DRN-3572633

The complaint

Mr K 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 K 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 1997, Mr K was advised by Wesleyan to start contributing to an FSAVC plan.
At the time, Mr K was a member of his employer's OPS. The FSAVC plan commenced with him making a monthly contribution of £200 (gross). Contributions to the plan continued at the same level until 2017.

In June 2007, while still making contributions to the FSAVC plan, Mr K contracted to buy added years through his employer's OPS. He paid a total of 9% of his pensionable salary to buy 272 days to age 60.

In 2018, Mr K 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 K 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 K's file to its actuaries for a loss assessment to be completed on an added years basis.

A further letter was issued after the loss assessment had been completed. The letter confirmed that overall Mr K had made a gain of £38,139.33 as a result of taking out his FSVAC plan. So no redress was due. This gain was in part due to the value that the guaranteed annuity rate (GAR) on Mr K's plan added to the fund value.

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

One of our investigators reviewed the complaint. He didn't think Wesleyan had treated Mr K unfairly so he didn't uphold the complaint. In summary the investigator thought that:

- The FSAVC review guidance supports Wesleyan's view that the GAR value can and should be included in the loss assessment. The GAR is also of considerable benefit to Mr K and will continue to step up in value until he reaches 75.

- Likely triggered by information that the in-house added years arrangement was going to close, Mr K started to make maximum contributions to the in-house added years scheme from July 2007 until the Scheme's normal retirement age of 60 in July 2009. The FSAVC Review Model Guidance states that the end date for the period of loss assessment is the earliest:

"The date at which the investor did or could reasonably have been expected to have started to receive the employer's matched contribution or other subsidised benefit by starting to contribute to the in-house AVC arrangement."

This would suggest that the end date in this case should be July 2007. But Wesleyan has decided to also look at the period July 2007 to July 2009. The business has offset the notional cost of his maximum purchase of 281 days vs the cost of purchasing these days had he been in the added years scheme from 1997 and calculated a net loss of 9 days.

Mr K's representative didn't agree with the investigator's findings. It maintained that the value of the GAR should not be included in a calculation for an added years loss assessment. And it didn't agree that it was appropriate for Wesleyan to use the value of Mr K's own purchase of added years, outside the liability period, to offset the loss he's suffered. It also thought there was an error in the calculation as the annual management charge had been input as 1.5% rather than 2.9%, which was the default amount in the FSAVC 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.*

The investigator didn't uphold the complaint as he thought it wasn't unreasonable for the value of the GAR to be included in the calculation. I agree with this for reasons that both parties will be aware of from my previous correspondence. I also don't think it's unreasonable for Wesleyan to have included the value of the added years Mr K has purchased. I do appreciate that a different actuary may take a different approach here. But I don't think that means that what Wesleyan has done is unreasonable.

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 whether Mr K has suffered a loss.

Mr K also continued to contribute to his FSAVC plan until 2017. 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.

Just because Mr K 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 K 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.

What if Mr K uses the GAR when he takes his benefits?

As I understand it, Mr K 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 K 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 of the higher charges when the benefits are taken, should Mr K use the GAR."

Mr K's final submissions

Mr K'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.
- 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 all Pension Firms to automatically advise clients to take advice when looking at their pension options at or nearing retirement; accordingly we believe it would be a more balanced approach in terms of treating their customers fairly, if Wesleyan gave the client a choice based on informed information, whereby they perform a loss calculation without the use of the prospective potential value of the GA, and let the consumer decide whether they want to accept the compensation and forego their guaranteed annuity options, always after first seeking professional advice.

Wesleyan's final submissions

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. It's also queried whether it is still required to recalculate using the RPI linked GAR terms if this is likely to increase any gain Mr K may have suffered.

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.

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 K's complaint.

Mr K 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 2007. 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 K with fair compensation.

If Wesleyan didn't take account of the added years that Mr K actually contracted to buy he'd effectively have a benefit equivalent of over the maximum service he would have been entitled to. 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 not to strictly apply the FSAVC review guidance in the circumstances of this complaint is unreasonable.

<u>Charges on FSAVC plans</u>

Mr K'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 K 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 K'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 K, 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 K's plan on the guaranteed income Mr K's plan can provide. The comparison here is being made with 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 K'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 K 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 K 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 K is being treated unfairly.

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 K's case, in order to see if it does make a difference overall to his loss. However, I do agree that, once there is a larger sample of cases, it might not be necessary to always rerun the calculation if the data does suggest that recalculating on this basis will always increase the value the GAR adds to the plan. But other factors, such as whether the consumer has retired since the initial calculation was completed, may mean a recalculation on those cases will always be necessary.

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>FSAVC contributions paid after April 2006</u>

If Wesleyan wishes to consider whether no loss has been suffered, it should calculate a notional value for 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 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 K into that position. It does not mean that Mr K 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 K 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 K 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 K use the GAR.

My final decision

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

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

Lorna Goulding
Ombudsman