DRN-3571532

The complaint

Mr W complained about the advice he received from Wesleyan Assurance Society ("Wesleyan") to take out two free-standing additional voluntary contribution (FSAVC) plans. 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 W is being assisted with his complaint by a claims management company (CMC). And both Wesleyan and the CMC have actuaries working with them to resolve this matter.

What happened

In May 1993, Mr W was advised by Wesleyan to start contributing to an FSAVC plan.
At the time, Mr W was a member of his employer's OPS. The FSAVC plan commenced with him making a monthly contribution of £94.95 (gross). These ceased in November 1995 and re-started in June 1997 until October 2002. Another plan was taken out in June 1997, with gross level monthly contributions of £105.05. The last contribution was paid in November 2002.

In 2019, Mr W complained to Wesleyan about the sale of the FSAVC plans. In summary, he complained that they were not suitable for his needs and he should've been advised to purchase added years through his employer's OPS instead.

Wesleyan reviewed the complaint. In its final response it explained that, having considered the sales paperwork and the information Mr W 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 W's file to its actuaries for a loss assessment to be completed on an added years basis.

A further letter was issued in 2020 after the loss assessment had been completed. The letter confirmed the following:

- Mr W had a break in NHS service for longer than a year, so Wesleyan had assumed that a first added years contract would've been terminated (August 1993 to October 1995) and a second contract would have started in August 1997.

- Over the first period of liability (February 1993 to October 1995), the total contributions paid to the FSAVC plan represented 5.12% of pensionable pay. The maximum allowed under the scheme was 40 years pensionable service, so Mr W had 'headroom' of 5 years 175 days, which he could've bought at 3.94% of pensionable salary. However, contributions ceased in October 1995 rather than the full term of 29 years, this would've been reduced the added years purchased to 157 days.

- Over the second period of liability (August 1997 to November 2002), the overall contributions paid to both plans were the equivalent of 5.24% of pensionable pay. This would've purchased 6 years 62 days. However, as contributions were only paid to the two plans until October and November 2002 respectively, rather than the full 25 year contract term for added years, this would have further reduced the added years to 1 year 116 days. So the total added years purchased would have been 1 year 273 days.

- The plan values in January 2020 were £65,015.04 and £43,031.48 respectively. Both plans benefitted from a valuable Guaranteed Annuity Option. At age 60, there was a Guaranteed Annuity Rate (GAR) of £7.016 per £100 fund value payable monthly in advance guaranteed for 5 years and with no escalation. To use the funds to purchase an equivalent annuity based on the FCA calculation methodology (to be consistent with the valuation of the lost scheme benefits) would require a total amount now of £170,008.54. Therefore, the fund value on which the calculations are based is this higher figure. The GAR adjustment only applies to 75% of the fund, the balance being the maximum 25% which may be taken as tax free cash.

- The combined value of the FSAVC plans was £170,008.54 – this was reduced to £160,178.44 to remove the value of the contributions paid outside of the liability period and to recognise the maximum available headroom for added years.

Wesleyan's letter explained that the combined adjusted value of the FSAVC plans was higher than the value of the prospective lost added years (£102,443.24) that Mr W would have bought in the OPS by a margin of £57,735.20. As a result, no compensation was due as its calculations showed that Mr W hadn't incurred a financial loss.

Mr W didn't agree with the methodology Wesleyan had used in its loss assessment, so he referred the complaint to our service for review.

In summary, Mr W said he's concerned about Wesleyan's use of the GAR in the loss assessment. He doesn't think it's fair to apply the GAR to a notional fund value and believes this goes against the loss calculation rules as set out in the FSAVC Mis-Selling Review Guidance.

<u>Ombudsman's provisional thoughts on the complaint</u>

"*This complaint has been upheld on the basis that Mr W would have bought added years if the FSAVC plans hadn't been mis-sold. During the relevant period, Mr W had some part time service and he also had a two year break in service. This would have meant the added years contract would have stopped and a new contract would have started when he re-joined service. Mr W didn't go on to buy added years in the NHS Pension Scheme and, as far as I'm aware, he is yet to take the benefits of his FSAVC plans.*

The FSAVCs both have a GAR attached and Wesleyan has included the value the GAR adds to Mr W's plans in its calculation, which has determined he has made a gain of over £57,000 as a result of taking out the FSAVC plans.

The main point that is in dispute in this complaint is that Wesleyan has included the value of the GAR in its calculation. The GARs on Mr W's FSAVC plans allow him to take his benefits in a similar format to those provided by the added years arrangement insomuch as it can provide a guaranteed income. And Mr W can choose for the annuity to increase in line with RPI and to provide a 50% spouse's pension. Because of this, I'm satisfied the value of the GARs can be taken into account when a complaint is upheld on an added years basis.
I have previously addressed the arguments raised by [Mr W's representative] regarding the inclusion of the GAR and I've explained my reasons for believing that it is not unreasonable for it to be included.

In the interest of concluding this matter sooner, I don't intend to repeat that reasoning here. But I can of course provide this, should it be necessary.

However, the GAR Wesleyan has based its calculation on is a single life, level annuity that's guaranteed for 5 years. It has used this form of annuity because consumers that opt to take a guaranteed income generally take this option. But I think a fairer comparison would be to base the value on a GAR that more closely matches the lost benefits, so an annuity providing a 50% spouse's pension, increasing in line with RPI and guaranteed for 5 years. 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. But I think Wesleyan should rerun the calculation on this basis in order to determine what difference this makes. And if Mr W has taken his benefits since the complaint has been with this service, this will also need to be factored into the calculation.

In term of the number of added years Wesleyan has based its calculation on. For the first added years contract, it has calculated that Mr W paid the equivalent of 5.12% of his pensionable pay to his FSAVC plans. But at this time 3.94% would have secured 5 years 175 days (the maximum level of service). As these contributions were only paid between 1993 and 1995, when Mr W took a break in service, the contract would have ended and the number of added years would have reduced to 157 days.

If a second added years contract had started when Mr W re-joined service, his contributions would have been equivalent to 5.24% of pay. But because these contributions were only paid until 2002, the number of added years would have again been reduced, to 1 year 116 days, to reflect this. So, overall, Wesleyan has based its calculation on a total number of added years of 1 year and 273 days. I don't think the approach Wesleyan has taken here is inappropriate in the circumstances of this complaint.

Mr W paid more to his FSAVC than he would have needed to pay towards the added years arrangement. But if he'd been a member of the added years arrangement, he would have been expecting to receive the maximum service. Therefore, I think it's unlikely that he would have also been permitted to make contributions to the in-house AVC. And so, I don't think Wesleyan needs to take any further action with regards to these excess contributions."

<u>Wesleyan's final submissions</u>

Wesleyan has said that it agrees with my findings. It's happy to recalculate, with the value of the GAR benefit attaching to the FSAVC Plan based on an annuity rate on an equivalent basis to the added years arrangement. But it expects this approach to significantly increase the value of the GAR benefit and hence the plan value used within the loss assessment.

<u>Mr W's final submissions</u>

Mr W's representative has said that it is in agreement with the main conclusion, with the exception of the following points.

- These historical Medical Sickness Society policies, that Wesleyan is using in its loss assessments, were "with profit" policies up to approximately 1998. The pre-1998 schemes did not specify the charges associated with the policies. Bulletin No. 4 published after the FSAVC Review Guidance was issued, was intended to be specific to highlight *how such policies should be dealt with* when charges were not detailed in the policy documents. Wesleyan however uses 1.5% in its loss calculations which undercalculates the loss.

- It has also questioned why on a previous case I've said that the GAR shouldn't be included yet, I'm saying it's not unfair for Wesleyan to include it in this case.

- With regards to the advice requirement, it is common practice for firms to advise clients to take advice when looking at their pension options or when nearing retirement. It would be a more balanced approach in terms of treating customers fairly, if Wesleyan gave the client a choice based on informed information, whereby it performs a loss calculation without the use of the prospective potential value of the GA, and lets the consumer decide whether they want to accept the compensation and forego their guaranteed annuity options, always after first seeking professional advice.

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.

<u>Charges on FSAVC plans</u>

Mr W's representative remains of the view that the 1.5% annual management charge, or reduction in yield, that Wesleyan uses in it charges only calculation for the type of FSAVC plan that Mr W has, is unfair. It thinks that this is not in line with the FSAVC review guidance, in particular Bulletin No 4, which I've set out below.

> *"Model Guidance, Section 6 - Loss assessment) This section of the guidance states, among other things, that:*
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> *Firms should establish the charges that the investor would have incurred in the in-house AVC arrangement and those incurred on the FSAVC (Paragraph 6.17, emphasis added) As noted in paragraph 6.17.7 the FSAVC charges borne by the investor will normally be apparent.*
>
> *Where details of charges are available firms should use them. However, there may be exceptions to this – for example in respect of certain with profits policies. Where details of charges are not available, firms may reasonably use Reduction in Yield ('RIY') information calculated for product disclosure purposes as a proxy for the average charges. This RIY information is likely to be available within:*
>
> *• essential product information (Key Features), for sales from 1 January 1995; and*
> *• product particulars and With Profits Guides, for sales from 1 March 1990.*
>
> *Firms should use product specific RIY information where this information is readily available, or where the firm could reasonably be expected to obtain it. (…)*
>
> *Firms may reasonably use a default assumption, but only where they lack details of the charges or RIY information (…)*
>
> *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. This is based on the RIY for an FSAVC policy with contributions of £100 per month over a ten year term as reported in the Watson Wyatt AVC survey published in May 1999, see Consultation Paper 27 for details. Firms may use an alternative assumption if there is demonstrable evidence that the 2.9% a year assumption is inappropriate."*

Wesleyan has confirmed that its actuaries have recently completed a piece work where they looked at the RIY for Medical Sickness Society Fund FSAVC plans with a range of entry dates, where the plans are shortly coming up to retirement. Its actuaries have found that the maximum RIY was 1.2% and the average was 1%. So, being prudent, Wesleyan considers 1.5% reasonable at this point in time.

I've thought carefully about what Wesleyan has said and whether it's in line with the above guidance.

The guidance states that if the RIY is unknown, or the firm lacks details of the RIY or this information is not available, then the default assumptions should be used. But that's not the case here. Wesleyan does know what the RIY is, or, it knows the range that its within. The guidance also allows a firm to make an alternative assumption if there is demonstratable evidence that the 2.9% a year assumption is inappropriate. So overall, while I accept that the default assumption would work in favour of the consumer, I'm not persuaded that Wesleyan is being unreasonable by using 1.5%, when its actuaries have determined that the RIY for plans, such as Mr W's is actually between 1% and 1.2%.

<u>Inclusion of GAR value</u>

On a previous case I acknowledged that, since the introduction of the pension freedoms legislation, there has been a reduction in the number of consumers that opt to take a guaranteed income at retirement. That complaint had been upheld on the basis that the consumer would have joined the in-house AVC scheme if they hadn't been mis-sold the FSAVC. So I said that I didn't think it was fair to include the value of the GAR when determining whether a loss has been suffered. This was because, if the consumer had been in the in-house AVC, their options at retirement wouldn't haven't been limited to securing a guaranteed income. They would have had more flexibility in how they took their benefits. And crucially, when making a comparison between the FSAVC and the in-house AVC, it's either based on the fund values of each arrangement, or the difference between the charges. And so I didn't think it fair for the value of the GAR to be included. That's not to say that the GAR on these plans isn't valuable, it is. That's why I also said that Wesleyan can take any payment it makes now for higher charges into account, should the consumer go on to use the GAR on their plan.

In the case of Mr W, both parties have agreed that he would have bought added years in his employer's OPS had the FSAVC plan not been mis-sold. The added years arrangement would only have provided a guaranteed income, there would not have been any flexibility in the way the benefits could be taken. And so, I don't think it's unreasonable for Wesleyan to base the value of Mr W's plan on the guaranteed income it can provide. The comparison here is being made with the value of the guaranteed income that the added years arrangement would have provided and so I'm satisfied that this is a fair way to make the comparison.

<u>The advice requirement for safeguarded benefits</u>

I agree with what Mr W's representative has said about it being common practice for firm to recommend a plan holder takes advice when looking at their pension options or when nearing retirement. But the rules around taking advice when the plan has safeguarded benefits valued at over £30,000, are set out under Section 48 of the Pension Schemes Act 2015. These regulations require pension scheme members who have subsisting rights in respect of safeguarded benefits worth more than £30,000 under the scheme to take appropriate independent advice from an FCA authorised adviser before:

- converting safeguarded benefits into flexible benefits
- using a transfer payment in respect of safeguarded benefits to acquire flexible benefits under another scheme
- being paid an "uncrystallised funds pension lump sum" (UFPLS) in respect of their safeguarded benefits

If a consumer was to take this advice before taking their benefits, in order to obtain a larger compensation payment, I don't necessarily think this would remove the requirement at the point the benefits are taken, when the consumer may well have already waived their rights to those benefits. And think this has potential to cause problems in the future if a firm has to provide advice on a benefit that the consumer has already waived their right to. But in any event, even if there wasn't an advice requirement, I still wouldn't think it was fair to allow Mr W to waive his right to the GAR and for the value not to be included in the loss calculation.

As I've said above, Mr W complained to Wesleyan that he would have bought added years. The comparison of the added years arrangement is based on the value of the benefits it can provide. So I'm satisfied that the value of the FSAVC plan should also be based on the value of the equivalent benefits that it can provide. I don't think this means that Mr W is being treated unfairly, I think this is the fairest way of comparing the different arrangements.

I appreciate that Wesleyan believes it's likely the value of providing the GAR will increase significantly, due mainly to the increasing in line with RPI option being included. But I'm conscious that it has only run this calculation on one other case so far. And so I think it should still rerun the calculation on Mr W's case, in order to see if it does make a difference overall to his loss.

For the reasons explained, I see no reason to depart from my provisional findings. I've set about below what I think Wesleyan needs to do.

Putting things right

As at the date of my final decision, Wesleyan should rerun the calculation to bring it up to date using the most recent financial assumptions. The value of the GAR should be based an annuity that provides a 50% spouse's pension and increases in line with RPI.

My final decision

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

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 28 July 2022.

Lorna Goulding
Ombudsman