

Ombudsman's Determination

Applicant	Mrs R
Scheme	Aviva Section 32 Policy
Respondent(s)	Aviva

Complaint Summary

1. Mrs C has complained that Aviva has refused to pay a 3% per annum compound escalation rate on her policy, from its maturity date, which she says was agreed at the outset.

Summary of the Ombudsman's Determination and reasons

The complaint should not be upheld against Aviva because:

- The policy expressly provided for the escalation element to be withheld if the policy did not accrue sufficient value to meet the guaranteed minimum pension.

Detailed Determination

Material facts

2. In January 1987, Mrs R transferred her pension benefits from the Boots Pension Scheme to a Norwich Union Transfer Plan 32 which is now known as the Aviva Section 32 Buyout Bond (**the Plan**).

Proposal Form

3. The policy proposal was completed and signed by Mrs R on 13 August 1986 and then countersigned by a representative of the Trustees on 9 January 1987.
4. The proposal form asked Mrs R to "...tick to denote benefits as specified by the Scheme Rules and complete where necessary".
5. Mrs R completed the relevant sections of the proposal form and indicated that the following options should apply.
 - A guaranteed fund of £15,235.00.
 - A *Single Life Pension*. Guaranteed Payable for 5 years.
 - A Widows Pension equal to 50%, which is to *commence from the date of the members death and which does not cease on remarriage*.
 - All Pensions in payment to increase at a rate of 3% pa compound.

Figures and entries in *italics* represent information manually added or selected by Mrs R.

Acceptance terms for Transfer Plan 32 Policy

6. Norwich Union wrote to Mrs R on 26 January 1987, confirming that, among other things, her:

"...recent proposal has been accepted for the benefits stated therein..."

and

"It is guaranteed that this sum will provide a Revalued Guaranteed Minimum Pension of £1999.92 per annum at State Pension Age."

...

"The benefits payable will not exceed the Maximum Approvable Benefits quoted in the proposal..."

"Terms regarding payment of the benefits will be set out in the policy."

Policy details

7. The policy covering the Plan's benefits was issued on 29 September 1987 and the First Schedule to the Policy identifies, that the "Benefit Date" is 11 July 2016, Mrs R's 60th birthday.

8. The Second Schedule states, under the heading "BENEFIT AND EVENT CAPITAL SUM:

On the survival of the Insured until the Benefit Date a Capital Sum of £15235.00 (plus compound bonus declared thereon by the Society from time to time) which shall be applied in accordance with Policy Condition 7."

9. Then, under the heading "DEFINITIONS" it states:

"GUARANTEED MINIMUM PENSION

£187.72 per annum increased by 8.5% compound for each complete year from 6th April 1987 to the 6th April immediately preceding the attainment by the Insured of the State Pensionable Age of 60 or the Insured's death whichever is the earlier.

ESCALATION PERCENTAGE RATE

3.00% per annum compound."

10. Policy Condition 7 says:

"Application of the Capital Sum

At the Benefit Date or the Substitute Benefit Date subject to the election of the Insured under Condition 8 so much of the Capital Sum as shall be appropriate shall be applied using the Society's then current annuity rates to purchase an immediate pension payable to the Insured which shall not be less than the Guaranteed Minimum Pension nor more than the Maximum Pension..."

11. Policy Condition 8 says:

"Pension Payments

Each pension purchased in accordance with Condition 7 shall be payable for the lifetime of the person to whom it is payable in regular instalments of such frequency as the Insured shall elect provided that the total amount of pension and Widow's pension payable shall not be less than the total amount of Guaranteed Minimum Pension and Guaranteed Minimum Widow's Pension respectively required by the Social Security Pensions Act 1975"

12. Policy Condition 9 says:

“Increases in Pension

“Pensions purchased under Condition 7 shall increase at the Escalation Percentage Rate specified in the Second Schedule. If an Escalation Percentage Rate is not specified the Insured may elect that the pension purchased shall increase at a percentage rate not exceeding 8.5% compound per annum. The increases in pension shall apply from each anniversary of the Benefit Date or the Substitute Benefit Date. This is subject to the amount of the pension per annum being limited to the Maximum Pension or Maximum Widow’s Pension as appropriate increased by the accumulated increase in the Retail Prices Index published in the calendar month preceding the month in which such anniversary occurs since that published in the calendar month preceding the month in which the Benefit Date or Substitute Benefit Date occurred or 3% compound per annum whichever is the greater less in the case of a pension payable to the Insured the pension equivalent of any cash sum taken at the Benefit Date or Substitute Benefit Date under condition 10. If the value of the Retail Prices Index is not published in any particular month the most recently published value will be applied.

The rate of increase in pensions shall not be such that the pension payable to the Insured which can be purchased by the Capital Sum shall be less than the Guaranteed Minimum Pension and the Guaranteed Minimum Widow’s Pension respectively.”

Summary of Mrs R’s position

13. Mrs R says that Aviva has complied with all the features of the Plan, except the 3% per annum escalation.
14. She argues that Aviva has contractually agreed to provide this escalation and must now do so.

Summary of Aviva’s position

- The assumed growth rates used were those approved by the regulator at the time, the actual performance has not lived up to those expectations. This combined with significant reductions in annuity rates, has meant there is a shortfall in the funding of the basic Guaranteed Minimum Pension and the Guaranteed Minimum Widow’s Pension respectively (**GMP**) for which Aviva is having to meet the cost. It has therefore meant there are no surplus funds available to provide for the pension to escalate in payment.
- As the Plan contains only Pre 1988 Contributions there is no legal requirement for firms to provide escalation on the GMP.

- Condition 7 relates to the application of the capital sum and confirms any pension should not be less than the GMP. The second paragraph of Condition 9 states 'The rate of increase in pensions shall not be such that the pension and widow's pension which can be purchased by the capital sum shall be less than the Guaranteed Minimum Pension and the Guaranteed Minimum Widows pension respectively.' Therefore, applying an indexation of 3% per annum would reduce the GMP by almost a half and so is not permitted.

Adjudicator's Opinion

15. Mrs R's complaint was considered by one of our Adjudicators who concluded that further action was required by Aviva. The Adjudicator's findings are summarised briefly below:

- Aviva have a contractual obligation to pay increases at 3% per annum compound from Mrs R's 60th birthday.
- The Pensions Ombudsman has previously issued a determination in the case of Mr A Harris (the Harris case) PO-2269, and the conclusions drawn from that case are directly applicable here. The Adjudicator did however note several key differences between the Harris case and this case.
- The key differences with Mrs R's policy compared to the Harris case were:-
 - There are no references to the legislation in Condition 7 of Mrs R's policy, but there are references to the legislation in Condition 8.
 - Condition 8 states that the pension purchased in relation to Condition 7 shall not be less than the GMP. It does not say that in the event that only the GMP is payable it is limited to that payable under the legislation.
 - Condition 9 states that the pension purchased under Condition 7 shall increase at the Escalation Percentage Rate specified in the Second Schedule that is 3 per cent per annum.
- The Adjudicator said that other Aviva Section 32 Buyout policies had been seen that state, under Condition 9:

"That part of the pension purchased under Condition 7 which exceeds the Guaranteed Minimum Pension and the Guaranteed Minimum widow's pension respectively shall increase at the Escalation Percentage Rate specified in the Second Schedule..."

But there is no such restriction under Mrs R's policy and, indeed, if there was such a restriction it would limit Mrs R's pension increase from age 65 to zero.

- The original policy proposal gave Mrs R two alternatives, either to have all of the pension increasing at a fixed percentage or for the increase to only apply to the pension in excess of the GMP. Mrs R chose for all of the pension to increase at 3% a year.
- That various options were presented to Mrs R when taking out the policy suggests, on the balance of probabilities, this was a deliberate act by the then scheme administrators to change or augment the standard policy wording that normally applied at the time, to coincide with the terms specified on the Proposal Form.
- There is nothing in the legislation that would prevent an equivalent pension having pension increases applied after age 65, and given that the policy does not define the GMP in relation to statute, it should be read as requiring pension increases to be provided in accordance with the Escalation Percentage Rate stated in the policy document.
- The standard policy wording was altered to ensure the Plan complied with the Second schedule, the proposal form and the Acceptance terms letter issued by the scheme administrator.

16. Aviva did not agree with the Adjudicator's views and submitted the following, in summary: -

- The conclusion reached in the Opinion would have a serious impact on Aviva and its with-profits policyholders.
- The Opinion places too much emphasis on a previous Ombudsman's determination about early retirement options, which is not relevant in this case.
- The Opinion fails properly to take into account the contractual context or the specific effect of the key contractual provisions in the Policy in relation to the escalation payments.
- The Opinion incorrectly determines that the proposal form altered the standard terms and conditions of the Policy, and that ordinary principles of contractual interpretation do not support the conclusions reached.
- The Opinion erroneously states that the fact the Policy does not define GMP in relation to statute means it should be read as requiring escalation payments to be made.
- The Opinion does not deal with the express provision in the Policy that the escalation payment cannot be made where providing the full rate of escalation would result in the annuity that can be purchased on behalf of the policyholder paying less than his or her GMP.

Conclusions

17. The premise behind Section 32 Buyout Bonds such as the one sold to Mrs R was that the transfer value would be invested and at retirement the total fund would be used to provide a pension. There would, however, be a guarantee that the pension would not be less than the GMP that the individual would have been entitled to under the transferring scheme. The expectation promoted by insurers and their agents was that there would be sufficient funds available at retirement to provide the GMP and additional pension benefits as well.
18. The proposal form that Mrs R completed gave various options as to the pension increases which could apply at normal retirement date. These included the option for all of the pension, inclusive or exclusive of the GMP, to increase at a fixed rate. So it must have been in the contemplation of all the parties that significantly higher benefits than just those required to meet the statutory obligation (the GMP) were achievable and intended. However, that is not the same as guaranteed.
19. In this instance Mrs R selected the proposal form option that all her pension benefit, inclusive of the GMP, to increase at 3% pa. On that basis Mrs R signed the proposal.
20. In response, Norwich Union issued Mrs R with a letter dated 26 January 1987, confirming acceptance of her proposal. It did, however, say that terms regarding payment of the benefits would be set out in the policy. So the policy was where to look for the full terms and conditions being entered into by the parties.
21. The letter also said that the benefits payable would not exceed the maximum permitted by the Inland Revenue, so even those specifically negotiated or agreed were subject to the requirements set by the relevant authority under the powers granted to it by legislation.
22. Finally, the letter said "It is guaranteed that this Sum (the Capital Sum of £15235.00 with profits) will provide a Revalued Guaranteed Minimum Pension of £1999.92 per annum at the State Pension Age." Thus the letter confirmed *a guarantee of GMP* (as required by statute) *but no additional guarantee to escalation* on that figure. It would, therefore have been open to Mrs R to clarify whether the escalation was guaranteed, as she had expected it to be, or she would only proceed if it was guaranteed.
23. Norwich Union issued a policy document in relation to the Plan and set out in Policy Condition 7 that the Capital Sum at Mrs R's Benefit Date would not be less than that required to meet the GMP. Schedule 2 of the Policy said that the escalation or increase on the pension would be 3% per annum compound. However, this definition was itself not explicit as to whether the 3% applied to the total pension benefit, inclusive of the GMP.
24. Condition 9 also confirmed that pensions purchased under Condition 7 would increase at the Escalation Percentage Rate specified in the Second Schedule. Again,

though, without clearly stating whether this was intended to be inclusive or exclusive of GMP.

25. Since Norwich Union drafted the policy terms, any ambiguity is to be read against Norwich Union/Aviva under the 'contra preferentum' rule. This doctrine provides that, where a promise, agreement or term is ambiguous, the preferred meaning should be the one that works against the interests of the party who provided the wording. The doctrine is often applied to situations involving standardised contracts or where the parties are of unequal bargaining power.
26. However, having carefully considered all the provisions and pre-contract paperwork, I am not satisfied that a contractual or other guarantee to provide an escalation over the GMP was made or can be inferred in Condition 9 or otherwise.
27. Clearly, it was hoped that the policy would accrue sufficient value to meet the GMP and also the escalation rate. The option set out in the proposal form was to select an escalation rate applying to a part or to all of the pension benefit.
28. But neither the confirmation letter nor the policy guaranteed, *without exception*, that the escalation rate chosen by Mrs R would be met.
29. Norwich Union knew they were obliged, whatever happened in the investment market, both under statute and contract, to ensure an annuity would be purchased for Mrs R to cover the cost of the GMP. Although it may have seemed unlikely at the time, the prospect that investment returns might not be sufficient to meet the escalation rate as well as paying the GMP, was obviously considered by Norwich Union. So the policy has a caveat, in condition 9, whereby escalation rates can be suspended if the capital sum fails to achieve the necessary return required to meet the cost of providing the GMP.
30. In the event, the Capital Sum could not provide sufficient monies to purchase the GMP annuity, so it obviously could not provide the benefit escalation. Aviva are obliged to cover the GMP shortfall and if necessary, to top up the policy to do so, but given the proviso set out in condition 9, in my view, they are not required to also provide additional monies to pay the escalation rate.
31. I appreciate this will be extremely disappointing for Mrs R. My decision is that I do not uphold her complaint against Aviva.

Anthony Arter

Pensions Ombudsman
5 October 2017