DRN-3567581

The complaint

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

Mr R 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.

What happened

In September 1994, Mr R was advised by Wesleyan to start contributing to an FSAVC plan. At the time, Mr R was a member of his employer's OPS. The FSAVC plan commenced with Mr R making a monthly contribution of £200 (gross). The last contribution was paid to the FSAVC plan in March 2012 and Mr R left his employer's OPS in August the same year.
In 2018, Mr R complained to Wesleyan about the sale of the FSAVC plan. In summary, he complained that the FSAVC plan was not suitable for his needs as the full risks, implications, and alternatives in respect of the FSAVC plan were not fully and properly explained
Wesleyan reviewed the complaint. In its final response it explained that, having considered the sales paperwork and the information Mr R had provided in his FSAVC questionnaire, it wasn't satisfied that he'd been given adequate information during the sale. So it was upholding the complaint. And it said that it would be forwarding Mr R's file to its actuaries for a loss assessment to be completed on an added years basis.

A further letter was issued in 2019 after the loss assessment had been completed. The letter confirmed the following:

- The fund value as at the date of the calculation was £177,035.47. However, the FSAVC benefits from a valuable Guaranteed Annuity Rate (GAR). At age 62 there is a guarantee of £7.48 per £100.00 (of the fund value). To use the funds to purchase an equivalent annuity based on the FCA calculation methodology would require an amount now of £275,335.05. The calculation has been based on this higher fund value.
- The total contributions paid to the FSAVC plan represented 2.693% of Mr R's pensionable pay. At the time of advice, if Mr R had directed 2.693% to the added years arrangement, it would have secured 2 years and 327 days added years if payments had been maintained to age 60.
- Mr R only had headroom to buy 2 years and 261 days, which would have taken him to his maximum service of 40 years. This would have cost 2.523% of his pensionable pay. So in recognition of this, only 93.78% of the FSAVC fund value was being taken into account. But Mr R left his employer's OPS in 2012, which would have been 17 years into a 23 year added years contract. So the number of added years he would have secured would have been reduced to 2 years 27 days.
- Calculations completed as at 1 April 2019 determined that

The prospective value of the lost Added Years	£150,477.98
Less the value of the plan attributable to the liability period	£257,988.94

The value of the gain	£107,510.96

Mr R didn't agree with the methodology Wesleyan had used in its loss assessment so he referred the complaint to our service for review. Mr R said he had concerns about Wesleyan's use of the GAR in the loss assessment. He said the method of loss calculation put him at a disadvantage by effectively forcing him to take an annuity at retirement. In addition, he said the GAR was based on a single life annuity with no increases for inflation, whereas his added years pension offers a 50% spouse's pension and is index linked. So he said the comparison was flawed. Mr R said that he's unlikely to utilise the GAR when he takes his benefits and Wesleyan has recommended that he moves his FSAVC fund to a drawdown plan.

Both Mr R's representative and Wesleyan have previously provided submissions regarding the use the GAR on another case. But the arguments raised are also relevant to Mr R's case.

<u>Mr R's representative's comments regarding the GAR</u>

Wesleyan has been using a methodology of loss calculation that reduces the loss caused by mis-sold FSAVC's by a very substantial margin. Its actuaries are adopting this methodology and using Guaranteed Annuity Rates (GAR) in order to potentially deprive the consumers of compensation.

Regulatory Guidance states that the GAR should not be used in loss calculations in order to reduce the amount due to the customer. The only part of the regulator's "FSAVC Review Model Guidance" which allows for the inclusion of the value of a GAR, is when doing a loss test per paragraph 6.25. However, if the calculation under that paragraph produces a loss greater than zero, then the loss and redress has to be re-calculated using the Calculation Tables shown in paragraphs 6.26 and 6.27 of the guidance. Those tables effectively only allow the *charges* of the FSAVC policy to be included, and as well as for instance ignoring the actual performance of the FSAVC policy, they also ignore any value of a GAR in the FSAVC policy. There is an exception only for FSAVCs converted from personal pensions, where the values of the policies are brought into the calculations.

The FSAVC Review Bulletin 3 said "the redress calculation for augmentation should follow the full loss assessment calculation… mirroring that required for the Pensions Review" (i.e. the main Pension Review for Personal Pensions, not FSAVCs). And Mr R's CMC isn't aware of any Pension Review Guidance on the use of GARs in Personal Pension values.

<u>Wesleyan comments regarding the GAR</u>

Paragraph 6.25.1 of the FSAVC Review Model Guidance makes reference to the situation in which the FSAVC offers "some kind of valuable guarantee of benefits in retirement". Wesleyan considers that this would encompass a GAR. However, Wesleyan disagrees that such a guarantee should only be considered in carrying out the initial assessment of whether a loss calculation is required. Whilst benefit guarantees from the FSAVC are not referenced in paragraphs 6.26 and 6.27, Wesleyan doesn't read this as meaning that such guarantees should be excluded from the loss assessment. It thinks that such reference was omitted (perhaps because at the time the guidance was written such guarantees were not expected to have a material outcome on the loss calculation). This is supported by the following observations:

- Intuitively, if the existence of a guarantee can be used to exclude a case from the loss assessment process (under paragraph 6.25) then it is logical to expect that it would also be allowed for in the loss assessment calculation. Any inconsistency in this regard could result in the unfair treatment of one investor compared to another.

- 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, 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.
- Within paragraph 6.26 allowance is made in the loss calculation for any "additional subsidised benefits" that would have been provided in the occupational scheme AVC arrangement. Wesleyan considered that this would include guaranteed terms for annuity purchase (for example the option provided by some schemes to purchase scheme pension using an AVC pot, on fixed conversion terms – this having been relatively common in the past). Wesleyan considers that if allowance is being made for such guarantees in the valuation of the occupational scheme AVC then it would also be reasonable to make allowance for similar terms in the FSAVC.
- Overall, Wesleyan considers that applying an "objectively justifiable" test to the GAR scenario, it's clear that the GAR holds significant value for the Investor and to ignore it for the purpose of loss assessment would result in an outcome which is overly generous to the Investor and not representative of their actual loss. Another way of thinking of this about this is that the loss assessment should compare the lost income stream from the occupational scheme to the lost income from the FSAVC. If there is no GAR then using the fund value is a proxy for this income. However, where there is a GAR, using the fund value with no adjustment is not an appropriate way of valuing the future income from the FSAVC. And it's relevant to also acknowledge the fact that at Wesleyan, although GARs were originally based on nil increasing and nil spouse's benefit, from a treating customers fairly perspective, if any policyholder wants a different form of pension they will still get the value of the GAR as an uplift.

I issued a provisional decision rejecting the complaint on 31 March 2022. In summary, I said I intended to reject the complaint because:

- I didn't think the argument Mr R had made about the benefits of the FSAVC plan not being comparable with the added years arrangement was valid. I thought this because if the FSAVC is used to purchase an annuity, the GAR is available even if the annuity is taken on a different basis to the single life, level annuity Wesleyan has based its calculation on. So an investor could opt to take benefits similar to those that would have been received through the added years arrangement, had they been a member. As such, I thought it was appropriate to take the value of the GAR into account. If the GAR wasn't taken into account, there was a risk that the consumer could be placed in a better position at retirement if they received redress on the basis of the FSAVC fund value (without the GAR uplift) and then subsequently went on to utilise the GAR when they took their benefits.
- I'd thought about the fact that Mr R was considering transferring his FSAVC to a drawdown plan and so he thought the loss calculation put him at a disadvantage by effectively forcing him to take an annuity at retirement. But I was of the view that, had Mr R been a member of the added years arrangement through his employer's OPS, the options for what he could have done with his benefits at retirement are limited. I didn't think it would have been possible for him to transfer his added years to a drawdown plan or for him to have taken his benefits as a lump sum. So, as long as Mr R (and his financial adviser) were provided with enough information to make an informed choice about Mr R's options in retirement, including that the GAR wasn't just available on a single life basis, and could potentially be taken on a similar basis to the added years arrangement, I thought that it was fair for Wesleyan to include the

value of the GAR in the loss assessment calculation.
- I'd thought about whether the calculation should be rerun to bring it up to date and to base it on a GAR that more accurately reflected the benefits provided by the added years arrangement. But when the calculation was initially run it was determined that Mr R hadn't suffered a loss as a result of taking the FSAVC out; he had in fact made a considerable gain. So I said that I didn't intend to ask Wesleyan to take any further action.
- I also acknowledged that Mr R had paid more to his FSAVC than he would have needed to pay to the added years arrangement, had he joined it. So Wesleyan has only used 93.78% of the fund value in its calculations. I thought that Mr R might argue these additional contributions would have been directed to the in-house AVC, But I said didn't intend to ask Wesleyan to complete a charges only calculation because I'm conscious of the value the GAR adds to the fund, and so if Mr R opts to take an annuity, I thought this would place him in a better position than if he'd directed these contributions to the in house AVC arrangement.

After issuing my provisional decision, it came to light that Mr R had recently transferred his benefits to a drawdown plan, following advice he received from Wesleyan. And so, he did not receive the value of the GAR, despite it being included in Wesleyan's calculations. Having considered this new information, I updated my findings, upholding the complaint, in part. My updated findings are set out below:

"*Added years*

I've noted everything that Mr R's representative has said regarding the inclusion of the GAR but I remain of the view that it's not unreasonable for Wesleyan to include its value in its calculation.

The benefit the GAR provides is valuable and now it's been confirmed that a consumer can opt to take the GAR with a 50% spouse's pension, increasing in line with CPI/RPI, I'm satisfied that if a consumer wishes to secure a guaranteed income, providing a similar benefit to the added years arrangement, then this would be possible through the FSAVC.

I note what Mr R's representative has said about the GAR not producing a guaranteed pension, whereas the added years arrangement does. But I think it's important to point out that the GAR itself is guaranteed once the basis its being taken on, and at what age, has been determined.

What isn't guaranteed is the fund value that the GAR is being applied to. However, this issue isn't unique to this particular batch of complaints bought by X-Claims. All prospective loss case calculations for pension transfers that are completed in line with the regulator's FG17/9 guidance, such as FSAVC complaints where the consumer would have bought added years, have to use projections to determine the fund value at retirement. This is no different to what Wesleyan is doing here, before the GAR is being applied. So I don't think the approach taken here is unfair. I do agree that the GAR Wesleyan has been using in its calculations doesn't accurately reflect the benefits provided by the added years arrangement and I'm pleased it's said that, where necessary, it can base its calculations on a GAR that more closely matches the lost benefits. It's not clear at present what difference this will make to a loss calculation because the GAR is determined on the same actuarial basis as the one Wesleyan has already used in its calculations.

However, in the case of Mr R, I don't intend to ask Wesleyan to complete a recalculation in respect of the added years part of the complaint. This is because Mr

R has said that he didn't require an income from his FSAVC plan and he wanted to move it to a product where it wouldn't be subject to inheritance tax. I appreciate that Mr R didn't receive an uplift to reflect the value of the GAR when he transferred; he only received the actual fund value. But it wouldn't have been possible for Mr R to have moved his fund if he'd joined the added years arrangement. So it seems that Mr R has in fact benefited from the flexibility the plan has given him. And because he wasn't looking to replicate the benefits he'd lost by not being in the added years arrangement, I'm not minded to ask Wesleyan to recalculate.

I appreciate that the advice to transfer and give up his GAR was provided by Wesleyan. But that doesn't alter my decision. I don't think it can be argued that Mr R didn't know the GAR was valuable. I say this because the main point to his complaint has been that the GAR has inflated his fund value significantly. And just because someone has chosen to give up a GAR, it doesn't automatically follow that that advice was inappropriate. It has to be weighed up against, among other things, the consumer's objectives, capacity to give up the guaranteed income and their other pension provisions. It's not for me to comment on Wesleyan's advice in this regard. If Mr R has any concerns about this, that's a separate matter that he will need to raise with Wesleyan.

Therefore, I don't think Wesleyan needs to take any further action in respect of the added years side of the complaint.

<u>Excess contributions</u>

In my provisional decision I said Wesleyan didn't need to take any action regarding the excess contributions. But having reconsidered this position, taking account of the fact that Mr R has now moved his FSAVC to a SIPP, I do think Wesleyan needs to do more here, in order to provide Mr R with fair redress.

Mr R paid more to his FSAVC plan than he would have needed to pay towards the added years arrangement, had he been a member. And I'm of the opinion that these excess contributions would have been directed to the in-house AVC arrangement, had Mr R been suitably advised when he took out his FSAVC.

I've recently issued findings to both parties on other cases regarding consumers that would have chosen the in-house AVC option had the FSAVC not been mis-sold. In these findings I have set out in detail why I don't believe it's appropriate to include the value of the GAR in these calculations. This is also applicable to the excess contributions so I don't intend to repeat my reasoning here. However, Wesleyan has recently raised the point that it considers its FSAVC funds have performed particularly well and so it considers that some consumers may not have suffered a loss as a result of taking the FSAVC rather than the in-house AVC, despite paying higher charges to an FSAVC plan.

As explained in other correspondence, 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 – in respect of the excess contributions. If it can demonstrate that the FSAVC's performance has exceeded the in-house AVC by more than the higher charges Mr R has paid, then it may conclude that he has not suffered a loss as a result of paying the excess contributions to the FSAVC rather *than the in-house AVC. However, if a loss is identified Wesleyan should pay Mr R 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."

My correspondence went on to set out what Wesleyan needed to do to put matter rights. However, following additional submissions from both parties, I issued a further revision to this and addressed a number of new arguments. I've set this out below:

"Firstly, Mr R's representative says that it's unfair the decision allows Wesleyan to use the value of the GAR for cases where the FSAVC has been moved and there is no longer an opportunity to obtain an uplift. Instead it's suggested that Wesleyan could calculate a transfer value with the uplift, then apply an early penalty moving the fund. It believes this would be similar to how a with profits plan is treated when it's surrendered early. Wesleyan is calculating the value of the GAR but this is being retained and it believes provision will have been made to meet these long term policies with GAR liabilities. So allowing it to retain 100% of that provision is unfair. As both parties will be aware, it's not for me to tell Wesleyan how it should operate. I can only look at the complaint in front of me and make a decision on what I think needs to be done to put things right. Having said that, we do expect firms to take account of the decisions issued and learn from mistakes. So there are instances where a decision on individual case will lead to a firm making changes to its operation. But this service does not set policy which firms much follow.

In terms of Mr R's complaint, I've already explained why I think it's fair for the value of the GAR to be included in the calculation. There isn't much more I can say on this aspect. Mr R could have chosen to utilise the GAR and take a guaranteed income, similar to that provided by the added years arrangement. Instead he opted not to do this in order to meet his objectives.

Wesleyan may well have factored its GAR responsibilities into its future liabilities (or they may have been factored into the with profits fund Mr R was invested in). But this is no different to any other firm that offers a product with a GAR, where the plan holder chooses to give up those safe guarded benefits. The regulator hasn't set rules for firms requiring them to provide an increased transfer value to take account of the GAR value. Whereas with profits funds have specific rules regarding the distribution of funds and surrender values. So I won't be asking Wesleyan to make a payment to Mr R to reflect the fact that he hasn't utilised his GAR.

I previously said that I didn't intend to ask Wesleyan to rerun its calculation. This was because the original calculation had shown that Mr R had made a significant gain as a result of taking the FSAVC. So I didn't think changing the GAR within the calculation to one with a 50% spouses' benefit, increasing in line with RPI, would have ultimately made enough difference to turn this into a loss. However, Mr R has highlighted that since the calculation was run, he has taken the benefits of his FSAVC plan. And the initial calculation was based on a retirement age of 62 whereas he actually took his scheme benefits just before his 65 birthday. Although the initial calculation showed a significant gain, I don't know the impact these other factors will have.

So I intend to ask Wesleyan to rerun the calculation using the most recent financial *assumptions. And for the fund value to be based on the GAR for an annuity providing a 50% spouses benefit, increasing in line with RPI.*

I also intend to make a slight change to the in-house AVC side of the calculation. Wesleyan has sourced an NHS AVC booklet to support its view the scheme would have restricted contributions being made to the in-house AVC arrangement with Equitable Life if the member was already purchasing the maximum amount of added years. It therefore believes that there has been no loss associated with the contributions to the FSAVC plan in excess of the maximum that could have been directed to the added years arrangement.

I've reviewed the booklet provided and I agree that it seems likely that Mr R would have been impacted by these restrictions. The scheme booklet says that:

"INLAND REVENUE LIMITS

The main restrictions imposed on pension benefits by the Inland Revenue at normal retirement age are as follow:

1. your maximum total pensions – i.e. your pension from this employment and pensions from all other pension schemes except the State Scheme, together with the pension value of any cash lump sum taken – must not exceed two-thirds of your final earnings…

…The Inland Revenue also require that your total contributions to a pension scheme including additional voluntary contributions must not total more than 15% of your gross earnings in any year"

Given the above, although Mr R would have been within the 15% contribution limit, I think it's likely that, had he been a member of the added years arrangement, he would have been restricted on making further contributions to an AVC as he would have been expecting to receive 40 years' service – the equivalent of two thirds of his final earnings – from the NHS when he retired.
Wesleyan accepts that this limit is only relevant until the pension simplification rules were introduced. So after the 6 April 2006, any contributions paid to the FSAVC plan could have been directed to the in-house AVC scheme.

In view of the above, I intend to direct Wesleyan to compare only the FSAVC contributions paid after 6 April 2006 with the in-house AVC."

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having reconsidered matters, I'm satisfied that, for the reasons explained previously, the complaint should be partially upheld.

I acknowledge that Mr R's representative has concerns that a one size fits all approach to applying the value of the GAR is not treating customers fairly. And it's concerned that any protocol set by the Financial Ombudsman Service will be used in a broad brush way.

I can only comment on the complaint in front of me and as I've explained previously, it's not my role to set the rules or policy for Wesleyan. Wesleyan shouldn't be taking a one size fits all approach to this matter. It should consider whether the approach its taking is fair in each individual complaint. But in doing so, I would expect it to take account of previous decisions this service has issued.

Mr R's representative is still of the view that it's unfair to include the value of the GAR, particularly as Mr R has transferred his plan and hasn't received any form of uplift to his fund. But I don't think it's unfair for the value of the GAR to be included when Mr R has complained that he would have bought added years if the FSAVC plan hasn't been mis-sold. And before he made the decision to transfer his plan, he was aware that it contained a valuable GAR. But in order to meet his objectives, he opted not to take a guaranteed income. Although the advice to transfer was provided by Wesleyan, it's a separate issue to the sale of the FSAVC plan. So if Mr R has concerns about this particular advice, he'd need to raise that as a new complaint with Wesleyan.

I don't think the value should be included where it has been determined that Mr R would have opted to contribute any excess contributions to the in-house AVC had the FSAVC not been mis-sold. This is because the benefits that would have been available from the in-house AVC wouldn't have been limited to a guaranteed income; Mr R would have had more flexibility in the way the benefits could be taken.

I've set out below what I think Wesleyan needs to do to put matter rights.

Putting things right

<u>Added years</u>

As at the date of my final decision:

Wesleyan should rerun its calculation using the most recent financial assumptions. And the fund value should be based on the GAR for an annuity that provides a 50% spouses benefit and increases in line with RPI.

<u>Excess contributions paid after April 2006</u>

As at the date of 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 (in respect of the excess contributions) 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 the 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 R into that position. It does not mean that Mr R 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 R could have obtained from investments suited to his objective and risk attitude.

Wesleyan should then compare the actual value of the FSAVC (in respect of the excess contributions) 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 R 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 complete calculations as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr R to accept or reject my decision before 26 July 2022.

Lorna Goulding
Ombudsman