

Ombudsman's Determination

Applicant	Mr R
Scheme	Scottish Widows Personal Pension Plan (the Plan)
Respondent	Scottish Widows

Outcome

1. I do not uphold Mr R's complaint and no further action is required by Scottish Widows.

Complaint summary

2. Mr R complains that Scottish Widows has interpreted the Plan policy provisions incorrectly, by refusing to allow the pension commencement lump sum (**PCLS**) available to him on retirement and the lifetime allowance charge, to be taken entirely from the unit-linked investments held in the Plan. He contends that Scottish Widows is therefore improperly preventing him from using the whole of his investment in the with-profits fund, to purchase an annuity using the favourable Guaranteed Annuity Rate (**GAR**) available to him in the Plan.

Background information, including submissions from the parties

3. Mr R's date of birth is 2 July 1957.
4. The Plan was set up in November 1989, with a selected retirement age (**SRA**) of 60 for Mr R. He initially invested his contributions wholly in unit-linked funds but in March 1992, switched half of the Plan fund into the with-profits fund, and split his ongoing contributions between the two types of investment.
5. Scottish Widows says that the Plan has 12 identical segments to allow for future phased annuity purchase, and contributions into each would be split equally between the unit-linked and with-profits investments.
6. In June 2017, Mr R's Independent Financial Adviser (**IFA**) informed Scottish Widows that Mr R was liable to a lifetime allowance charge in the Plan and enquired whether it could be covered wholly by the unit-linked investments. Scottish Widows replied that this charge, and the PCLS available to Mr R on retirement, had to be paid from

both types of investments held in the Plan. Scottish Widows provided the IFA with a copy of the Plan policy document showing this.

7. The IFA replied in an email dated 21 June 2017 as follows:-

“[Mr R] invested in with-profits for the smoothed growth, prospects of a terminal bonus and to benefit from GARs...

He did not invest in with-profits to see the - now judged to be valuable and considerable - advantages of GAR eroded by the interpretation of how the policy operates from Scottish Widows’ point of view...

Clause 6.5a (of the Plan policy document) allows the Member to specify “in respect of such part of the total amount available under provision 6.4 as the Member specifies (in lieu of pension under that provision a reduced pension payable...”

The key words here are “in respect of such part of the total amount” and “as the Member specifies” and there is no restriction or limitation placed by this clause on how the Member can specify what “part of the total amount” is to be used.

Clause 6.5b allows the member to do likewise to receive a cash payment. It goes to say that “If the total amount includes values in respect of both unit-linked and with-profit benefit, the balance remaining will be deemed to be split between those types of benefit in the same proportion as the total for the purposes of provision 4.4.

The key words here are “if” and “the balance remaining will be deemed...”

It is therefore the case that Clause 6.5a gives [Mr R] unfettered access to his funds and he can instruct you – “as he specifies” to receive an annuity - “reduced pension” – and he can, by virtue of the wording... “as he specifies” elect to receive it from 100% of the with-profit fund and under 6.5b, a cash sum which you contend has to be pro-rata from the U/L: W/P fund mix.

...if [Mr R] requests a PCLS paid out of the Pension Mixed Fund - as he is entitled to under 6.5a, his reduced pension can only be based on any remaining Pension Mixed Fund and 100% of the W/P fund and not as you suggest is the case in 6.5b...these two clauses work against each other.

It surely cannot be equitable for Scottish Widows to place an interpretation on how policy provisions are to work in practice, many years after they were drafted, within a legislative and financial environment which now places a significantly greater value on the GAR – originally acknowledged to be valuable in any event, in any product literature Scottish Widows will have produced and which puts the Member at a significant disadvantage...the monetary amount by way of forced reduction of the GAR ...is easily

calculated; the effect is to render the GAR policy promise worthless if Scottish Widows can arbitrarily withdraw part of the original promise by their action.”

8. The IFA requested that Scottish Widows should allow Mr R: (a) to receive as PCLS, 25% of the total value of the units-linked investments held in equal proportions across all 12 Plan segments in accordance with clause 6.5b; (b) to decide whether the lifetime allowance charge in the Plan should also be paid entirely from the unit-linked investments; and (c) to specify the criteria with which the annuity available from the residual Plan fund should be calculated.
9. Scottish Widows reiterated that according to the Plan policy document, Mr R's PCLS (and lifetime allowance charge) in the Plan could not be paid in the way he desired and had to be paid from both the with-profits and unit-linked investments in their current proportions. It informed the IFA that:

"Part 6.4 is in relation to the total policy value (both U/L & W/P) buying an annuity single life annually in arrears, level with no guaranteed period.

Part 6.5 allows alternatives:

6.5a is to allow, in lieu of the full annuity under 6.4, the policy to purchase a reduced policyholder's annuity with the remainder providing a spouse's dependant's annuity;

6.5b is to allow, in lieu of the full annuity under 6.4 for a maximum cash sum to be paid with the remainder to purchase an annuity in the same split of U/L and W/P as the whole policy...”

10. Scottish Widows explained that:

“...each segment of the policy can indeed be used to independently purchase annuities (and to withdraw tax-free cash) if the customer wishes. However, the GAR only applies at NRD and therefore in order benefit from this on each... segment they must be taken together.

...each segment is identical and therefore invested in both the unit-linked and W/P (in the same proportion in each segment) and therefore the segmented nature of the policy design has no bearing on the argument over whether tax-free cash or tax charges can be taken from unit-linked investments only.

Phased retirement is an option although, of course, concepts such as drawdown did not exist at the time the product was sold ...so the segmented nature was specific to phased annuity purchase.

For some customers, even today, the GAR may not be deemed as valuable because they are in ill-health. The phased annuity feature may be of some use to a customer who does not require the GAR but could phase, for example, enhanced annuity purchases because the E/A rate is superior to the GAR...

Given that the GAR is now in today's market, a valuable benefit, it is understandable that the customer would wish to exercise it and not phase benefits...we do not see how it can be argued that this should not also carry some share of the lifetime allowance excess charge...

The lifetime allowance excess is after all a mechanism to recover income tax relief that the customer has already had because the Finance Act 2004 rules now limit the customer to tax relieved benefits within a lifetime allowance. In effect, it is an additional tax liability on top of the standard income tax due. No one would reasonably argue that the GAR pension should not bear tax in the hands of the customer, so we do not see why it be exempt from the lifetime allowance charge.

You cannot separate out the unit linked portion despite the segmentation as each segment consists of both unit-linked and W/P benefits. In the same way you cannot separate out the PCLS as 25% of each segment is a mix of W/P and unit linked..."

11. Scottish Widows has submitted, as evidence, a copy of the relevant page of a Plan booklet published around 1987, to substantiate its position that phased annuity purchase was an element of the Plan design which "has little in common with more modern segmented policies". This booklet stated that:

"You may have as many as 20 identical policies under the plan...

As each policy is a separate arrangement under the scheme rules, the multiple policies enable you to phase your retirement by taking benefits from different policies at different times."

12. The IFA was dissatisfied with Scottish Widows' explanation and complained to the Pensions Ombudsman on behalf of Mr R.
13. The IFA says that:

"There is no compulsion in the policy conditions to dictate which option Mr R opts for first; therefore, if he opts for firstly; a reduced pension using 100% GAR – as the member specifies – he then opts for secondly; a PCLS, if the GAR has been extinguished funding the reduced pension, the PCLS (and the LTA excess charge) can only come from the UL funds...

Scottish Widows have not been able to demonstrate that the policy clauses force Mr R to determine his benefits in a particular order...

Scottish Widows' business decision to only make GARs operative at SRA totally negates and undermines their promotion of segmentation as a "benefit" and acts as a restriction to Mr R. This stipulation that GARs can only be taken at SRA means that "phased annuity purchase" can only be a benefit to Mr R if annuity rates rise above the GAR on the profile he selects on the first segment

at age 60 and continue to do so on each remaining segment which then do **not** have the benefit of GAR.

...enhanced annuity rates were not generally available when the policy was set up in the form they are currently and therefore this can have no bearing on the inter related policy features phased annuity purchase and GAR from outset. Scottish Widows' commercial business decision to insist that GAR can only be linked at SRA across the **whole** policy, and not be segment specific, destroys all advantages that Scottish Widows have consistently touted in their marketing material.

...Scottish Widows have not addressed the conflicting nature of their policy provisions in the light of previous complaints about their commercial operation of discretionary interpretation of these policy provisions; have they ever issued further guidance to affected policyholders since the first complaint about GAR? It is very clear that Scottish Widows has financially benefitted from previous Ombudsman decisions but have failed to clarify how their interpretation affects policyholders with GAR who have yet to convert their policies at SRA...

It is, very demonstrably, in the commercial interests of Scottish Widows to reduce the GAR because it, directly and immediately, transfers a financial advantage to their balance sheet to do so, and the LTA excess charge payment methodology is another example of Scottish Widows making a judgement, without reference to the policyholder, which confers a financial advantage to them at Mr R's expense.

Because the LTA excess charge is a modern feature of HMRC rules it requires the operation of interpretative discretion to facilitate this payment. It is not for Scottish Widows or their authorised representative to determine how this charge should be defrayed. The policy clauses do not allow for it expressly, so it relies on the discretion of Scottish Widows to make the payment.

The policy funds are Mr R's **not** Scottish Widows; they have recouped their costs by making management charges throughout the life of the policy, built in margins within annuity rates for profit...By insisting that the excess LTA charge is spread over the WP and UL funds, Scottish Widows derives a financial benefit by reducing the funds available for GAR, which imposes an additional financial cost to Mr R over and above the amount of the excess charge. It is inescapable that this contravenes the statutory duty on SW to "treat customers fairly".

...SW's interpretation has induced a loss to Mr R of part of the GAR; this loss is compounded month by month and... has...the potential for loss to Mr R based on the reduction in his monthly annuity, over the period to his expected mortality.

Scottish Widows are **not** independent; they have a clear vested interest to further their previously made commercial decision to reduce their financial exposure to GAR (by ceasing to accept new monies into GAR funds from circa 1999) by interpreting the conflicting policy decisions **in their favour and not Mr R.**"

Adjudicator's Opinion

14. Mr R's complaint was considered by one of our Adjudicators who concluded that no further action was required by Scottish Widows. The Adjudicator's findings are summarised below:-

- Clause 4.4 of the Plan policy document (relevant provisions of which have been reproduced in the Appendix) stipulated that a GAR is applicable at Mr R's SRA, "as specified in the schedule" or if "endorsed on the policy" at a later deferred pension date only to the with-profits investments (including any bonus addition) held in the Plan. Scottish Widows' standard market annuity rate would consequently apply to any unit-linked investments.
- Clause 6.4 stated that the funds available from both types of investment in the Plan would be combined and used to determine the amount of annuity available to Mr R, calculated using the GAR and standard annuity rate for the with-profits and unit-linked elements respectively. This essentially meant that Mr R's annuity would consequently be calculated by applying a "blended annuity rate" based on the GAR and the standard annuity rate, to the total Plan fund value.
- The relevant provisions in the Plan policy booklet were convoluted and should have been drafted in a clearer and more precise way, which would not have left them open to different interpretations.
- Mr R's IFA had placed great emphasis on the phrase "as the Member specifies" in clause 6.5a in his interpretation of the Plan policy provisions allowing Mr R to specify from which investment fund(s), his PCLS and lifetime allowance charge should be taken. Whilst this phrase, interpreted as the IFA suggests, could be construed to support his understanding, if clause 6.5a was read in its entirety with the other relevant provisions, it is clear that this was not what Scottish Widows intended, and the correct interpretation is that Mr R is only allowed to specify the amounts of the Plan fund which he would like to use to purchase his own annuity, and one for his spouse. The Plan policy provisions do not therefore support the IFA's interpretation that they also permit Mr R to specify how the with-profits and unit-linked investments held in the Plan, should be used to pay the PCLS and lifetime allowance charge.
- Scottish Widows said that the Plan was established with 12 identical segments to allow for future phased annuity purchase, and contributions into each segment would be split equally between unit-linked and with-profits investments. The

Adjudicator saw no reason to disagree with this statement, particularly when Scottish Widows had submitted evidence to demonstrate that the purpose of setting up to 20 identical policies in similar plans, was to enable members to phase their retirement “by taking benefits from different policies at different times.”

- In Mr R’s case, the GAR only applied at his SRA. Whilst the principle of phased annuity purchase remained, the practice was probably not there because it was only useful if Mr R did not require the GAR, but wished to phase annuity purchase using one or more segments at different times for some other reason (for example, purchasing phased enhanced annuities available on ill health but it was difficult to see the benefit in delaying annuity purchases in such a scenario).
 - The availability of phased annuity purchase supported Scottish Widows’ view that Mr R could not specify from which investment funds his PCLS and lifetime allowance charge should be taken. For the 12 separate segments in the Plan to be identical, each would be allocated one twelfth of the Plan fund value, with the same proportion held in the with profit and unit linked funds. If Mr R was permitted to take his PCLS and life time allowance charge wholly from unit linked investments held in the Plan, then clearly the proportions invested in the two types of funds remaining in the segments afterwards would have changed which, in the Adjudicator’s view, was not permitted by clause 6.5(b).
 - There was nothing in the Plan policy provisions which supported the view that the PCLS and lifetime allowance charge could be paid solely from unit linked funds. In fact, they indicated that these payments should be made from the total of the value of the unit-linked and with-profits funds and split between them.
 - There were no grounds to conclude that Scottish Widows must allow Mr R to extract a greater value from the GAR in the way that he was seeking.
 - Scottish Widows did not act inappropriately in denying Mr R the opportunity to take the PCLS, and lifetime allowance charge from the unit-linked investments only.
15. Mr R did not accept the Adjudicator’s Opinion and the complaint was passed to me to consider. Mr R provided his further comments which do not change the outcome. I agree, in the main, with the Adjudicator’s Opinion and I will therefore only respond to the key points made by Mr R for completeness.

Ombudsman’s decision

16. Having carefully examined the relevant provisions in the Plan policy document, I concur with the Adjudicator that they are unnecessarily complicated. If Scottish Widows had drafted them in a precise and transparent manner, then it would not have been possible for Mr R’s IFA to now interpret them in a way different to what Scottish Widows had intended the Plan provisions to mean.

PO-19981

17. Although, the provisions, considered in the way the IFA proposes, could be construed to support his understanding, my interpretation of them is the same as the Adjudicator's, I completely support his analysis, and I do not support the IFA's view that they permit Mr R to specify how the with-profits and unit-linked investments held in the Plan should be used to pay the PCLS and lifetime allowance charge.
18. I do not therefore consider that Scottish Widows has acted inappropriately by not allowing Mr R the opportunity to take the PCLS, and lifetime allowance charge only from the unit-linked investments held in the Plan.
19. Therefore, I do not uphold Mr R's complaint.

Anthony Arter

Pensions Ombudsman
26 March 2019

Appendix

Extract from the Plan policy document entitled “Personal Pension Plus Policy Provisions PPP (1988)”

4.2 On entry on pension the cash sum available in respect of the with profit benefit will be as follows

(b) At original pension date (if entry on pension has been deferred), at deferred pension date - The with profits cash benefit shown in the schedule (or in any endorsement thereto) together with any bonus addition.

4.4 The cash sum available at the date of entry on pension under provision 4.2 will be applied in accordance with provision 6. If entry on pension is at the original pension date the annuity rate used for the purpose of provision 6.4 in respect of that cash sum will not be less than the GAR specified in the schedule (if entry on pension is at the deferred pension date, not less than the GAR endorsed on the policy).

6.4 At the date of entry on pension the total of the value of any units allocated to the policy in respect of the unit-linked benefit...and any cash sum available in respect of with profits benefit (determined in accordance with provision 4.2) will be applied to secure a pension payable yearly in arrear during the subsequent lifetime of the Member...The amount of pension will be calculated by applying the total amount to the Society's annuity rates current at the date of entry on pension or at such..., subject to provision 4.4 when appropriate

6.5 The Member may elect to take alternative benefits at the date of entry to pension...

The following options are available:

- (a) to receive in respect of such part of the total amount available under provision 6.4 as the Member specifies (in lieu of the pension under that provision) a reduced pension payable yearly in arrear during the Member's lifetime...and in respect of the balance of the amount available under provision 6.4, a pension or pensions for the Member's spouse and/or a dependant (the survivor) commencing after the Member's death and payable yearly in arrear during the subsequent lifetime of the survivor...
- (b) to receive in lieu of part of the Member's pension under provision 6.4 or under option (a) above, as appropriate, a cash payment at the date of entry on pension provided that such cash payment does not exceed the maximum allowed under the Rules. If the total amount includes values in respect of both unit-linked and with profits benefits, the balance remaining will be deemed to be split between those types of benefit in the same proportion as the total for the purposes of provision 4.4.