DRN-3559688

The complaint

Mr M complained to Wesleyan Assurance Society (Wesleyan) about the sale of three freestanding additional contribution (FSAVC) plans.

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

What happened

In 1997, following advice from Wesleyan, Mr M took out a FSAVC plan [plan 1], contributing £3,690.80 annually until 2006 when a final contribution of £2,628.86 was paid. At the time Mr M was a member of his employer's occupational pension scheme (OPS). Mr M took out a further plan [plan 2] in November 1998, making a single lump sum contribution of £2,628.86.

A further plan was taken out in 2001 [plan 3] but was subsequently cancelled in 2005 after a review was completed and it was determined that Mr M didn't have the headroom to make the additional contribution. Mr M received a refund of the single contribution he paid into plan 3 in 2005.

In 2019, Mr M's representative complained to Wesleyan about the sale of the FSAVC plans. Wesleyan explained that Mr M had received a refund in respect of plan 3 and it didn't consider the complaint about plans 1 & 2 as it thought it had been made too late under the rules that apply.

Mr M referred his complaint to our service where it was considered by one of our investigators. The investigator didn't think the complaint had been made too late under the relevant rules and so was satisfied it was one this service could consider. And having, reviewed the merits of the complaint, the investigator thought the complaint should be upheld. In summary the investigator said that, by Wesleyan's own admission, there was no evidence to show that Mr M was provided with a comparison of benefits between his OPS and the FSAVC plans, nor that he was informed of the difference in charges.

The investigator thought that if Mr M had been made aware, he would most likely have joined the in-house AVC arrangement. The investigator didn't think Mr M would have taken added years if he'd been told about them.

Mr M accepted the investigator's opinion and Wesleyan completed a loss assessment on a charges only basis.

Wesleyan wrote to Mr M's representative in October 2020. It said that, having completed its review and calculations, it had determined that Mr M had not suffered a loss as a result of the advice he received to take out the FSAVCs instead of being a member of the in-house AVC scheme. Its letter said:

> *"[plan 1] for annual contributions (gross) of £3,690.80 commencing in January 1997, reducing to an annual contribution (gross) of £2,628.86 from January 2006, which was the last payment. The contributions were invested in with profits funds*

A second [plan 2] was taken out in November 1998 and a single contribution (gross) of £2,382 was paid and invested in unit linked funds.

Both plans transferred out of Wesleyan Assurance Society on 11 July 2009. The advice to transfer was not provided by Wesleyan Financial Services.

Instead of paying contributions to the Plans, you could have directed them to the Scheme AVC arrangement. The Scheme offered members a choice of securing additional benefits on a money purchase basis and an added years basis. We have assessed your case assuming you would have made contributions to the NHS Pension Scheme 'money purchase' AVC.

Loss calculations have been performed based on a comparison of charges between the FSAVC Plans and the alternative in-house AVC option assuming that you had chosen to invest initially in the Equitable Life unit linked fund (this attracting lower charges than the available with profits fund).

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.

As the advice to transfer out of the Plans on 11 July 2009 was not provided by Wesleyan Financial Services loss has been assessed as if you had not transferred out. This means that a charges comparison has been carried out for the period from January 1997 to your Normal Retirement Date in the [OPS] (1 March 2020).

The calculation of loss is limited to the contributions paid whilst employed and a member of the relevant Scheme.

On this basis, at 1 March 2020, the value of the investment charges incurred within the two FSAVC Plans were higher than those under the [OPS] AVC option by ***£18,498.74.***

However, [plan 1] benefited from a valuable Guaranteed Annuity Option (GAO) which provided for an enhanced annuity at retirement by comparison with a competitive annuity expected to be available in the annuity market. Allowance is made in the loss assessment for the notional enhancement to the fund value due to this GAO.

Under the GAO at age 60 on 1 March 2020 there would have been a guaranteed annual pension of £7.016 per £100.00 (of the fund value) payable monthly in advance with a 5-year guarantee and with no increases. The notional value of Plan [plan 1] at 1 March 2020 has been calculated to be £84,641.29. To purchase an equivalent pension at this date as that available from the notional fund would have required an amount of £143,312.79 (this being calculated based on the FCA calculation methodology for defined benefits).
The notional fund enhancement at 1 March 2020 is therefore ***£58,671.50***
In calculating the notional fund enhancement, allowance has been made for 25% of the Plan to be taken in the form of a tax-free lump sum.

Comparing the charges loss of £18,498.74 with the notional fund enhancement of £58,671.50 due the GAO there is a gain of ***£40,172.76****.*

Therefore, there is no loss to you and no redress is due.”

Mr M's representative challenged Wesleyan about its approach but ultimately the matter remains unresolved so the complaint has been passed to me to decide.

In summary, Mr M's representative has said the value of the GAO should not be included in charges only calculations. In addition, it has queried the annual management charge used in the calculation – that being 1.5%. It says that FSAVC review bulletin 4 says that:

> *"The default assumption of 1.3% a year is likely to be appropriate for cases where the FSAVC was set up on a nil commission basis but it is likely to be inappropriate for cases where commission was taken. ... Where commission has been taken and annual management charge or RIY information is not available, it is reasonable for firms to assume that the charges borne by the investor for the purposes of loss assessment are 2.9% a year. ... Firms may use an alternative assumption if there is demonstrable evidence that the 2.9% a year assumption is inappropriate. For example, where a fee was paid by the investor in place of commission in return for a reduction in charges, then a lower figure, plus the amount of the fee, might be appropriate."*

The actuaries assisting Mr M's representative has said that, for FSAVC default charges, they model 1.3% pa if they know that the FSAVC was set up on a nil commission basis and 2.9% per annum otherwise, i.e. if they don't know the commission status or they don't know that commission was taken.

Wesleyan remains of the view that it's not inappropriate to include the value of the GAO in its los calculation.

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.

> "Both parties agree that Mr M would have joined his in-house AVC arrangement had his FSAVC plans not been mis-sold. So, all that's left for me to decide is what needs to be done to put matters right.
>
> Following concerns about mis-selling, the regulator at that time told businesses to carryout 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 M's plans 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.

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.

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.

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.

My understanding of the above is that 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.[my emphasis]"**

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 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 utilised their GAOs at retirement, had that been an option on their plan. And under these 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 Mr M, he has transferred his plans away from Wesleyan and so hasn't benefited from the GAO. I appreciate that the advice given to Mr M to transfer away may not have been provided by Wesleyan but I don't think that alters my decision. I say this because Wesleyan has upheld the complaint on the basis that the FSAVC was mis-sold and Mr M would instead have joined the in-house AVC arrangement. If Mr M had been in the in-house AVC then he could also have transferred his plan to another provider; he would not have been restricted to buying an annuity with the in-house fund. So, 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. Had Mr M been a member of his in-house AVC, he would also have had the option to take his benefits flexibly – but, as at 1 March 2020, he would have paid £18,498.74 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 Mr M would have paid less in charges, it doesn't necessarily mean that he 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 Mr M has paid, then it may conclude that he has not suffered a loss as a result of taking the FSAVC. However, if a loss is identified Wesleyan should pay Mr M 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.
Mr M's representative has also queried the rate of annual management charge that Wesleyan has used in its calculation. The guidance states the default is either 1.3% or 2.9% per annum, depending on whether commission was paid. However, it's only necessary to use the default if the actual charges are unknown. If Wesleyan can demonstrate that it's using the actual the annual management charge that applies to Mr M's plan, then it doesn't need to use the default. However, if it's unaware of what the actual charge is, then it should revert to the applicable default.

Responses to my provisional findings

Mr M'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.

In terms of the annual management charge that it's used in its calculation, it's explained that it's recently completed a piece of work looking at the reduction in yield for the fund Mr M is invested in. And it considers 1.5% to be fair.

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.

In terms of the annual management charge Wesleyan has used in the calculation, having considered what it's said, I'm satisfied that 1.5% is fair as it reflects the reduction in yield in the fund. And as explained in my provisional findings, I'm satisfied the default charge amounts Mr M's representative has referenced are only relevant if the business is unaware of the actual charge.

However, I do acknowledge that Mr M'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.

Mr M'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 Mr M transferred away from Wesleyan:

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 his 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 Mr M into that position. It does not mean that Mr M would have invested 50% of his 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 Mr M could have obtained from investments suited to his 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 Mr M 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 his likely income tax rate in retirement – presumed to be 40%. So making a notional deduction of 30% overall from the loss adequately reflects this.

My final decision

For the reasons explained, I uphold this complaint. I direct Wesleyan Assurance Society to carry out calculations as above. If Mr M 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 Mr M to accept or reject my decision before 21 July 2022.

Lorna Goulding
Ombudsman