DRN-3223617

The complaint

Mrs M complains that The Prudential Assurance Company Limited (Prudential) will not allow her to cash in her 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:

'Mrs M had a Additional Voluntary Contributions (AVC) plan through an employer. In 2014 Mrs M enquired about taking her benefits. The employer scheme contacted Prudential, who administered the employers AVC's, to ask it to send Mrs M quotations to take her benefits on the basis of tax-free cash of approximately £5,400 and the remaining fund of approximately £2,500 to be paid as an annuity.

Following her acceptance of the quotation, Mrs M took out an annuity with Prudential which paid her £55.56 a year payable monthly in advance, increasing at 3% per annum and guaranteed for five years.

More recently, Mrs M approached Prudential after she'd spoken to her financial adviser who'd told her she'd be able to cash-in the annuity. Prudential said legislation did allow annuities valued under £10,000 to be cashed in but this was at providers' discretion and it had chosen not to offer this. Mrs M was unhappy with this as she's explained the £4 a month she receives is of no benefit to her and it must cost more for Prudential to administer the annuity. She says it would be better for all parties for a lump sum to be paid as the £4 a month she receives doesn't even buy her a bus ticket. Before Mrs M took out her annuity in 2014, she says she asked if she could take all of her benefits as a lump sum but says she was told this wasn't possible. Prudential says that this would've been the decision of the trustees of the employer scheme (or the rules of the scheme) rather than Prudential.

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.

Mrs M has told us that when she came to take out her annuity she was told she couldn't have a lump sum by Prudential. Prudential says this was a decision made by the employer scheme trustees and it just offered Mrs M what it was told.

I can see that Prudential did include on its original quote the option to take all her benefits as a lump sum (caveated by the fact she'd need to approach the scheme about this). But only if these benefits plus other provisions were less than £30,000 as per the triviality rules at the time. However, it didn't also include the option to take her benefits under the small pots legislation which at the time was based on single funds under £10,000. But, if Mrs M was able to take this option and chose to do so, it seems she would've lost her protected tax-free cash and instead only received 25% tax-free. In reality it looks like Mrs M received approximately 68% of the fund as tax-free cash. So the option to take her benefits as a lump sum (if available) might not have been that attractive after all due to the additional taxation it seems would've occurred.

As this point doesn't form part of the complaint put to Prudential, it isn't something I can consider in this decision. If Mrs M wishes to complain about this, she'll need to approach Prudential first.

This complaint is about whether Mrs M should be able to cash in her annuity and so I've considered whether Prudential has been unfair and unreasonable in not offering this.

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.

I'll firstly set out what I think are the relevant considerations here:

<u>What are the regulations about cashing-in or 'commutation'?</u>

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 <u>paragraph 1 of Schedule 28)</u> ;

(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 Mrs M'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.

<u>What are the relevant regulatory rules and guidance?</u>

<u>COBS 2.1 Acting honestly, fairly and professionally</u>

‘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 Mrs M’s annuity as requested? For example:*
    - *Is the ‘value’ under £10,000?*
    - *Is Mrs M 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 Mrs M’s best interests to allow commutation? For example:*
    - *Would it expose her to the risk of financial difficulty in the future?*
    - *Would it affect other income that she relies on - such as state benefits being reduced due to the commutation payment?*
3. *If Prudential was free to grant Mrs M’s request to commute the annuity and doing so*

would have been in her 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

Prudential hasn't made any specific arguments in relation to this case as to why it isn't free to allow Mrs M to cash-in the annuity. So I am proceeding on the basis that it does have discretion to commute her annuity.

It's also not provided any information specific to Mrs M to show that she would be worse off if she were to commute the annuity to a cash lump sum. Having considered what Mrs M's told us and the value of her annuity, which is paying her just £4 a month, I'm satisfied the annuity is so small it doesn't provide any meaningful income on which she relies. I accept her position that she'd benefit more from a cash lump sum, even if small. I also note this is what Mrs M has said she preferred to do before taking out the annuity (i.e. she wanted to take her 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 Mrs M's personal interest to encash the annuity.

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

Prudential has told us it is unwilling at this point in time to offer a cash in value to Mrs M, 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 Mrs M 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 Mrs M'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 Mrs M'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 Mrs M's case to treat her differently to other customers with small annuities. (It's my understanding that is a significant portion of customers.)

I've kept in mind that Mrs M would probably be better off with a cash lump sum and the annuity isn't useful to her. I've balanced this against the fact that commutation wasn't something Mrs M had a right to. And while Prudential was free to allow her 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 Mrs M's request. It acted in line with the contract and the rules and treated Mrs M in line with other customers.

We have seen that some providers are looking into their stance on cashing-in annuities and I'm aware that some businesses have previously offered cash values to customers. If in the future Prudential changes its position on cashing in annuities or legislation changes, it's possible Mrs M may benefit from such a change. But in the present circumstances I don't think she's been treated unfairly.

I appreciate Mrs M will be disappointed with this but for the reasons explained I am not intending to uphold her complaint.'

Mrs M is understandably disappointed with my decision and doesn't agree with it. She's asked how it can be fair that if her pension had been with other companies, she would've been able to cash it in. She's also said how can one company have its own rules that differ wildly from others in the industry.

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 response to Mrs M's question following the provisional decision – we've had other similar complaints to hers with other pension providers and in our experience Prudential's stance is also mirrored by the other providers. I know in the past there has been exceptions made and I'm aware of one provider who as part of its business model buys up annuity books and then offers cashing in to those customers – but as of now businesses offering cashing in to customers looks to be very much in the minority. With regards to the rules that apply to the businesses, I set these out in the provisional decision. And the Finance Act which brought about the ability to offer cashing in is permissive legislation which allows businesses to use it at their discretion.

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

M**y 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 Mrs M to accept or reject my decision before 18 January 2022.

Simon Hollingshead
Ombudsman