DRN-2607745

The complaint

Mr S complained about the advice he received from Wise Financial Consulting Limited to buy a level payment annuity rather than a drawdown plan. Mr S has been represented by a claims management company, who I refer to below as “F”.

What happened

In January 2013 Mr S met with one of Wise’s advisors. The advisor completed a *fact find* which recorded details of Mr S’s financial situation and his pension requirements. The key information in respect of this complaint in the fact find is:

- Mr S had two pension schemes that he wanted to draw benefits from
- Mr S had savings in a deposit account, but no other investments
- Mr S had a ‘conservative’ attitude to risk – which according to a table in the fact find correlated to him wanting to take no risk whatsoever with his pension income [for completeness, the other options were ‘cautious’ (which meant Mr S was prepared to take a limited risk with his pension income) and ‘medium to speculative’ (which meant Mr S was prepared to accept an increased risk with his pension income)]
- it was important for Mr S to provide a pension for Mrs S after he died
- Mr S wasn’t interested in ensuring that his pension kept up with the rise in the cost of living (which would in turn mean lower starting pension payments)
- Mr S wasn’t interested in ensuring that if he died within a set period of time his estate received the value of all payments that would have been made – a further comment said Mr S didn’t want to place a guarantee on the pension as he felt his children would inherit a substantial amount anyway.

A few days later the advisor wrote to Mr S outlining his recommendation and the reasons for it. The key information in respect of this complaint in the letter is:

- Mr S’s attitude to risk was discussed in detail and he didn’t want to take any risk with his retirement income
- the options available were highlighted and discussed in a bit more detail:
    - drawing benefits from the existing provider – Mr S could take the tax free cash available but the current provider didn’t have the option to provide Mrs S a pension if Mr S died first
    - drawing the tax free cash allowed from the existing provider and buying an annuity with a different provider – shopping around could increase the level of income; but income depended on several factors, including the type of pension chosen

- moving to a drawdown pension – Mr S could take the tax free cash available and instead of buying an annuity the remainder of the fund would remain invested
  - capped drawdown – income can be withdrawn from the invested fund each year; the maximum amount of income is 'capped'
  - flexible drawdown – there is no limit on the amount that can be withdrawn each year; but Mr S would have to have income of at least £20,000 per annum from other secured pension assets
- moving to a phased retirement – the pension fund is spilt into equal segments which can be phased in over a number of years; the remaining segments continue to be invested
- moving to a combination of the above – essentially a combination of drawdown and phased retirement

- the drawdown, phased retirement and combination options were discounted as Mr S indicated that he wanted a fixed level of income with no risk

- the different annuity options were outlined:

  - unit linked and with profit annuity – this was discounted as Mr S wanted a fixed and ongoing income stream
  - impaired life annuity – Mr S's good health meant he couldn't benefit from this
  - level annuity – Mr S would receive a higher income initially (compared to an annuity that increased over time) and if inflation remained low it could take 20+ years for an increasing pension to match a level annuity's overall return
  - Retail Price Index ("RPI") and Limited Price Indexation ("LPI") escalation – the annuity would be index-linked to the RPI or LPI so the income would rise with inflation and maintain its value
  - fixed rate escalation – the income would increase each year by a fixed percentage.

The advisor recommended that Mr S buy a level payment annuity. This meant he would receive a regular pension payment of the same amount for the rest of his life. He said Mr S had decided that it made sense to have a higher level payment at the outset, rather than a lower index-linked income, due to the number of years it would take for an increasing annuity to reach the same income as a level annuity.

Mr S followed the advisor's recommendation and bought a level annuity.

In August 2019 F complained to Wise about the advice Mr S received. In essence F felt the advice was unsuitable as the various options weren't presented to Mr S in a fair and balanced way and Wise didn't act in his best interest when recommending a level annuity when there were more attractive options available. F made various points and arguments in support of the complaint:

- annuity rates in 2013 were near all-time record lows

- Mr S's attitude to risk was recorded in 2013 "no/low risk" and "limited risk"; however he would have been willing to take a small amount of risk in order to have a higher retirement income than was available from an annuity if he'd been properly informed of the different options available and of the effect that inflation would have on the future purchasing power of his retirement income

- because Mr S's income from the annuity doesn't increase, its purchasing power is eroded each year by inflation

- Mr S wasn't properly informed of the advantages of a low-cost, low-risk income drawdown plan

    - F gave an example that a well-diversified portfolio of low-cost index funds would mean a drawdown plan carried minimal risk and could provide a much higher lifetime income, which increased each year in line with inflation
    - to illustrate the point, F said from 1985 to 2018 the average annual return from a simple low-risk portfolio of 40% UK Equities and 60% UK Bonds was 9.2%; and in only four of those years would the portfolio's value have decreased

- a large and low-cost index fund provider offered a fund to UK retail investors where the total expense ratio of the fund is 0.15% per year and the average annual net returns since 2011 were around 7.75% per year; if Mr S invested in this fund he would now be significantly better off

Ultimately, F said Mr S would have taken a small amount of risk and chosen a low-risk/low cost drawdown plan if he'd been made fully aware of the advantages and disadvantages of the different options available; which in turn would mean he would be better off today. The redress F sought for Mr S was based on the notional current value of a drawdown plan, if the funds had been invested according to the FTSE Private Investors Income Index.

Wise didn't think it had done anything wrong. It felt Mr S had been properly advised given the information in the fact find. In summary, it said:

- the regulator's guidance at the time was that drawdown was likely to be unsuitable to someone in Mr S's position

- there is no such thing as a low-risk drawdown – F's example of a fund investing in 40% UK Equities didn't match Mr S's attitude to risk

- Mr S had been made aware of all options

- Mr S said at the time that he didn't want his pension income to keep up with the rise in the cost of living, and he didn't want to take any risk whatsoever with his pension income

- the risk associated with the funds F had referred to (where the returns were around 7.75% per year and in the proposed redress) was far higher than the 'no risk' Mr S said in 2013 that he was prepared to take.

Our investigator didn't think the complaint should be upheld. In summary, he felt the options were sufficiently explained to Mr S, and that the advice was suitable given the information in the fact find.

F disagreed. It remained of the view that the advice to purchase the annuity was unsuitable and that Wise had failed to present the options to Mr S in a fair and balanced way. In addition to the arguments previously made, F said that a level annuity isn't a "no-risk" option, and a low-cost/low-risk income drawdown plan would have been more suitable.

What I provisionally decided – and why

I issued a provisional decision which explained why I didn't think the complaint should be upheld. I've repeated that below. It forms part of my final decision.

Issue for me to determine

Ultimately, the issue I need to determine is whether Wise treated Mr S fairly. For me, the two main issues I need to consider and decide in that respect are whether the advice Mr S received to buy an annuity was suitable and, if so, whether the advice Mr S received to by a *level* annuity was suitable.

Relevant rules

There were various regulations set by the regulator that were in force at the time of the advice. They are in COBS, which replaced the COB rulebook. F referred to two of them in its submission to Wise:

- COBS 2.1.1 – a firm must act honestly, fairly and professionally in accordance with the best interests of its client

- COBS 4.5.6 – if information compares relevant business, relevant investments, or persons who carry on relevant business, a firm must ensure that the comparison is meaningful and presented in a fair and balanced way.

In addition, there is:

- COBS 9.2.1 – a firm must take reasonable steps to ensure that a personal recommendation is suitable for its client; and when making the recommendation the firm must obtain the necessary information regarding the client's:

    - knowledge and experience in the relevant investment field
    - financial situation, and
    - investment objectives

  so as to enable it to make the recommendation which is suitable for the client

- COBS 9.2.2 – a firm needs to get enough information from the customer to be able to make sure the recommendation meets their objectives, they're able to bear any related investment risk and they understand the risks involved in the transaction

- COBS 9.2.6 – if a firm doesn't obtain enough information to assess suitability, it mustn't make a recommendation.

The over-riding regulatory principle of the rules is that Wise had a duty to treat Mr S fairly.

Relevant documentary evidence

The two documents I've seen that I consider to be the most important to my determination of what happened at the time of the advice are the fact find document and the subsequent 'advice' letter sent by the advisor.

Mr S's attitude to risk

The fact find says that Mr S wanted to take no risk with his pension income; but F suggests that Mr S would in fact have been prepared to take some risk if he'd been properly informed.

The 'advice' letter said that Mr S and the advisor had a detailed discussion regarding Mr S's attitude to risk. So I think, on balance, any discussion on the subject was more than a simple ‘tick box’ exercise. The other options that were available in the fact find indicate that Mr S chose the ‘no risk’ option over the other two riskier choices.

I accept that Mr S’s attitude to risk at the time he met with the advisor might have changed once he became aware of the options. However, I consider the fact find to be the most persuasive piece of evidence I’ve seen which reflects what was discussed when Mr S met with the advisor. It’s contemporaneous documentation from the time, so it’s not subject to hindsight or faded memories. It was also signed by Mr S, so I think he probably saw it at the time. And the information contained within it is clear and unambiguous, and in terms I think Mr S would likely have understood.

So while I’ve taken the latest submissions into account, in light of the above I’m satisfied the fact find is an accurate record of Mr S’s attitude to risk at the time he met with the advisor. I therefore conclude that Mr S wanted to take no risk with his pension income. I think Mr S’s aversion to risk, and my conclusion on it, is supported by the fact he only had savings in deposit accounts (which are low risk) and he didn’t have any other investments.

Was the advice to buy an annuity suitable?

As I’ve outlined above, the advisor was required to gather and consider sufficient information from Mr S to ensure that his recommendation met Mr S’s objectives. In my view, the information contained within the fact find met this requirement. In addition to what I’ve listed above, the advisor got information about Mr S’s current income, assets and financial commitments. The information on the whole was sufficient to give the advisor a picture of Mr S’s financial position, objectives, attitude to risk and capacity for suffering loss.

There were several options available to Mr S in terms of the type of pension he could have. F has made the comment that annuity rates in 2013 were at an all-time low. It’s true that annuity rates were low in 2013; but that in itself, in my opinion, doesn’t automatically mean the advice given to Mr S to buy an annuity was unsuitable. It needs to be compared to what other options were available to Mr S and ultimately depends on Mr S’s circumstances at the time.

I’ve already discussed Mr S’s attitude to risk above. Further to that, apart from his state pension this was Mr S’s only pension income. So he had no capacity to suffer a loss on it – he didn’t, for example, have other pensions or investments he could fall back on if this income was lost. In my view, an annuity was the only option that closely matched Mr S’s (in)capacity to suffer a loss and his conservative attitude to risk. His income wasn’t exposed to investment risk and it provided planning security in retirement and was guaranteed for life.

So I think an annuity was suitable for Mr S.

Was the advice to buy a level annuity suitable?

There were several options available to Mr S in terms of the type of annuity he could have. Mr S was clear that he didn’t want to accept a lower starting annuity for the benefit of ensuring that his income kept up with inflation. All the annuity options were presented to Mr S in the advice letter in a clear, fair and balanced way. The letter set out and explained the available options and I think equal weight and consideration was given to each one.

It is true that a level annuity will lose its buying power due to inflation. But I don’t think that means it’s risky – in the sense that it shouldn’t have been recommended. There was (and remains) no risk to Mr S’s pension income as he will continue to receive the same payments for the remainder of his life. The reason his pension income will lose buying power is because he specifically told the advisor that he wasn’t interested receiving lower income initially to ensuring that his pension increased in line with inflation over time and maintained its value.

I'm satisfied the advisor sufficiently informed Mr S about the effect inflation would have on his future income. He wasn't explicit in his explanation of the level annuity that its buying power would reduce over time. But I think that was inherent from what he said about the annuities that increased ie that they would maintain their value (or purchasing power) as they increased in line with the relevant index.

Mr S was given clear annuity options to choose from and given his stated preferences in this regard I think Wise's advice to buy a level annuity was suitable in the circumstances.

More suitable options

F argued that a drawdown would have been more suitable. There were two types of drawdown mentioned by the advisor. I don't think flexible drawdown would have been available as Mr S didn't have a minimum secure income of £20,000 from other sources. A capped drawdown didn't have such a requirement, so would have been an option for Mr S.

Even if the drawdown was low risk (as suggested by F) that doesn't align with the fact that at the time the advice was given Mr S didn't want to take any risk whatsoever with his pension income.

In any event, I'm not persuaded that a drawdown plan is low risk. The pension funds remain invested and are exposed to investment fluctuations so while there's a chance they will grow there's also a chance they will reduce. The pot also reduces if ongoing charges aren't outweighed by investment returns, which generally tend to be lower the more cautious an investor is. And there's the risk that withdrawals and not high enough returns might lead to a consumer running out of money before they die or having to heavily reduce their income later in retirement. These are real risks that can't and shouldn't be underestimated.

F referred to three types of portfolio/fund in support of his argument that a drawdown was the most sensible alternative. Given what I've said above about the risky nature of drawdowns, I think this largely falls away. Nevertheless, while it might be true that the returns from the suggested portfolio was 9.2%, the portfolio invested 40% of the funds invested in equities. In respect of the fund where the returns were around 7.75% per year, I've seen a document titled 'Key Investor Information'. Under the heading 'Risk and reward profile' it shows that the fund is rated '5' (out of '7') – with 0 being no/low risk and '7' being high risk. In respect of the Index F referred to in respect of the redress, 52.5% of the fund is invested I equities. So I don't think any of the portfolio/funds F referred to match Mr S's attitude to risk at the time or F's submission that Mr S was willing to take a *small* amount of risk. I would also like to note that past investment returns shouldn't be used as a guarantee for future returns.

For the above reasons, I conclude that a drawdown was unsuitable for Mr S given his objectives, attitude to risk and capacity for loss.

F also argued that the options available to Mr S weren't properly explained to him in a fair or balanced way. That in turn leads to the point about Mr S being prepared to take a small amount of risk in order to get a higher retirement income if the options had been properly explained.

I've just concluded above that a drawdown plan was unsuitable for Mr S. So I don't think it really matters in this case whether or not the option was properly explained – this only really becomes relevant if several suitable options are presented. Nevertheless, I've commented on the point for completeness. As I've set out above, the 'advice' letter outlined the various pension and annuity options that were available, and explained why each option (apart from the level annuity) was being discounted. In my opinion, the way the options were set out was sufficiently fair and balanced as equal weight and consideration was given to each option.

Conclusion

F said it's clear there were more attractive options than the annuity Wise's advisor recommended. But apart from the drawdown option (which I've concluded was unsuitable) he hasn't said what those options were or provided anything showing that they aligned with Mr S's objectives, capacity to suffer loss and attitude to risk at the time.

Mr S wanted a secure pension with no risk to his future income. Mr S also wanted pension income that didn't take account of inflation. In my opinion, the advice to buy a level annuity was suitable and met his requirements and objectives.

I therefore conclude that Wise treated Mr S fairly and acted in his best interest.

Responses to my provisional decision

Wise confirmed that it didn't have anything further to add. F didn't accept my provisional decision and asked me to change it. It made various points which I've outlined and commented on below.

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.

I don't think F's response to my provisional decision contains any new points that I haven't already considered – they're essentially the same points it made previously, which I discussed in my provisional decision. I'm not therefore persuaded to change my mind.

The first point F made was that an investor can only decide how much risk they're prepared to take if the options are explained to them in a fair and balanced manner. In my provisional decision I concluded that the options had been presented to Mr S in a fair and balanced way. I also concluded that Mr S wanted to take 'no risk' with his pension income. I gave my reasons for those conclusions.

The next point F made was that the two main options for Mr S were an annuity or an income drawdown plan, neither of which it said is risk free – the main risk with level annuities being that purchasing power of the income reduces over time due to inflation; and the main risk with drawdown plans being short-term fluctuations in the value of the fund.

I agree with F that, technically, a drawdown plan was an option for Mr S. However, in my provisional decision I concluded that the only option that closely matched Mr S's capacity to suffer a loss and his attitude to risk was an annuity. I gave my reasons for that conclusion. I also said that a drawdown didn't match Mr S's risk profile because of the risks (which I outlined) involved.

I accepted that with a level annuity the purchasing power of the income reduces over time; however I explained why I didn't think that meant it was risky. I also said the reason Mr S's pension income will lose purchasing power is because he wasn't interested in ensuring that his pension increased in line with inflation over time.

The third point F made was that a sensibly diversified portfolio of funds with a low-risk asset allocation and with fixed regular withdrawals equivalent to those of a level annuity has virtually zero risk of failing to maintain that level of income for the rest of an investor's life. It further said it is virtually certain to provide substantially more total income to the investor than a level annuity.

I explained in my provisional decision why I didn't think a drawdown plan is low risk. I disagree with F's view that there is a low-risk drawdown. I also disagree that there's virtually no risk a drawdown will fail to maintain a similar income for the rest of an investor's life. The mere fact the remaining pot could reduce or run out altogether before the investor dies (for reasons I outlined in my provisional decision) is evidence of this.

F's final point was that if Mr S had been properly given all the information it would have been easy for him to conclude that a drawdown plan would be in his best interests. I said in my provisional decision that as I'd concluded a drawdown was unsuitable for Mr S, I didn't think it mattered whether the option was properly explained. I nevertheless concluded – and explained why – that the options were set out in a sufficiently fair and balanced way.

In summary, the fundamental basis of F's argument seems to me to be that Mr S could have taken a low risk drawdown which would have been more suitable than the level annuity. I disagree with F on both fronts. I don't think a drawdown is low risk; and I don't think a drawdown fitted within Mr S's wish to take no risk with his pension income and his (in)capacity to suffer any loss. My conclusion therefore remains that Wise treated Mr S fairly and acted in his best interest.

My final decision

I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 23 March 2021.

Paul Daniel
Ombudsman