Our ref: L0904

10th October 2008

Dear Complainant

Thank you for your letter of 19th August, which details the elements of your complaint against the FSA. This letter sets out my final decision on the complaints you have raised.

At this stage I think it would be worth explaining my role and powers. Under the Complaints Scheme (Complaints against the FSA-known as COAF) my role is as an independent reviewer of the FSA's handling of complaints. I have no power to enforce any decision or action upon the FSA. My power is limited to setting out my position on your complaint based on its merits and then, if I deem it necessary, I can make recommendations to the FSA. Such recommendations are not binding on the FSA and the FSA is at liberty not to accept them. Full details of Complaint Scheme can be found on the internet at the following website; http://fsahandbook.info/FSA/html/handbook/COAF

The Complaint

Your complaint relates to a long term equity based retirement annuity policy which incorporated a guaranteed annuity rate (GAR) that you held with the Firm in question (the Firm). You state in your complaint that the Firm without your knowledge or consent switched the fund from equities to bonds and property between approximately 2001 and 2003. You took the benefits of this policy in 2006. That period according to your submissions, marked a "low point in the market". You state that you have lost £100,000 as a result of this change of investment focus by the Firm. According to your submissions you have complained to the Firm and it has responded that this change in investment strategy was done "in line with FSA requirements". You go on to raise the issue of the FSA requirement of Treating Customers Fairly (TCF), and you submit that the results of this investment change demonstrate that the Firm has not treated you fairly, and hence has not followed the FSA initiative in this area. Lastly you have stated that the FSA has failed to "properly intervene on my behalf" in regard to the events that have occurred and to, presumably, either compensate you for these monies "lost" or to enforce the Firm to do so.

My Position

Before I turn to the FSA's handling of your complaint I would like to emphasise some particular issues which I consider to be important in this case.

1) Clearly the product you purchased from the Firm entailed you entering into a contract with the Firm. In your complaint you refer to the action taken by the Firm, namely a change in investment strategy, as "illegal". As this is essentially a

contractual matter between a consumer and a provider the contract entered into will set out what the Firm can, and by implication, cannot do. Clearly if the Firm is acting outside of the bounds of the contract you had with it then this dispute could be decided by a legal process through court action. As you appear not to wish to take such action, this suggests to me that the Firm was entitled by virtue of the contract entered into, to take the action it did. This clearly calls into question the correctness of your allegation of the Firm's actions being "illegal". In your submissions to the FSA you have stated that it would be "absurd" for the FSA to expect you to take legal action in this case. It is my preliminary view that if the case was as clear cut as you suggest, legal action would be the correct approach.

2) You state that you have "lost" approximately £100,000. At this time I do not consider this to be an actual "loss". I consider it to be a perceived loss or a loss of expectation, which is significantly different from an actual loss. Considering the amount of time you contributed to this plan and based on the information you have provided to me I have assumed that the returns you are receiving, based on the 'pot' you had accumulated is not £100,000 less than the amount you have invested into the plan. Obviously in your submissions to this preliminary report I would expect you to provide evidence to me on this point if my assumption is in fact incorrect. If my assumption is correct your "loss" would be better defined as not benefiting from a "potential gain".
3) It is important to remember that policies such as these, that is where there are different types of investments which can be invested into what are different risk profiles, there are two distinct elements which defines what the returns are likely to be. Namely the investment decisions taken, or investment strategy, and the subsequent investment performance in these areas. No investment is without an element of risk and when investment decisions are taken there can be no guarantee as to future performance. It is quite possible that when the change in investment strategy your complaint centres upon was taken, subsequent events could have led to you avoiding a substantial perceived loss, and possibly an actual loss, if the equity markets had continued to fall until after you encashed the policy. This leads to the unavoidable conclusion that it is the overall fund performance which your complaint is about and not the choice of investment strategy made between 2001 and 2003.
4) Similarly your illustration using the FTSE All share index is also misleading. The 'pot' you accumulate in a with-profits fund is based on the bonuses that are attributed to it by the Firm on a regular basis. These bonuses are at the discretion of the Firm and in most cases they do not reflect the entire growth of the markets invested in during that period of time. This is because in deciding the size of the bonus to be allocated, the Firm takes into account many issues such as potential falls in future, the benefits of smoothing, its own investment analysis of the markets invested in and such other issues that it considers pertinent. This normally leads to bonus size being carefully considered before being awarded cautiously. A consequence of this is that individuals' 'pots' are less than the gains that would have been made on a straightforward index linked policy on encashment during times of growth, but similarly would not be as catastrophic as would be the case of

encashment in times of decline. The benefits of smoothing should not be underestimated.

5) The FSA initiative of Treating Customers Fairly, often known as TCF, is often misunderstood. TCF refers to consumers as a whole, or at least as a class of consumer, as opposed to the often assumed consumer as a single individual. When applying TCF in your circumstance it refers to ensuring that the class of consumer you fall into, namely those holding the policy which you complain about, refers to ensuring that all such policyholders are treated fairly as a whole. From the evidence I have seen I understand that this fund is a closed fund, that is, there cannot be new entrants to it. Consequently as its investors seek to encash their policies the fund is steadily shrinking. This poses problems to the Firm, much the same as funds whose popularity is increasing get benefits from their increasing size. As funds reduce in size they lose buying power in the market as incrementally each encashment by an investor reduces the fund by a larger percentage on each occasion. This, when not anticipated and acted upon benefits those encashing early and damages those who encash their proceeds later. Eventually this leads to the very last policyholders receiving either a return amounting to an actual loss or nothing at all. As a consequence it is only fair and proper that Firms take steps to ensure that its classes of policyholders are treated equally, rather than some getting maximum benefits and others nothing. It is my view that this change of investment strategy was in keeping with the FSA initiative of TCF.
6) It is appropriate at this point for me to rehearse what Parliament has legislated as the FSA's regulatory objectives. In discharging its general functions the FSA must act in a way which is not only compatible with these regulatory objectives but appropriate to the purpose of meeting them. The objectives are market confidence, public awareness, the protection of consumers and the reduction of financial crime. In that context therefore the relevance of the preceding paragraph is, I hope, clear to you. I should also add that the protection of consumers includes by virtue of both section 5 of Financial Services and Markets Act 2000 (FSMA) and section 138, the collective interests of a group of consumers who individually may not replicate each others' interests.
7) I now turn to the issue of capital adequacy. You have referred to the importance of the GAR element of the policy you have and how the change of investment strategy changed the effect of this. In your submissions you have referred to another firm which has been in the public eye for some years now in relation to problems it had in relation to its own GAR holders. However you do not expand upon the key issue in that particular case, namely that enterprise's ability to meet its liabilities. It does not seem unreasonable to me to expect firms to take steps to ensure that they have adequate resources so that they can ensure that they can pay their current and future liabilities. In the wake of this public interest in such firms and their ability to meet their liabilities the FSA took action to ensure that all firms were fully aware of the need to ensure that their future liabilities could be met. Many firms having appraised their own situations then took corrective action to ensure that all liabilities could be met. This often meant that investment strategies reduced the level of risk involved in such pooled investments. I do not consider a firm's decision to reduce risk to its

customers to ensure it could meet its liabilities to those very same customers to be unreasonable, even if this led to "potential" extra gains for those customers being missed out upon.

In your complaint you have stated that the FSA has failed to "properly intervene on your behalf", however you have not demonstrated any fault by the FSA. Neither have you demonstrated any wrongdoing by the Firm or any breach of your contract with the Firm. It appears to me that your argument in support of your complaint is that because you have missed out on a potential extra gain then the Firm, and consequently the FSA, must be at fault. Just because you did not receive as much of a return as you had hoped for does not necessarily mean that any negligence or malfeasance by any party has taken place. When a firm manages a fund it is constantly evaluating the overarching position that the fund faces. These will include the fact that it is a closed fund, the fact that there are potential liabilities in the context of contractual guarantees that the fund faces, that equity performance is always uncertain (in your case your complaint would not arise had the market fallen even further) and finally that there is an anticipated timescale within which liabilities must inevitably arise given governmental policy in this area which is currently common to both main political parties. In the light of all this and indeed particularly current volatility in the stock market I do not see how you can just use the argument that the FSA is responsible for what has occurred in the context of the value of the fund diminishing in the way that it has.

In your complaint you suggest that the FSA has "failed to comply with the principles established…. in the (another Firm's) case". The FSA, in my view, dealt adequately with this issue in its letter of 23rd May 2008. I will however for the sake of completeness add this. The case and judgment that you refer to does not have the effect that you maintain in your correspondence. The particulars of the case are relevant in that they arose within the constitution of a mutual organisation with a policy of no reserves being put in place for future liabilities, differing priorities of different classes of members and a Board policy that was challenged by one of the classes in question on the basis that allocating proceeds in terms of bonuses in a particular manner did not lie solely in the hands of the Directors for the time being. The *ratio decidendi* of the case had nothing whatsoever to do with the management of a closed fund with the issues that affect such a fund that I have outlined in the proceeding paragraph.

For this reason and for the issues I have raised earlier I do not uphold your complaint.

Yours sincerely

Sir Anthony Holland
Complaints Commissioner