

The complaint

Mr B complains that The Prudential Assurance Company Limited failed to manage and invest his pension in a way which provided investment returns in line with performance in the stock market.

What happened

Mr B has a with-profits pension policy with Prudential. He says he pays charges of around £1,000 each year. He says that in 2020 the transfer value for his pension increased by around £10,000 whereas the following year it only increased by around £1,000. He says this is not in line with how the stock market was performing in the respective periods. He complained to Prudential.

Prudential investigated his complaint. It said that Mr B held a with-profits policy. This meant that the value of his policy was linked to the investment return on its with-profits fund which invested in a wide range of assets including equities, government securities and property. Prudential said its with-profits policyholders received returns on their investments by way of bonuses. Each year Prudential declared both a regular bonus and a final bonus.

Prudential said it applied a smoothing process when declaring bonuses which worked to protect policyholders from the extreme ups and downs of investment performance. It said it had been able to keep regular bonus rates, paid to Mr B, at the same level as those declared in 2019. But its terminal bonus rate for the year 2020, declared in February 2021, had been reduced due to the impact of the global pandemic and ongoing market uncertainty.

Mr B did not agree with what Prudential said. He referred his complaint to our service. He provided further information about the performance of the stock markets in both 2020 and 2021. He said this showed that his pension had increased by over £10,000 in 2020 which had been a “very bad year.” So, he couldn’t accept that in 2021, which he said had been the “best year for stock markets since 2016”, his pension had only increased by just over £1,000.

Our investigator looked into his complaint. He said that with-profits policies didn’t work in the same way as other investment funds. Instead bonus payments were declared each year and these were based partly on investment performance. The with-profits fund manager used “smoothing” which meant that the amount of bonus declared was not necessarily equal to the growth of the fund in a particular year. As a result of smoothing the fund manager was able to support bonus rates even when markets underperformed. So, for example, despite market volatility in 2020, Prudential had declared a bonus.

Our investigator also referred to the fact that Prudential was regulated by the Financial Conduct Authority (FCA) and Prudential was required to publish its “Principles and Practices of Financial Management” (PPFM). He didn’t think that Prudential should have to do anything further to resolve the complaint.

Mr B didn’t agree. So, the complaint has been referred to me to decide.

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.

Mr B's complaint is that the transfer value of his pension didn't increase in 2021 by as much as he would have expected given how stock markets were performing at the time. He says that Prudential hasn't invested or managed his policy properly. Having considered everything I've decided not to uphold this complaint. I'll explain why.

Mr B had a with-profits policy. This meant his funds were invested in Prudential's with-profits fund. This type of fund operates differently to other types of investment fund. Generally policyholders in an investment fund will participate in any gains or losses in the underlying fund in equal proportion. But a with-profits policy operates differently.

Each year the value of the with-profits policy will increase by the amount of the annual bonus which is declared by the Fund Manager. The annual bonus once added to the policy cannot be taken away as long as the policy holder continues to meet the terms of the policy. At the maturity date, surrender of the policy or death of the policy holder, a final bonus might be added. The amount of the final bonus is not guaranteed. It will depend on how well the fund has performed over time.

Bonus rates are partly based on gains within the with-profits fund after a process known as "smoothing" has been applied. Smoothing means that in future years, even where stock markets might be underperforming bonuses can still be added.

Because of the nature of a with-profits policy, as described above, its value doesn't necessarily reflect the current performance of the stock market. I've looked at the documentation which Prudential provides to its customers. Some of this is available online. So, for example, in its document "Your With-Profits Plan – a guide to how we manage the Fund", Prudential describes how it works out the amount of the annual bonus. It also explains how it applies "smoothing" before declaring bonus rates.

As our investigator said, Prudential is regulated by the Financial Conduct Authority (the FCA). The FCA requires it to have and publish a document called "Principles and Practices of Financial Management" (PPFM). This document is also available online. It explains in more detail how Prudential manages its with-profits funds and how it calculates policy values. I've noted that it includes details about the investment strategy adopted and how it seeks to treat all with-profits policyholders fairly when determining bonus rates.

Having considered the information available to policyholders, I'm satisfied that Prudential has explained how it calculates its bonus rates and why the value of its with-profits policies is not directly linked to stock market performance.

The amount of the bonus is a commercial decision for Prudential and it can be difficult for a policy holder to be satisfied that the bonus rate is accurate.

As mentioned above Prudential is regulated by the FCA. It is required to operate its with-profits fund in line with its PPFM and it must appoint a with-profits actuary who must comply with rules and guidance. In addition it has a With-Profits Committee which is responsible for independently assessing the way in which Prudential manages its with-profits business and how it balances the rights and interests of policy holders and shareholders in relation to its with-profits Fund. An annual report is provided to policyholders setting out how Prudential has complied with its PPFM. So, I don't think that a reduction in bonus means something has gone wrong or that the fund is being managed improperly.

Mr B says he cannot understand why the increase in the value of his policy in 2020, which he says was a “very bad year” insofar as stock markets were concerned, was higher than the increase in value for the following year, which he says was the “best year since 2016.” The difference was around £9,000.

In broad terms, the transfer value of Mr B’s policy was made up of the amounts he’d contributed, the value of any annual bonuses which had already been added to his policy and the amount of any final bonus payment (less charges).

Prudential has explained that the annual bonus it declared in 2020 and 2021 remained the same. So, despite stock market performance, there was no reduction in the annual bonus. The annual bonus is added to the guaranteed benefits of Mr B’s policy. But Prudential acknowledges that the final bonus included in Mr B’s transfer value for the year 2021 had reduced. It says this was linked to investment returns in 2020.

Prudential declares its annual and final bonus amounts each February. So, the bonus declared in February 2021 related to performance of the with-profits fund in 2020. I’ve noted that although the annual bonus rate had remained at the same level as 2019, the final bonus rate declared in 2021 had reduced – which meant that the transfer value for Mr B’s policy did not increase by as much as he thought it should have.

There’s no dispute between the parties that 2020 was a difficult year for financial markets. Prudential says that given the global market volatility in 2020, its smoothing process has worked to benefit its policyholders by smoothing some of the extreme ups and downs of investment performance. And, having considered both performance in the markets and the impact of the smoothing process, I think Prudential’s explanation for reducing the final bonus rates it declared in 2021, is reasonable.

Having considered everything here, whilst I can understand that Mr B was disappointed that his transfer value had not increased at the same rate as the previous year, I’m satisfied on balance that Prudential acted fairly and reasonably, in line with its policies and procedures, when it provided the transfer value for the year 2021.

My final decision

For the reasons given above, I do not uphold this complaint about The Prudential Assurance Company Limited.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr B to accept or reject my decision before 3 March 2023.

Irene Martin
Ombudsman