DRN-4409347

The complaint

Ms Z's complaint is about advice given by Medical Money Management (MMM) in 2007 to transfer her Freestanding Additional Voluntary Contributions plan (FSAVC) with Wesleyan to a stakeholder pension (SHP) with Norwich Union (now Aviva). Ms Z says she's financially worse off as the annuity she could've bought with her SHP fund was lower than the annuity she could've had from the FSAVC.

What happened

I issued a provisional decision on 10 October 2023. I've repeated here what I said about the background to Ms Z's complaint and my provisional findings.

'*We've previously dealt with Ms Z's complaint against Wesleyan about the sale of the FSAVC in 1993. We upheld that complaint. We said Ms Z should've bought added years in her employer's occupational scheme (OPS) instead of taking out the FSAVC. Wesleyan was required to undertake a loss calculation. That's since been done based on Ms Z having actually retired in July 2022 (just before her 61st birthday in September 2022). The loss assessment showed that Ms Z hadn't suffered any loss as a result of taking out the FSAVC instead of buying added years.*

Ms Z's current complaint is about MMM's advice in 2007 to transfer the FSAVC to the SHP. The FSAVC was invested in Wesleyan's with-profits fund and had a guaranteed annuity rate (GAR). The exact rate depended on the annuity option selected. The transfer value paid in 2007 was £26,523.

Initially the investigator upheld the complaint. He said the documents relating to the transfer to the SHP didn't mention the GAR and that it would be lost if Ms Z transferred. The GAR was important as, in many cases, it would be higher than the best available open market annuity rate. The investigator said, if the GAR had been properly explained to Ms Z, she'd likely have retained the FSAVC plan. The investigator said MMM should undertake a loss calculation.

MMM didn't accept the investigator's view. Amongst other things, MMM referred to the low bonus rates on the FSAVC plan; the fact that Ms Z hadn't taken benefits at age 60; her significant OPS benefits and that she wanted flexibility, the potential for greater growth from an alternative pension arrangement with active management, diversification and ethical investment. MMM also pointed to Ms Z's earnings, her service in the OPS (34 years) and the tax she'd have paid if she'd taken the GAR at age 60.

Ms Z said there were some inaccuracies in what MMM had said. For example, she had slightly less than 30 years' service in the OPS and she'd always planned to retire at 60.

The investigator issued a revised view. He maintained that the SHP was mis sold as the GAR was an important benefit that should've been explained at the point of sale. But he didn't think Ms Z would've taken the GAR at age 60. It seemed she was in a better position than if she'd retained the FSAVC – the returns on her SHP had been significantly better than the bonuses that would've been paid on the FSAVC.

In response Ms Z's representative told us that Ms Z had now retired. A copy of the revised loss calculation on the added years complaint was provided, done on an actual, not prospective, loss basis. It indicated the annuity that would've been available from the FSAVC was £3,451.56 pa. An illustration for the SHP had also been obtained. It showed Ms Z could buy an annuity of £2,535.15 pa. Ms Z's representative said both illustrations were on the basis that Ms Z took 25% tax free cash.

The investigator shared Ms Z's further comments with MMM. The investigator said, as it was unclear whether Ms Z was financially worse off as a result of having transferred to the SHP, it would be fairest for MMM to complete a loss assessment.

MMM didn't agree. It said Ms Z was better off. The FSAVC benefited from a GAR (6.122%) if taken at age 60 with no indexation increases and payable monthly in advance – so single life with a five year guarantee. Current open market annuity rates with a ten year guarantee were 6.06% at age 60. In October 2022 the value of the SHP was £52,203. An annuity rate of 6.06% would produce an annuity of £3,163.50. The value of the FSAVC, if Ms Z hadn't transferred, would've been £38,821. An annuity rate of 6.122% pa gave an annuity of £2,192.96 pa. So Ms Z was £970.54 pa better off with the SHP. And the annuity quotation for the SHP showed a fund value of £55,940.84 less 25% tax free cash (£13,985.15). The annuity income was £2,535.15, based on the residual fund value of £41,955.63, which equated to a rate of 6.04%. If that rate was applied to the full fund value it gave an annuity of £3,378.83 pa, which was more than the FSAVC would've paid.

As agreement couldn't be reached the investigator told MMM and Ms Z that the complaint would be referred to an ombudsman to decide.

What I've provisionally 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.

I'm issuing a provisional decision as, since the complaint was referred to me, we've obtained further information from Wesleyan. I've referred to what Wesleyan has told us below. We've shared the new information with MMM and but Ms Z's representative hasn't seen it. It's important, before I issue a final decision, that both parties understand how I've come to my decision and on what evidence it's based. And where, as here, I'm awarding redress, that both parties see what that is and have the chance to comment.

After I'd considered Ms Z's complaint on a preliminary basis, we told MMM that, from what I'd seen, I didn't think the sale of the SHP was compliant. As the investigator had pointed out, the GAR doesn't seem to have been mentioned. I didn't think Ms Z would've switched to the SHP if the GAR, which was valuable, had been discussed. I went on to explain why I thought there was evidence that Ms Z had suffered a financial loss by switching to the SHP.

The SHP quotation was for an annuity after payment of 25% tax free cash. The annuity using the whole fund would be £3,378.83 pa. The annuity which Wesleyan had referred to in its calculations as what the FSAVC would've paid using the GAR was £3,451.56 pa. That was on the basis Ms Z didn't take any tax free cash – the final sentence of the sixth complete paragraph on page two of the loss assessment says, as Ms Z took the maximum tax free cash permitted from her OPS benefits, it had been assumed that the plan (FSAVC) benefits would've been taken as pension with no cash. So it wasn't right to compare the £3,451.56 with the quotation of £2,535.15 – which was after tax free cash had been paid. But, if no tax free cash was taken, the annuity would've been £3,378.33, which was still lower (£73.23 pa) than the £3,451.56 pa which Ms Z would've got from the FSAVC.

MMM asked if Wesleyan could confirm the hypothetical value of the FSAVC when Ms Z was 60 and on 23 May 2023, the date of the SHP quotation.

We asked Wesleyan if it could provide a notional value for the FSAVC policy and details of the annuity that would've been available using the GAR at both Ms Z's 60th birthday and the date of her actual retirement in July 2022. We also said we weren't sure of the basis on which the GAR was available on either date – for example, if it was restricted to single life, non increasing etc or if there were other options – and we asked for details.

Wesleyan said that the notional value of the FSAVC policy as at Ms Z's 60th birthday in September 2021 was £137,655.17 and £158,374.82 when she retired in July 2022. Details of the annuities available and information about the GAR were also given.

We thought the notional values seemed high, given that the transfer value paid in 2007 was £26,523 and so it seemed the growth would've been around 12.5% pa compound. We asked Wesleyan if they could check the figures and, if they were correct, provide details as to how they'd been calculated.

Wesleyan did that and confirmed they were correct. Wesleyan said:

'The notional values are correct; a breakdown of each is shown below and the end stage calculations are attached.

To calculate these values, the following methodology has been used:

> *i) reversionary bonus for which the policy would have been eligible in the period since transfer has been added (at the Society's historically declared rates) for each intervening bonus year to the amount of reversionary bonus which stood at the date of transfer;*
> *ii) for the calculation at September 2021, the value of the policy is total of the guaranteed cash sum (at the date of transfer), the appropriate reversionary bonus derived from i) and the terminal bonus which would have then been payable, each of which is increased by 5% as per the Society's standard practice;*
> *iii) for the calculation at July 2022, the value of the policy is total of the guaranteed cash sum (ie the amount which would have been due if the vesting date had been July 2022 when the policy was transferred), the appropriate reversionary bonus derived from i) and the terminal bonus which would have then been payable, each of which is increased by 5% as per the Society's standard practice;*

As at 3 September 2021:
Guaranteed Cash Sum: *£31276.80*
Reversionary Bonus: *£21262.90*
Interim Reversionary Bonus: *£437.83*
Terminal Bonus: *£78122.63*
Uplift (5%): *£6555.01*
Total: *£137655.17*

As at 3 July 2022:
Guaranteed Cash Sum: *£32212.32*
Reversionary Bonus: *£22845.84*
Interim Reversionary Bonus: *£481.76*
Terminal Bonus: *£95293.24*

Uplift (5%):	*£7541.66*
Total:	*£158374.82*

NB Interim Reversionary Bonus is the reversionary bonus attributable to the period between 1 January and the valuation date in the year the value is calculated. Also, the revised Guaranteed Cash Sum at July 2022 is based upon the Society's prevailing premium rates at inception of the policy.'

Wesleyan had also looked at the returns on the policies from an underlying asset point of view and the enhancements applied. The returns on average since 2007 when the transfer value was paid were 7% pa. On top of that, asset shares had been enhanced, to reflect the closed fund being run off, in order to make sure any surplus is distributed at a fair rate. Since 2007 that had averaged 4% pa. On top of that there was the fact that pay outs for these policies are smoothed and based on sample policies grouped by term. These policies which became paid up early in the term on average tend to get a higher pay out than their underlying asset share, due to the way pay outs at a grouped level are set.

Wesleyan said there were a variety of annuity options at age 60 and when Ms Z had retired and the precise GAR would depend on the annuity selected.

We shared that information with MMM. We said, based on the information Wesleyan had provided, it seemed Ms Z had suffered a loss in consequence of the transfer in 2007. MMM didn't offer any further comments.

I propose to uphold the complaint. I don't think the advice to transfer from the FSAVC to the SHP was suitable. And I'm satisfied that Ms Z has suffered a financial loss – the annuity available from the SHP is less than the annuity she'd have been able to get from the FSAVC. In the end that's come down to the higher notional fund value of the FSAVC. Recent increases in annuity rates mean there may not be much difference in the GAR (and the exact annuity rate will vary, depending on the annuity option chosen). But if, with suitable advice, Ms Z would've retained the FSAVC, she's entitled to redress on that basis.'

I went on to set out what MMM needed to do to put things right for Ms Z.

MMM didn't offer any further comments in response to my provisional decision. Ms Z accepted my provisional decision. She said she'd actually retired on 27 June 2022, she was in good health, she was a higher rate tax payer and she'd prefer a cash payment.

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.

In the absence of any further substantive comments, information or evidence my views remain as set out in my provisional decision which I've repeated above and which form part of this decision.

Putting things right

I've repeated the redress I set out in my provisional decision. But I note that Ms Z actually retired on 27 June 2022 and not, as I'd thought, on 3 July 2022 and on which date I'd based redress. The dates are only a few days apart and, in my view, sufficiently proximate on which to base fair and reasonable redress. So, and in the interests of bringing the matter to a conclusion as quickly as possible which would be in both parties' interests, I've repeated the redress I set out in my provisional decision. But, if Medical Money Management is unhappy with that, Medical Money Management should ask Wesleyan to provide the notional value of the FSAVC as at 27 June 2022. In which case that amount should be substituted for the figure of £158,374.82 and the date of 27 June 2022 used instead of 3 July 2022 and the below redress read accordingly.

Wesleyan has said the notional value of the FSAVC on 3 July 2022 would've been £158,374.82 so that value should be used to determine what annuity Ms Z could've bought on the assumption (consistent with the redress calculation on Ms Z's added years complaint) that she wouldn't have taken any tax free cash and she'd have bought an annuity providing a 50% spouse's pension, increasing in line with RPI and guaranteed for five years.

Ms Z would've had past payments from that annuity from 3 July 2022 to the date of settlement. Interest at 8% simple pa should be added to each payment from the date it would've been paid to the date of settlement. I'll call that amount (missed payments plus interest) A.

Going forwards, Ms Z would've also been entitled to future annuity payments. The value of those future payments is represented by calculating the current capital cost of buying the same annuity based on Ms Z's current circumstances and taking into account any applicable annuity expenses. Medical Money Management wish to require that Ms Z completes a medical/lifestyle questionnaire to ascertain if an enhanced annuity rate might be available to her. I'll call that amount B.

Medical Money Management should ascertain from Aviva the transfer value of Ms Z's SHP. I'll call that C.

Ms Z's loss and the amount Medical Money Management needs to pay to redress her is A+B less C.

Redress should, if possible, be paid into Ms Z's pension plan to increase its value by the relevant amount. The amount paid should allow for the effect of charges and any available tax relief. Compensation shouldn't be paid into the pension plan if it would conflict with any existing protection or allowance.

If Medical Money Management is unable to pay the compensation into Ms Z's pension plan, it should pay the relevant amount direct to her. But had it been possible to pay into the plan, it would've provided a taxable income. So the compensation should be reduced to notionally allow for any income tax that would otherwise have been paid. This is an adjustment to ensure the compensation is a fair amount – it isn't a payment of tax to HMRC, so Ms Z won't be able to reclaim any of the reduction after compensation is paid. Ms Z is now retired and the notional allowance should be calculated using her actual marginal rate of tax. She's confirmed that she's a higher rate tax payer so on that basis the reduction would equal 40%.

My final decision

I uphold the complaint. Medical Money Management must redress Ms Z as I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms Z to accept or reject my decision before 28 November 2023.

Lesley Stead
Ombudsman