

The complaint

Mr D complains that The Prudential Assurance Company Limited (Prudential) will not allow him to cash in his annuity with it.

What happened

I set out the background to this complaint and my provisional findings in a provisional decision. This is included below and forms part of this decision:

'Mr D had a personal pension with Prudential. In 2011, Mr D enquired about taking his benefits early under the policy. He spoke to Prudential and it was agreed he would be sent transfer forms as he was not entitled to take the full value of the policy as a lump sum with it. Prudential sent Mr D a claim form and explained in this letter that if he chose to transfer, he may lose his protected tax-free cash – which was higher than the standard 25% available from a personal pension.

Mr D decided to take his benefits with Prudential, he selected to take the maximum tax-free cash of £987.57 available and an annuity. Mr D selected to have an annuity with a five year guarantee and a 50% spouses' pension. Prudential wrote to Mr D confirming that his annuity would commence paying him £48.72 a year.

More recently, Mr D asked Prudential if he could cash in his annuity. Prudential said legislation did allow annuities valued under £10,000 to be cashed in but this was at its discretion and it had chosen not to offer this. Mr D was unhappy with this as he felt it was his money and he'd bought a pension and not an annuity. So if it couldn't be cashed in he felt he'd been mis-sold the policy. Prudential explained the relationship between pensions and annuities – and that pension funds at the time had to be converted into an annuity. But Mr D remained unhappy and felt he should be allowed a cash value in place of his annuity.

Mr D spoke to our investigator and explained that he receives such a small amount and a lot of paperwork for the annuity and it doesn't seem worth the hassle. He'd much prefer a lump sum. Mr D said he wasn't happy about having an annuity. Our investigator explained that at the time his options were limited and it's only after pension freedoms in 2015 that more flexibility about how benefits could be taken was introduced. Mr D said he understood that, but he knew of a friend who'd had an annuity cashed in and would like the same option. Our investigator explained we were still looking into things but that the legislation didn't require businesses to make offers, it was at their discretion.

What I've provisionally 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.

Before Mr D took out his annuity in 2011, he says he asked if he could take all of his benefits as a lump sum but was told he wasn't entitled to do so.

The rules at the time only allowed a payment of a pension as a lump sum in certain conditions. Mr D's pension value was above the limit allowing for small pot cash values to be paid. There was also legislation that allowed a cash value to be paid if your total pension benefits (excluding state pension) was under the triviality limit of £18,000 (this figure was amended over the years) but Mr D told us he had valuable pension benefits elsewhere. So I think this would've been the basis of the conversation that ended with him realising he wasn't entitled to a cash sum. Therefore, he was

limited to the legislation at the time and if he wished to take his benefits, realistically, he'd have to take an annuity. So my findings have concentrated on whether he should be allowed to cash in his annuity.

Relevant considerations

DISP 3.6.4 R says that in considering what is fair and reasonable in all the circumstances of the case, I will take into account the relevant law and regulations; regulators' rules, guidance and standards; codes of practice; and (where appropriate) what I consider to have been good industry practice at the relevant time.

What are the regulations about cashing-in or 'commutation'?

Various bits of legislation have helped form the current legislation that allow annuities to be cashed in. These include:

- The Finance Act 2004 Section 164
- The Finance Act 2004 Section 273B
- Registered Pension Schemes (Authorised Payments) Regulations 2009/1171 - reg. 11 De minimis rule for pension schemes
- Registered Pension Schemes (Authorised Payments) Regulations 2009/1171 reg. 11A (inserted on 6/4/12)
- Finance Act 2014 Section 42 Pension flexibility: taking low-value pension rights as lump sum

As a result of the above, the legislation in regard to commutation payments now reads:

Registered Pension Schemes (Authorised Payments) Regulations 2009/1171

PART 2 COMMUTATION PAYMENTS

reg. 11A

'(1) A payment to a member by a pension scheme which is not a public service pension scheme or an occupational pension scheme in respect of an arrangement under that scheme if—

- (a) the member has reached normal minimum pension age or the ill-health condition is met (see paragraph 1 of Schedule 28);
- (b) the payment does not exceed £10,000;
- (c) the payment extinguishes the member's entitlement to benefits under the arrangement;...

The Finance Act which allowed providers/schemes to over-ride the rules of the scheme and make payments that otherwise previously wouldn't have been allowed (which now includes cashing-in of annuities) – was a permissive over-ride. What this means is the schemes are allowed to make these payments if they wish to do so – it isn't mandatory legislation.

So in essence what the legislation says is a person in Mr D's position doesn't have a right to commute their pension pot to a cash lump sum. However, if a provider wants to offer this it can, but only up to a limit of £10,000.

What are the relevant regulatory rules and guidance?

COBS 2.1 Acting honestly, fairly and professionally

'The client's best interests rule'

COBS 2.1.1R (1) A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).'

Principles for Businesses

'PRIN 2.1.1R The Principles...

6 Customers' interests – 'A firm must pay due regard to the interests of its customers and treat them fairly.'

Guidance to firms:

FCA Alert to firms: Fair Treatment of Customers 12/05/2015

'All firms must be able to show consistently that fair treatment of customers is at the heart of their business model.'

Taken together, all of this means in essence that firms must take the best interests of their customers into account in the actions they take. However, this doesn't mean that it should act in the interest of a single (or a small group of) customer(s) which would be at the expense of other customers. Nor to act in a particular customer's interest without consideration of other factors or wider implications.

I'm aware of no other codes of practice that would apply here, other than the legislation and regulatory rules I've referred to above. However I've also considered:

- What would have been good industry practice at the relevant time? I'm aware some providers have allowed commutation of small annuities in the past.
- Contractual and other legal matters. I'm aware that in some annuity contracts, there may be ownership issues (it may be subject to a separate contractual/legal arrangement with another party) or other lives attached to the annuity that could cause issues with commutation.
- Practical matters. For example, an annuity is a life-long insurance contract that is not designed to be cashed in. For that reason, it is often backed by long-term less liquid investments that may be more difficult to value or sell; and doing so might negatively affect the pricing of annuities for other customers.

The key questions that I need to consider in deciding what is fair and reasonable in this case

1. Does Prudential have discretion to commute Mr D's annuity as requested? For example:
 - Is the 'value' under £10,000?
 - Is Mr D the legal owner of the annuity?
 - Is Prudential the other contracting party or has it been re-insured?
2. If Prudential is free to commute the annuity, would it have been in Mr D's best interests to allow commutation? For example:
 - Would it expose him to the risk of financial difficulty in the future?
 - Would it affect other income that he relies on - such as state benefits being reduced due to the commutation payment?
3. If Prudential was free to grant Mr D's request to commute the annuity and doing so would have been in his best interest, was it fair and reasonable for Prudential to refuse? In other words, did it exercise its discretion in a fair and reasonable way?

My findings in light of the above considerations

Prudential hasn't made any specific arguments in relation to this case as to why it isn't free to allow Mr D to cash-in the annuity. Mr D's annuity does have a joint-life. And Prudential has raised this as an issue generally. But it hasn't gone as far as to say it couldn't make cash in offers in this situation – just that it could require both lives on the annuity to agree to cash in the annuity. So I am proceeding on the basis that it does have discretion to commute his annuity.

It's also not provided any information specific to Mr D to show that he would be worse off if he were to commute the annuity to a cash lump sum. Having considered what Mr D's told us and the value of his annuity, which is paying him just £50 a year, I agree the annuity is so small that it doesn't appear to provide any meaningful income on which he relies. And a cash lump sum in place, even if relatively small, would most likely benefit him more than the annuity. I also note this is what Mr D has said he preferred to do at the outset (i.e. take his whole pension as a cash lump sum) had that been possible at the time. For these reasons, and subject to the lump sum value (which hasn't been determined), I've proceeded also on the basis that it would be in Mr D's personal interest to encash the annuity.

This case therefore comes down to whether Prudential fairly took into account Mr D's interests when it chose not to exercise its discretion to allow him to cash-in his annuity. I think it did.

Prudential has told us it is unwilling at this point in time to offer a cash in value to Mr D, essentially because the annuity product wasn't designed to be cashed in, so it would be difficult to offer that option now without incurring significant cost and inconvenience – and possibly to the detriment of other customers. It made a number of points about this, for example:

- Offering commutation to Mr D simply because the annuity is small means it would have to offer the same option to all customers with small annuities. Otherwise, it wouldn't be treating its customers consistently (and therefore fairly). It doesn't have the systems and processes in place to facilitate significant numbers of commutations.*
- Without appropriate processes and checks, customers could be exposed to the risk of poor outcomes.*
- Designing an appropriate framework to allow a commutation option would require significant time, planning and regulator engagement (and presumably cost).*
- Annuities are long-term commitments, backed by long-term and illiquid assets, so cash values aren't easily realised.*

Having thought about this very carefully, I think Prudential's points are fair ones. I don't think Prudential simply disregarded Mr D's interests in this case. Its position is based on its considerations of what allowing commutation could mean for its customers and business model more widely.

It seems to me that Prudential could avoid many of the challenges it has raised if it were to treat Mr D's case as exceptional. The cost and impact in this one case would be small for a business the size of Prudential. However, I acknowledge Prudential's difficulty here. I'm not persuaded there is reason in Mr D's case to treat him differently to other customers with small annuities. (It's my understanding that is a significant portion of customers.)

I've kept in mind that Mr D would probably be better off with a cash lump sum and the annuity isn't useful to him. I've balanced this against the fact that commutation wasn't something Mr D had a right to. And while Prudential was free to allow his request, I'm satisfied it did have other legitimate interests to weigh up, including the way the annuity product was designed, the impact on Prudential's existing systems and processes, the interests of its customers more widely and the potential cost.

On balance, I don't think it was unfair or unreasonable for Prudential to decline Mr D's request. It acted in line with the contract and the rules and treated Mr D in line with other customers.

Mr D has mentioned that he knows of a friend who was offered a cash-in value, I can't comment specifically on this. But it's worth explaining that the stance Prudential has taken is mirrored by most of the other pension providers in the industry. We are aware that initially some providers used their discretion to allow the occasional exception – and at least one provider made group offers as part of their business model. But generally speaking it seems most providers are not making offers at this present time.

We have seen that some providers are looking into their stance on cashing-in annuities. If in the future Prudential changes its position on cashing in annuities or legislation changes, it's possible Mr D may benefit from such a change. But I cannot fairly say Prudential must change its position at present, in the circumstances I've considered in this decision.

I appreciate Mr D will be disappointed with this but for the reasons explained I am not intending to uphold his complaint.'

I understand Mr D is disappointed with my decision and doesn't agree with it, but he hasn't added anything new or substantive that hasn't already been considered.

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.

Having done so, I see no reason to depart from the findings reached in my provisional decision. And so my final decision remains the same and as set out above.

In summary, I don't think it was unfair or unreasonable for Prudential to decline Mr D's request. It acted in line with the contract and the rules and treated Mr D in line with other customers.

My final decision

For the reasons explained above and in my provisional decision, I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr D to accept or reject my decision before 17 January 2022.

Simon Hollingshead
Ombudsman