DRN-3572067

The complaint

Mr M 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 M 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 November 1993, Mr M was advised by Wesleyan to start contributing to an FSAVC plan. At the time, Mr M was a member of his employer's OPS. The FSAVC plan commenced with him making a monthly contribution of £109.42 (gross) which was reduced to £97.53 in August 2001. The last contribution was paid to the FSAVC plan in June 2018, when Mr M transferred his plan to another provider.

In December 2001, while still making contributions to the FSAVC plan, Mr M contracted to buy added years through his employer's OPS. He paid a total of 4.66% of his pensionable salary to buy 4 years 98 days. This was the maximum available under the scheme rules. In 2018, Mr M 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 as a result of being mis-sold, he's suffered a financial loss;

- The full risks, implications, and alternatives in respect of the FSAVC plan were not fully and properly explained. And he wasn't provided with a full or descriptive comparison of benefits between his in-house scheme and the FSAVC plan;

- He was unaware that the FSAVC plan had higher charges and he should've been advised to purchase added years through his employer's scheme.

Wesleyan reviewed the complaint. In its final response it explained that, having considered the sales paperwork and the information Mr M 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 M'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 (December 1993 to December 2001), the total contributions paid to the FSAVC plan represented 4.56% of pensionable pay. If 4.56% of pensionable pay had instead been directed to added years, Mr M could have purchased added years of 6 years 30 days up to age 60 if working full time throughout. However, he had periods of part-time work. This would have reduced the number of years that could've been purchased in 1993 to 4 years 90 days.

- In December 2001, Mr M started an added years contract of 4 years 98 days for a contribution rate of 4.66% of pensionable pay. This was the maximum allowed under the scheme rules. But because of his part time service during this period, this contract will reduce to 4 years 80 days.

- Mr M has not lost the opportunity to purchase additional years of service up to the maximum allowable. However, the delay in contracting to purchase additional years of pensionable service has caused him to pay a higher contribution rate. He could have bought 4 years 98 days for 3.20%, so he's paying 1.46% more than he would have done since 1993. And the ways the accrual works for part time service, he will actually receive 10 days less added years at age 60 than if he'd started the contract in 1993. He'll receive 4 years and 80 days, rather than 4 years and 90 days.

- Contributions that Mr M could have directed to an added years contract from December 1993 to December 2001 have instead been paid into the FSAVC policy. The part of the FSAVC fund value that is attributable to contributions that he could have paid to an added years contract is a gain that offsets the loss due to the additional added years contributions that he is paying subsequently.

- Calculations completed as at 1 October 2019 determined a notional fund value of £90,134.51, calculated from the transfer value and added interest at Bank Basic Rates +1%. There was a further adjustment to represent only 70.19% of the value as only the liability period up to December 2001 is considered, which amounts to £30,369.01. This value is further reduced to £29,505.69 to account for estimated policy future charges.

- Assuming that Mr M maintains the added years contract to age 60, Wesleyan state that his loss is the value of the additional contributions of 1.46% of pensionable pay that he is paying since he commenced the added years contract in 2001, plus the value of the lost benefits due to the impact of part time working, less the value of the contributions of 3.20% that he paid instead into the plan between 1993 and 2001. This results in a loss of £5.113.18, net tax reductions as a higher rate tax payer is a redress amount of £3,579.23.

Mr M 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 M has said that Wesleyan's actuaries have used the value of his own contributions in the purchase of added years to offset the loss caused by the advice to purchase the FSAVC.

On another case - where the actuaries are assisting Mr M's CMC – the actuaries have said that that this is not allowed under the FSAVC Review Guidance. They say the loss calculation period is clearly set out in guidance and is stated to be:

"*The period for loss assessment will end on the earlier of:*

1) the 6th April after the investor stopped paying into the FSAVC policy, and
2) the date the investor started paying into the in-house AVC scheme.

Starting to buy added years counts as joining the in-house AVC scheme and so will end the period of loss assessment.

If the investor starts to buy added years but also continues to pay into the FSAVC policy, I believe that the period of loss assessment would end when the investor starts to buy added years (unless the investor can show that the insurer/adviser gave some subsequent advice, e.g. in connection with a subsequent FSAVC premium increment)."

Mr M states the value of the benefit is outside the loss calculation period and should not be applied. Wesleyan was therefore incorrect to state that the loss is simply the differential in the cost of purchase caused by deferring the start date of the added years. He says it's effectively deducting the added years purchased.

I issued my provisional thoughts on the complaint. In summary I said that:

- Having reviewed matters, I didn't think the methodology used for the added years side of the calculation was unfair. However, as more than 3 months had passed since the calculation was completed, I thought it should be rerun to bring it up to date using the most recent assumptions.

- I also thought that, had the FSAVC not been mis-sold, it's likely that any excess contributions Mr M paid (above what would have been required to purchase added years, and the contributions he continued to make after joining added years) would have been directed to the in-house AVC arrangement, rather than the FSAVC. Because of restrictions to what a member could contribute if they were already expected to receive the maximum service from their pension scheme, I thought it was only after April 2006, when the contribution rules changed, that Mr M would have been able to direct these contributions to the in-house AVC. So I said that Wesleyan should carry out a comparison between the FSAVC and the in-house AVC for contributions made after April 2006. If this demonstrates that the FSAVC's performance has exceeded the in-house AVC by more than the higher charges Mr M had paid, then I said it could conclude that he has not suffered a loss as a result of taking the FSAVC. However, if a loss is identified, I said that Wesleyan should pay Mr M the value of the excess charges.

Mr M and his representative didn't agree with my provisional findings. They have said that:

> "*The FSAVC Review Model Guidance (paragraph 6.20.6) indicates that the period for loss assessment in this case should end when Mr M actually joined the in-house added years arrangement in December 2001. Wesleyan has actually confirmed this on page 1 of its assessment saying "Period of liability: December 1993* ***to December 2001****".*
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> *This means that the actual added years contract (which Mr M took out from December 2001 onwards) should not be brought into the calculation of loss, as it applies solely to the period* ***after*** *the period to be loss-assessed. During the period for loss assessment (lasting 8 years), Mr M has missed out on purchasing 'added years' of* ***1 year and 80 days*** *(i.e. pro-rata, from missing making payments for 8 years out of a total of 28 years which would have bought 4 years 98 days of 'added years'). In effect, the large loss that was incurred from missing buying added years during the loss assessment period (from December 1993 to December 2001), has been steadily reduced by Wesleyan's calculations for each year that they have considered after December 2001*."

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.

Following concerns about mis-selling, the regulator at that time, told businesses to carry out a review of some FSAVC plans sold between 29 April 1988 and 15 August 1999. The main aim was to review the FSAVC plans of consumers who might have lost matching contributions or subsidies that the employer would've paid, had an in-house AVC plan been started instead.

Mr M's FSAVC plan didn't fall within the initial scope of the review for which the guidance was intended. And the guidance wasn't written to address every potential scenario, particularly those arising some 20 years after the guidance was issued, where action taken to mitigate loss was taken many years before the complaint was made. And crucially, there's nothing in the Dispute Resolution rules (DISP) – the rules in the FCA handbook that set out how complaints are to be dealt with by firms and the ombudsman service – which stipulates that this guidance must be applied to all FSAVC complaints being raised now, that didn't fall within the initial scope of the review.

That's not to say the guidance isn't relevant at all; it does still provide a useful guide, particularly when we consider complaints about mis-sold FSAVC cases where it's been determined that the consumer would've joined their employer's in-house defined contribution AVC scheme.

When a consumer has lost out financially as a result of something the business has done wrong, I'd generally expect the consumer to be put back into the position they would have been in now, had the business not made the error. So this is what I've thought about when considering Mr M's complaint.

Mr M believes that Wesleyan is using the value of the added years he has purchased to offset the loss he has suffered as a result of delaying the purchase of added years. He says its calculation takes into account of the added years he has actually purchased since contracting to do so in 2001. Instead he believes these years should be discounted because they fall outside the period of liability as the guidance states that the period of liability ends at the point the investor joins the in-house arrangement.

However, I'm tasked with reaching a decision on what I consider to be fair and reasonable. And while the guidance is useful and relevant in some cases, I'm not obliged to follow it. And in this case, I think departing from a strict interpretation of the guidance is necessary in order to provide Mr M with fair compensation.

If all had gone to plan, and instead of taking out the FSAVC Mr M had bought added years in 1993, taking account of part time service, he would be expected to end up with 4 years and 90 days added years at the age of 60 (December 2021). And he would only have paid 3.20% of his pensionable pay for these. So this is the position, or as close as possible, I think Mr M needs to be put in.

Mr M delayed purchasing added years until 2001 and he's actually contracted to buy 4 years 98 days, which when reduced for his periods of part time service will mean he's expected receive 4 years 80 days at age 60. So he'll be 10 days short of the position he would have been in had the contract started in 1993. He's also paid 4.66% for these added years, rather than 3.20%. Wesleyan has worked out the redress on this basis, so it calculated how much extra Mr M has paid up to the age of 60 and it's also calculated the cost of these missing 10 days. While this might not be in line with the guidance, I don't think this is unreasonable because it ensures the Mr M receives the same at retirement that he would have received if the added years contract had started in 1993.

Instead of the above, Mr M thinks Wesleyan should give him the value of the added years his contributions would have bought (1 year and 80 days) between 1993 and 2001 as he considers he's lost out on buying these as a result of the delay. But I don't agree he's lost out on buying these years. The maximum he could have bought in the scheme was 4 years 90 days, so he's only lost out on 10 days. If Wesleyan gave him the value of this 1 year and 80 days, he'd effectively have a benefit equivalent of 1 years and 70 days over the maximum he would have been eligible for from his added years arrangement. So I won't be asking Wesleyan to provide redress on this basis. I don't think the methodology Wesleyan has used is unfair. And I don't think its approach to not apply the FSAVC review guidance in the circumstances of this complaint is unreasonable.

I explained in my provisional findings that I thought the contributions Mr M continued to pay towards his FSAVC after he joined the added years arrangement would have been directed toward the in-house AVC instead. However, Wesleyan provided information to support its stance that this would only have been possible after April 2006 when the pension simplification rules came into effect.

Having reviewed the evidence provided by Wesleyan, I agree that it's likely Mr M would have been restricted on contributing to the in-house AVC if he was already expected to receive the maximum service under the scheme and added years arrangement. This would have changed after April 2006 when the pension simplification rules were introduced. So I think Wesleyan should complete a comparison of the FSAVC contributions paid after this date, with the in-house AVC. And as Mr M transferred his plan to another provider, the comparison should be run up to the date of transfer. If this comparison shows a loss, a standard charges only calculation should be completed on the contributions paid after April 2006.

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.

In terms of the FSAVC contributions Mr M 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 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.

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 above, I partially uphold this complaint. I require Wesleyan Assurance Society to calculate redress as set out above.

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

Lorna Goulding
Ombudsman