DRN-3572549

The complaint

Mr S 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 S 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 June 1991, Mr S was advised by Wesleyan to start contributing to an FSAVC plan. At the time, Mr S was a member of his employer's OPS. The FSAVC plan commenced with him making a monthly contribution of £158.25 (gross). This plan lasted until September 1995, with a final contribution of £121.76. Another plan was taken out in June 1996, by which time Mr S's membership within the OPS had changed. This plan had gross monthly contributions of £375. The last contribution was paid in February 2014.

Mr S has since moved the FSAVCs to a flexible drawdown plan.

In May 2007, while still making contributions to the FSAVC plan, Mr S contracted to buy added years through his employer's OPS. He paid a total of 9% of his pensionable salary to buy 5 years 254 days.

In 2018, Mr S 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 scheme.

Wesleyan reviewed the complaint. In its final response it explained that, having considered the sales paperwork and the information Mr S 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 S'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 that overall Mr S had made a gain of £56,565.70 as a result of taking out his FSAVC plans. So no redress was due. This gain was in part due to the value that the guaranteed annuity rate (GAR) on Mr S's plans added to the fund value.

Mr S 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 S is 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 findings</u>

"*Having now reviewed matters, I think Wesleyan needs to do more to put things right. So I've set my thoughts out below.*

Overall I don't think the approach Wesleyan has taken is unreasonable in terms of the added years side of the calculation. Both parties will be aware of my view in terms of the GAR being included. However, when the initial calculation was run, Mr S hadn't taken his benefits.

I understand he has now transferred his plan to drawdown plan, following advice from Wesleyan. This doesn't alter my thoughts around the inclusion of the GAR in the calculation, although I do appreciate that Mr S hasn't actually received this increased value as he opted not to utilise the GAR, it would appear because he didn't require the income and wished to retain the funds from the FSAVCs for his children. It wouldn't have been possible for Mr S to have moved his fund if he'd joined the added years arrangement. So it seems that he has in fact benefited from the flexibility the FSAVC plan has given him.

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 S 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 S has any concerns about this, that's a separate matter that he will need to raise with Wesleyan.

However, the GAR Wesleyan has based its calculation on is a single life, level annuity that's guaranteed for 5 years. 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. 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 in order to determine whether Mr S has suffered a loss.

Mr S also continued to contribute to his FSAVC plan until 2014. I'm satisfied that, had the FSAVC plan not been mis-sold, it's likely that the contributions paid after April 2006 would have been directed to the cheaper in-house AVC scheme. But just because Mr S 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 continuing to contribute to 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 S 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."

Mr S's final submissions

Mr S'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 use 1.5% in their loss calculations which undercalculates the loss.

- And it does not agree with my findings that Wesleyan isn't being unfair by advising Mr S to not select the guaranteed annuity option, but at the same time including the value of the GAR in the loss assessment, just because he "did not want to take an income". In today's market place the vast majority of clients do not want to take an annuity and it would appear that Wesleyan's own representatives are also agreeing that this GAR feature is not that attractive to the vast majority of consumer's in the same position as Mr S.

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

Wesleyan has said that it agrees with my findings. It's happy to recalculate the value of the GAR benefit attaching to the FSAVC Plan using an annuity rate on an equivalent but it expects this approach to significantly increase the value of the GAR benefit and hence the Plan value used within the loss assessment. But it has said that it would like confirmation as to whether, if allowing for the RPI linked GAR terms would increase the gain that it's previously calculated, is it still required to update the Added Years calculation, and if so whether it should do so based on the RPI linked GAR terms.

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.

Mr S'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 S has, is unfair. It thinks that this is not in line with the FSVAC 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 AVC 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 assumptions is inappropriate. So overall, while 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 S'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 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 FSVAC and the in-house AVC, that made on either the basis of the fund value, 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 S, 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 S's plan on the guaranteed income Mr S's plan could have provided.

The comparison here is being made with the guaranteed income that the added years arrangement would have provided - this isn't based on a fund value for the added years arrangement - and so I'm satisfied that this is a fair way to make the comparison as the value of the FSAVC plan should also be based on the equivalent benefits that could have been provided, had Mr S opted to take the guaranteed income, in the same way that he would been required to take it from the added years arrangement.

I don't the fact that Mr S has chosen to forgo this income in order to meet his objectives means that he is being treated unfairly. He has complained t he wasn't advised to take added years and the FSAVC plan could have provided virtually the same benefits, yet he opted to take his benefits in a different form.

While I acknowledge that in today's market place less consumers are taking annuities than before the pension freedoms reforms, I think that generally the reduction here has been with consumers that don't have a GAR attached to their plans. This is because annuity rates on the open market have dropped considerably. Wesleyan has said that the majority of its plans holders that have GAR use it at retirement. I do appreciate that's not the case for Mr S, and possibly some others in a similar position to him. But I still don't think this means Wesleyan is being unfair by including the value of the GAR in its loss assessment. Instead I think this suggests that although Mr S has complained that he should have been advised to take added years, in hindsight, he's actually in a better position for having not taken them and instead having the freedom to choose what he does with his benefits.

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 factor 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 S's case, in order to see if it does make a difference overall to his loss, particularly as Mr S has transferred his benefits since the calculation was initially run.

Putting things right

Added years

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.

Excess contributions paid after April 2006

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 S into that position. It does not mean that Mr S 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 S 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 S 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 and require Wesleyan Assurance Society to complete the calculation set out above.

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

Lorna Goulding
Ombudsman