PO-11331

Ombudsman's Determination

Applicant	Mr E
Scheme	The Coe of Ilford No 2 Discretionary Pension Scheme (**the Scheme**)
Respondent	Aviva

Outcome

1. I do not uphold Mr E's complaint and no further action is required by Aviva

2. My reasons for reaching this decision are explained in more detail below.

Complaint summary

3. Mr E's complaint against Aviva is that the transfer value he has been provided with does not reflect the value of the benefits within the Scheme.

Background information, including submissions from the parties

4. Mr E is the member and Trustee of the Scheme, which is a Small Self-Administered Scheme (**SSAS**). The previous version of the Scheme was created on 1 December 1974, with the current version established by a deed dated 13 April 1993. At the time the Scheme was established, the Trustee was Coe of Ilford Ltd.

5. Included in the assets of the Scheme, to provide benefits to Mr E, are two with profit deferred annuity policies (**the policies**) written by Norwich Union, now Aviva, in 1986. These policies offer guaranteed annuities of £29,023.72 and £17,506.12 per annum at the Benefit Date of 21 February 2015, at age 60. These figures were notified to Mr E in February 2015, including the Capital Sum's or transfer values of £296,622.46 and £178,912.55 respectively.

6. Mr E wishes to transfer these policies to a Qualified Recognised Overseas Pension Scheme in the Isle of Man; however, he is not satisfied with the values that Aviva has quoted. Mr E believes that the values are too low, and that the formula used to calculate them does not include the guaranteed annuity rates (**GARs**) and does not reflect the market value of the annuity policies.

7. The specific policy documents have not been provided for the policies in question, however there are policy terms and conditions available for a different policy which both parties have accepted are essentially identical. The terms and conditions state that a "Capital Sum" in lieu of an annuity will be calculated as "£10.18 in lieu of each £1 per annum of Annuity subject to General Provision VI(e)."

8. General Provision VI(e) states:

> "To take in lieu of all or any part of any Annuity a Capital Sum payable on the date from which such Annuity would have commenced; the Capital Sum on the Benefit Date will be that shown in the relevant Benefit Schedule and at any other date shall be of such an amount as the Society shall determine calculated on a similar basis".

9. The Benefit Date of the policies was 21 February 2015; therefore, Aviva has calculated the Capital Sums quoted of £296,622.46 and £178,912.55, as at the Benefit Date using the formula; £10.18 for each £1 per annum of annuity. Mr E maintains that this calculation basis does not reflect the true market value of the annuity policies as he would not be able to purchase the same benefit elsewhere with the Capital Sums offered. He says that where there is ambiguity such as there is here the policy should be interpreted in the manner in which it would make most commercial sense, and that is to value it at market rate.

10. Mr E believes that the Capital Sums of the policies should be approximately £749,072.24 and £406,092.92 respectively in order to be considered market value. These figures were calculated using market annuity rates at the time of calculation. He completed and returned the transfer paperwork, amending the transfer values to the figures he believed should be payable. Aviva refused to complete the transfer using the transfer values that Mr E had substituted on the paperwork.

11. Mr E was not satisfied and instructed Cubism Law who, on 21 April 2015, raised a complaint on his behalf. A series of letters regarding the points raised were exchanged. The position of each party is summarised below

12. Mr E was not satisfied with Aviva's response and brought his complaint to this office. Since Mr E is now past the Benefit Date the annuities payable and the Capital Sums payable now are to be calculated as post Benefit Date, therefore the values have now changed. The valuations given on 24 October 2017 were annuities of £32,264.07 and £19,460.59 or Capital Sums of £307,799.23 and £185,654.03 respectively. Aviva has confirmed after Benefit Date, the Capital Sum has interest added until the benefits are drawn, when they will be converted back to an annuity using a conversion factor calculated on a "similar basis" from the table established at the policies commencement which shows the factors applicable depending on age.

Mr E's position

13. The Capital Sums offered were exactly the same as the current pension fund value and are not comparable with the annuities given up in lieu.

14. The true value of the annuities is significantly higher than the Capital Sums offered, and legislation does not permit Aviva to make significant profit from a statutory right to transfer. Legislation requires transfer values to be calculated in line with the Occupational Pension Schemes (Transfer Values) Regulations 1996 (**the Transfer Regulations**).

15. The Transfer Regulations fix the value of benefits to be transferred. The current scheme provides money purchase benefits. Regulation 7C requires these to be valued as the "realisable value". Benefits cannot be reduced simply due to the transfer and any policy term that does not provide a fair value can be disregarded.

16. The Unfair Terms in Consumer Contract Regulations 1999 (**the UTCCR 1999**) apply to consumer contracts, including insurance contacts. While they may not have been in force at the time the policies were taken out, it has not been claimed that it was unfair at that time. The transfer value offered now is unfair as defined by the regulations. The Trustees are individuals, even so the statutory right to transfer is a member's right and it is the member that requests the transfer, so they are undoubtedly consumers.

17. To address the issues, it was proposed that a new contract be formed under current law upon surrender of the policy by means of a transfer. There is obviously a contract created upon benefit release. Fundamentally, its terms are that a sum of money is taken in return for releasing Aviva from its obligations under the policy. The Financial Services Authority took the view that Equitable Life's standard terms of surrender offend the UTCCR 1999.

18. To understand the contractual benefits the policies must be considered alongside the Scheme. The original Scheme policies were written for a final salary scheme and the Scheme rules allow for transfers under paragraph 11. Therefore, it is an implied term that the policies could be transferred without any diminution. This was done when the current scheme was set up in 1993. The benefits payable are guaranteed annuities. The contractual position taken in context is that the Capital Sum must represent the fair value of the annuities contracted.

19. General Condition VI (e) refers to the Capital Sum being calculated on a "similar basis", not the same basis. Therefore, the valuation is at Aviva discretion and the method chosen by Aviva will deprive him of the investment growth attributable to falling interest rates. It is in effect forced surrender of GARs. This position is similar to that taken in Hyman v Equitable Life.

20. There is no denial from Aviva that the policy can be interpreted as Cubism Law suggests. Interpretation of the policy should take into account the Scheme as the policy was taken out expressly for it. Therefore, the valuation should meet the Scheme's purposes.

Aviva's position

21. The contracts are insurance policies taken out by the Trustees of the Scheme in order to provide benefits permitted by the Scheme. The policy documentation sets out the benefits available under the policies and how they may be taken. General Provision VI (e) allows for a Capital Sum to be taken in lieu of an annuity and sets out how it is to be calculated.

22. The contractual benefits under the policy available to the Trustees are those set out in the policy, the fact that legislative changes allow the member to transfer from the Scheme does not alter the contractual benefits available to the Trustees under the Policy.

23. The UTCCR 1999, or the preceding 1995 regulations do not apply to this policy as it was taken out prior to the regulations coming into force. In any case the consumer is defined as a natural person, but the policy holder is a limited company. It was Coe of Ilford Ltd that proposed for the policy which is a corporate entity not an individual.

24. The policies do not incorporate the provisions of the pension scheme. It is an insurance policy held as an asset by the Trustees. The policy documentation outlines the benefits available under the insurance policy.

25. A new contract would not be formed by benefits being paid out. If the Trustees decides to surrender the policy then in paying the benefits Aviva will discharge its obligations under the policy, not create a new contract.

26. The statutory provisions referred to govern valuation of benefits by the Scheme, and do not increase the realisable value of an insurance policy.

27. The comments regarding Hyman v Equitable Life were noted but the comparison is disputed. The method for calculating the Capital Sum is fair. Equitable Life was exercising its discretion in relation to the amount of final bonus paid in a manner which was inconsistent with its policy terms. Aviva maintain that all benefits are paid in accordance with the policy terms and all final bonuses will be the same amount regardless of how benefits are taken. Aviva has not exercised discretion in the calculation of the Capital Sum.

Adjudicator's Opinion

28. Mr E's complaint was considered by one of our Adjudicators who concluded that no further action was required by Aviva. The Adjudicator's findings are summarised below:-

    - The policy states that the Capital Sum is calculated at the Benefit Date as £10.18 for every £1 of annuity. The calculation that Aviva used in the estimates provided on 13 and 16 February 2015, used the more generous factor of £10.22 for every £1 of annuity. Aviva has explained that the difference is due to the annuities

quoted being payable monthly in advance which means they are smaller in a proportion of 10.18/10.22, so the higher factor is used to reach the same Capital Sum.

- The Capital Sum at the Benefit Date was calculated using the factor set out in the policy terms and the annuity value. The annuity has been calculated using GARs, augmented by the terminal bonuses. Therefore, the Capital Sum includes the GARs and the terminal bonuses.

- The policy states "the Capital Sum on the Benefit Date **will** [Adjudicators emphasis] be that shown in the relative Benefit Schedule and at any other date shall be of such amount as the Society shall determine calculated upon a similar basis." While the Benefit Schedule states "Capital Sum In lieu of Annuity £10.18 in lieu of each £1 per annum of Annuity subject to General Provision VI(e)." The calculations over which the complaint arose are those provided in February 2015, for the Benefit Date. The term "will" implies a requirement, essentially Aviva has no discretion, therefore, Aviva is required to use the factor 10.18 at the Benefit Date, there is no option for Aviva to use a similar basis at the Benefit Date. There is no ambiguity.

- Since the complaint arose Mr E has passed the Benefit Date. VI(b) states:

  "to take an Annuity from such date earlier or later than the Benefit Date as the Grantee shall specify of an amount to be determined by the Society and payable as set out in the appropriate Benefit Schedule substituting the date so specified for the Benefit Date; provided that where a date earlier than the Benefit Date is specified no premium shall be payable after such specified date and where a date later than the Benefit Date is specified the benefits under the Policy shall be increased by reference to the period of deferment".

- The effect of VI(b) is that there is no guaranteed annuity where the policyholder wishes to take the pension otherwise than on the Benefit Date; and the effect of VI(e) is that the multiplier will not be 10.18, but an amount calculated using a similar methodology. Aviva says these alternative 'cash option factors' were fixed at the outset of the contract and linked to the premium rates. Aviva has provided a table setting these out.

- Following this, the policy terms state, at VI(e) that his Capital Sum is now to be calculated on a "similar basis" as it is no longer the Benefit Date. This is what Aviva has done in the valuations provided post Benefit Date. Aviva has said that as Mr E's policy has now matured, the benefits have been converted to cash and are increased at a deposit rate until the benefits are taken. If a pension is required at a later date a different factor will be used. For example, the valuation provided on 24 October 2017 uses a different factor.

- The Transfer Values Regulations do not apply in this case. The policies are a contract between the Trustees and Aviva to provide benefits as described in the

policy terms and conditions to the "grantees" upon the trust of the Scheme. The grantees in the case of the policy are the Trustees and the benefits are payable to the Scheme. I note that Mr E is Trustee and member, but this does not alter the terms of the contract. The policies are not an occupational pension scheme so, while these Regulations may apply to the Trustee and the Scheme, they are not applicable to the policies or Aviva. Aviva has confirmed that the transfer paperwork requires completion by the member and the Trustee. Aviva would then action the transfer as instructed on that paperwork.

- While the policies may refer to the Scheme and have been obtained for the Scheme, the terms and conditions of the policy are clear. There is no reference to, or clause that requires, the benefits to be altered from those provided for under the policy if they are no longer consistent with the Trustees' obligations to the Scheme. This is a matter for the Trustees to consider in order to meet their obligations to Scheme members.

- Hyman v Equitable Life is not applicable to Mr E's complaint. Equitable Life was applying a different terminal bonus depending on whether a guaranteed annuity rate policyholder opted to take Equitable Life's annuity (lower terminal bonus) or an open market option. This was because it had become too expensive for Equitable Life to honour its policyholders' guarantees. This decision is relevant only if there is evidence that the contractual guarantee is being undermined in some way by Aviva. Therefore, where the election is for benefits to be payable on the Benefit Date, the contractual terms must be adhered to in calculating the annuity and the Capital Sum, which mean the GARs must be taken into account. Consequently, the Adjudicator did not agree that Aviva is forcing surrender of the GARs, seeking to reduce the asset share, nor profiting from the calculation basis used as the Capital Sum was calculated in line with the policy terms.

29. Mr E and his representative did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. Mr E's representative and Aviva provided their further comments which do not change the outcome. I agree with the Adjudicator's Opinion and I will therefore only respond to the key points made by Mr E's representative for completeness.

Ombudsman's decision

30. Mr E's representative has said that the Adjudicator has not addressed all of the arguments based upon the UTCCR 1999 or the Consumer Rights Act 2015 (**the 2015 Act**). The policies were written in 1986. Therefore, the 2015 Act has no application. It does not apply to contracts entered into before 1 October 2015. Neither does the UTCCR 1999, nor the previous version, the Unfair Terms in Consumer Contracts Regulations 1994. Coverage under the earliest Regulations only began 1 July 1995, so about 10 years after these contracts were written.

31. Mr E's representative also refers to The Consumer Rights Act 2015 (Commencement Number 3, Transitional Provisions, Savings and Consequential Amendments) Orders 2015, which he claims preserve the application of the UTCCR 1999 for contracts entered into before 1 October 2015. I agree that this is correct, however the UTCCR 1999 does not apply to contracts made prior to it coming into effect, and the 2015 transitional order cannot change this to give the UTCCR 1999 retrospective effect, therefore it is not applicable to the policies written in 1986. As such it is not necessary to address all of the arguments raised in reliance of the UTCCR 1999 or the 2015 Act, as neither are relevant to the complaint at hand.

32. The two land law cases that Mr E's representative has cited to support his position, in respect of the 2015 Act and UTCCR 1999, do not appear to have any relevance to Mr E's complaint. There is no 'agreement to keep an offer open'. The policies simply allow the policyholder to take his retirement benefits in one of three ways: either as an annuity; or as a capital sum in lieu of the whole of the annuity; or as a capital sum in lieu of part of the annuity.

33. Mr E's representative maintains that Hyman v Equitable Life is relevant and that the policies are ambiguous. He states, "There is obviously evidence that the contractual guarantee is being undermined by Aviva – indeed it is not seriously in doubt. There is an undeniable mismatch between the annuity and the capital sum being offered in lieu. Research through the internet suggests to me that Aviva would convert the capital transfer value of £296,622.46 in [Mr E's] case to a level annuity of £5,884.36. That is to say, the current market rate offered by Aviva to [Mr E] is in the region of 5.84%. To offer a capital sum based on an annuity rate of 10.18% is obviously to undermine the value of that annuity."

34. Equitable Life argued that it had a wide discretion in its articles of association to award different final bonuses to its with profits retirement annuity policyholders whose policies provided for GARs, in effect to circumvent the guarantee. This was because it became too expensive for Equitable Life to honour it when the prevailing annuity rates at the time dropped below the GAR. Equitable Life sought to pay higher bonuses to policyholders agreeing to take a lower rate annuity than if they elected to take their higher guaranteed rate. Equitable Life was essentially bypassing the contract terms. It was not using the guaranteed contract rate in the calculation, in the way set out in the contract. The House of Lords held that the discretion could not be exercised in a way that went against the express terms of the policy. To do so put Equitable Life in breach of contract.

35. I do not agree that Aviva is in breach of contract in Mr E's case, or that a contractual guarantee is being undermined. Nor do I agree that the policies wording is ambiguous. If Mr E had opted to take his pension or lump sum on the contractual benefit date, the capital sum would have to be calculated taking the GAR into account, this is how the contract is expressly written. Indeed, this is how the benefits quoted in February 2015, as at Mr E's benefit date, were calculated. Aviva has calculated the transfer value in line with the policies, using the cash conversion factor

set out in the policies. The conversion factor is used to convert the annuity, which is calculated using the GAR and with profit bonuses, so I cannot agree that Aviva is depriving Mr E of the benefits of his with profits policy or the GARs.

36. The effect of VI(b) is that there is no guaranteed annuity where the policyholder wishes to take the pension other than on the benefit date; and the effect of VI(e) is that the multiplier will not be 10.18, but an amount calculated using a similar methodology. As explained by the Adjudicator, in accordance with VI(b), if benefits are taken at any other time, there is no guarantee. In this case, the amount of the annuity is to be determined by Aviva, it is not the amount specified in the benefits schedule, and the capital sum in lieu is to be calculated on a similar basis to the capital sum taken on the benefit date in line with VI(e). The alternative 'cash option factors' were fixed at the outset of the contract and Aviva has provided a table setting these out.

37. As such I am satisfied that Aviva has acted in line with the policies and that the UTCCR 1999 and the 2015 Act are not applicable to Mr E's complaint. The policies set out how the capital sum or transfer value is to be calculated and this is how Aviva has produced the quotations Mr E has been provided with. It is now up to Mr E to decide the best way for him to take his benefits if he still wishes to do so at the present time.

38. I do not uphold Mr E's complaint.

Anthony Arter

Pensions Ombudsman
14 December 2018