesleyan responded to Ms C's representative. It said:

> *" …, we remain of the view that it is not inappropriate to allow for the value of a guaranteed annuity option in such calculations. The FSA document is clear that the tables given are for guidance only and may not cover every scenario, also that where an FSAVC plan offers a valuable guarantee it may be included and indeed may be the reason for a 'no loss' conclusion. This is explained in the following preceding paragraphs on pages 59 and 60 of the guidance; -*
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> *6.24.1 The tables below set out how loss should normally be calculated for prospective and actual loss cases. There are different tables for the various categories of investor.*
>
> *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. Worked examples of how to use them in practice are in Annex C.*
> *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.*
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> *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.*
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> *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.*
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> *We trust that you will now accept that the inclusion of the value of a guaranteed annuity where available within the plan is appropriate."*

As no agreement could be reached on this matter, the complaint was referred to our service for consideration. In her complaint form Ms C said that she would most likely not wish to take an annuity at retirement, and she believes the method of loss calculation puts her at a disadvantage by effectively forcing her to take an annuity at that time. She also said the GAO only applies to a single life and the use of a GAO is therefore unfair as she's married. And the use of a Guaranteed Annuity to reduce the calculated loss is inconsistent with the FSA's guidance.

No additional submissions have been made in respect of Ms C's complaint but on another case that this service has considered with similar circumstances, the actuaries assisting Ms C'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".* It has also said that it would seem unfair to a consumer that, the vagaries of which actuarial firm makes the calculation, determines a large difference in the outcome.

Ms C's actuaries have also said on another case 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 use is a single life non escalating, whereas the alternative NHS benefits for an annuity are CPI linked with a 50% spouse's pension. They say 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. Wesleyan has confirmed that, while it has based its calculation on a single life level annuity, it does offer other annuities and these are on an equivalent basis. It says that it based its calculation on the single life level annuity as this is what most of its consumers take when they opt to take an annuity through Wesleyan. But it has explained that if consumer wishes to take an annuity on a different basis, for example an increasing annuity with a 50% spouses' benefit, then this is possible.

Wesleyan has also explained that even without the inclusion of the GAO in the fund value, it still believes there is a possibly that its fund outperformed the in-house AVC as it performed considerably well. So it considers that it should still be able to apply clause 6.25 to consider whether a consumer has in fact not suffered a loss as a result of the advice to take a FSAVC.

<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 C would have joined her in-house AVC arrangement had the FSAVC plan not been mis-sold. Ms C 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, given what was noted in the sales paperwork about Ms C's desire to retire at 55, the in-house AVC does seem to have been a more appropriate option for her than added years.
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> 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 C's plan didn't fall within the review because the OPS didn't match or subsidise payments to its in-house AVC arrangement.
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> 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.
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> 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, particularly when a complaint has been made, 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. What I need to consider is what is fair in the circumstances of the complaint before me.

Use of the GAO in redress calculations

Having reviewed matters, I do think the guidance allows firms to consider whether no loss has been suffered by a consumer. And I also think that one of the situations where it can do this is when the FSAVC has a GAO. I say this because of clause 6.25 of the guidance mentioned above. This allows firms to consider whether in fact no loss has been suffered and an example it provides 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****.*"

I think the GAO would qualify as a ***"valuable guarantee of benefits in retirement"****.* However, I don't think it necessarily follows that it will always be fair for a firm to include its value just because an FSAVC plan has a GAO.

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 – at that time - that the majority of consumers would take an annuity when they took the benefits of their FSAVC plans. I don't think it would have necessarily been unreasonable to suggest that many consumers would have therefore utilised their GAOs at retirement where available. So in those circumstances, it might have been considered reasonable 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 as drawdown or lump sum options are more widely available.

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 those that 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 the changes to the pensions legislation 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 C, she has transferred her plans away from Wesleyan and so hasn't benefited from the GAO. I appreciate the advice given to Ms C to transfer away may not have been provided by Wesleyan, but I don't think that matters. Wesleyan has upheld the complaint on the basis that the FSAVC was mis-sold and Ms C would instead have joined the in-house AVC arrangement. If Ms C had been in the in-house AVC then she could also have transferred her plan to another provider; she would not have been restricted to buying an annuity with the in-house fund. For these reasons, I don't think it's appropriate for Wesleyan to take the value of the GAO into account when the complaint has been upheld on this basis.

Charges and performance

Had Ms C been a member of her in-house AVC, she would also have had the option to take her benefits flexibly – but, as at 28 August 2019, she would have paid £18,178.99 less in charges to the AVC.

However, just because Ms C 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 it's this point that Wesleyan has raised because it considers its fund has performed particular well.

The guidance above does allow 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."*

It's clear from the above that a firm can consider whether no loss has been suffered if a fund has performed well. So, in my final decision I intend to direct Wesleyan to carry out a comparison between the FSAVC and the in-house AVC and if can demonstrate that the FSAVC's performance has exceeded the in-house AVC by more than the higher charges Ms C 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 C the value of the excess charges she paid to the FSAVC plan, calculated in line with a standard charges only calculation.

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 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 Wesleyan should use to run the comparison."

Responses to my provisional findings

Ms C's representative has said that it has nothing further to add.

Wesleyan remains of the view that the guaranteed benefits provided by the plan are valuable. But it is pleased that it is able to make an initial assessment of whether there has been a loss. But as the plan has been transferred away from Wesleyan, it says the comparison with the "benchmarked value of FSAVC contributions" (at the relevant date) should be based on the actual value of the Wesleyan FSAVC plan as at the date of transfer. It says that this is a fair and reasonable comparison that ensures that any liability for underperformance against the benchmark following the investor's decision to transfer the plan elsewhere does not fall to Wesleyan.

**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 appreciate Wesleyan considers that the guaranteed benefits are valuable. But I remain of the view that it would be inappropriate to take the value of the GAO into account when completing this type of calculation. My reasons for this were set out in my provisional findings so I don't intend to repeat these here.

However, I do acknowledge that Ms C's plan has been transferred. I agree that, in these circumstances, it's appropriate for Wesleyan to complete the comparison of the FSAVC and the notional value of the in-house AVC on the date the plan was transferred. I think this is a fair comparison. If a loss is identified at this stage, Wesleyan should revert to the standard charges only calculation as set out in my provisional decision.

Ms C's representative has been notified of this change and hasn't provided any further comments. So I see no reasons to depart from this. I've therefore set out below what Wesleyan needs to do to put matters rights.

**Putting things right**

As at the date the FSAVC plan was transferred:

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 C 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. I direct Wesleyan Assurance Society to carry out calculations as above. If Ms C accepts the final decision, Wesleyan should add 8% simple per year on any loss from the date of my final decision to the date of settlement.

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

Lorna Goulding
**Ombudsman**