DRN-3571956

The complaint

Mr R complained about the advice he received from Wesleyan Assurance Society ("Wesleyan") 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 February 1993, 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 him making a monthly contribution of £140 (gross). The last contribution was paid in March 2011.

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 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 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:

- Over the period of liability (February 1993 to March 2011), the total contributions paid to the FSAVC plan represented 2.91% of pensionable pay. If 2.91% of pensionable pay had instead been directed to added years, Mr R could have purchased added years of 4 years 149 days up to age 60 if working full time throughout. However, the maximum allowed under the scheme was 40 years, so Mr R had 'headroom' of 3 years 164 days, which he could've bought at 2.28% of pensionable salary.

- Mr R had periods of part-time service. This reduced the number of years he could've bought to 3 years 155 days. And as contributions were only paid for 18 years 2 months, rather than the full 32-year contract term for added years, this further reduced the number of years to 1 year 345 days.

- The plan value in July 2019 was £150,812.62. The plan 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 fund 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 £227,491.18. 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 value of the FSAVC plan of £227,491.18 was reduced to £177,924.04 to recognise the maximum available headroom for added years which represents 78.2114% of the full FSAVC plan contributions.

Wesleyan's letter explained that this value was higher than the value of prospective lost added years (£143,198.18) which Mr R would have bought in the OPS by a margin of £34,725.86. As a result, no compensation was due as its calculations showed that Mr R hadn't incurred a financial loss.

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.

In summary, Mr R said he was 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 R would have bought added years if the FSAVC plan hadn't been mis-sold. During the relevant period, Mr R had some part time service, he didn't go on to buy added years in the NHS Pension Scheme and he is yet to take the benefits of his FSAVC plan.*

The FSAVC has a GAR attached and Wesleyan has included the value the GAR adds to Mr R's plan in its calculation, which has determined he has made a gain of over £34,000 as a result of taking out the FSAVC plan.

The main point that is in dispute in this complaint is that Wesleyan has included the value of the GAR in its calculation.

<u>Should the value of the GAR be included?</u>

The GAR on Mr R's FSAVC plan allows 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 R can choose for the annuity to increase in line with RPI and provide a 50% spouse's pension. Because of this, I'm satisfied the value of the GAR can be taken into account when a complaint is upheld on an added years basis.

I think the FSAVC review guidance allows for a GAR to be included. But even if it didn't, I think it would be appropriate to do so anyway. And I don't have to apply the guidance if I think doing so would result in an outcome that isn't fair to both parties.

I've noted Mr R's representatives' suggestions on another complaint regarding how the GAR could be treated and I'd like to address why I don't think these are appropriate.

I accept that Wesleyan may well have factored its GAR responsibilities into its future liabilities. 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. Mr R's representative believes that the FSAVC fund could be treated in a similar way to a with profits fund. But with profits funds have specific rules regarding the distribution of funds and surrender values. The *regulator hasn't set rules for firms requiring them to provide an increased transfer value to take account of the GAR value if a GAR isn't utilised. And I don't think it would be appropriate for me to ask Wesleyan to provide an uplift in this case.*

I also don't think it would be appropriate to add a clause to any settlement agreement where a consumer effectively waives their right to the GAR feature on their plan. This is because a GAR of this value is a safeguarded benefit and pension legislation says that it can only be given up after advice has been received. So Wesleyan would not be complying with legislation if it allowed a consumer to waive their right to the GAR without advice having been provided.

Mr R has complained that his FSAVC plan was mis-sold and that he instead should have been advised to buy added years. The FSAVC gives Mr R the option to take benefits in a similar format to the added years arrangement. But if Mr R chooses to take his benefits in any other format other than an annuity - which wouldn't have been an option for him if he had taken added years - then he's making that decision knowing that he is giving up a valuable GAR.

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.

In terms of the number of added years Wesleyan has based its calculation on, it has calculated that Mr R paid the equivalent of 2.91% of his pensionable pay to his FSAVC plan between the relevant period. At the time of advice, 2.28% would have secured the maximum number of years if Mr R had paid this until the age of 60. However, the contributions to the FSAVC stopped in 2011 and Mr R also worked part time during the relevant period. So Wesleyan has reduced the number of added years down accordingly to 1 year 345 days. Had Mr R been a member of the added years arrangement these factors would have impacted the number of added years he would have secured. So I don't think the approach Wesleyan has taken here is inappropriate in the circumstances of this complaint.

I'm also conscious that Mr R paid more to his FSAVC than he would have needed to pay towards the added years arrangement. I think it's likely that, had the FSAVC not been mis-sold, these contributions would have been directed to the cheaper in-house AVC arrangement. But due to legislation limiting pension contributions, this would only have been possible after 2006, when the pension simplification rules were introduced.

Just because Mr R would have paid less in charges to the in-house AVC after 2006, it doesn't necessarily mean that he has suffered a loss as a result of taking the FSAVC. I think Wesleyan should carry out a comparison between the FSAVC and the in-house AVC (for excess contributions after April 2006 only). 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 these excess contributions being paid to the FSAVC rather than the in-house AVC. I have previously set out the benchmark that Wesleyan should use to make this comparison. I don't intend to repeat that in full here but I'm happy to confirm this if either party requires clarification.

If the above calculation produces a loss, Wesleyan should complete a standard charges only *calculation on the excess contributions paid after April 2006.*

<u>What if Mr R uses the GAR when he takes his benefits?</u>

As I understand it, Mr R is yet to take the benefits of his FSAVC plan. So I do accept that when he does, he may opt to take an annuity with Wesleyan and utilise the GAR. If Mr R has also received a payment to reflect the higher charges he has paid to the FSAVC arrangement in respect of the excess contributions paid to the plan after April 2006, this could leave him in a better position than he would have been in, had he joined his in-house AVC. He will effectively have received a refund of the higher charges and he'll also be benefitting from the increased value the GAR adds to his FSAVC fund. In these circumstances, I don't think it would be unreasonable for Wesleyan to take account of any payment it makes now as a result to the higher charges when the benefits are taken, should Mr R use the GAR."

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

Mr R'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.

<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.

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 R'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 R 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:*
>
> *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 R'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 R, 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 R'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 R'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. But in any event, even if there wasn't an advice requirement, I still wouldn't think it was fair to allow Mr R 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 R 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 equivalent benefits that it can provide. I don't think this means that Mr R is being treated unfairly, I think this is the fairest way or comparing like for like.

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 R'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

In terms of the added years, 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 on an annuity that provides a 50% spouses pension and increases in line with RPI. If Mr R has now taken his benefits, this should be taken into account in the calculation.

In terms of the FSAVC contributions Mr R paid after 2006, if it wishes to do so, Wesleyan should calculate a notional value for the excess contributions had they been paid to 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 their 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.

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 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.

As explained in my provisional findings, I don't think it would be unreasonable for Wesleyan to take account of any payment it makes now as a result to the higher charges when the benefits are taken, should Mr R use the GAR.

My final decision

For the reasons explained above, I partially uphold this complaint. I require Wesleyan Assurance Society calculate redress 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 28 July 2022.

Lorna Goulding
Ombudsman