

The complaint

Mr J complained that the residual funds under his Flexible Lifetime Annuity (FLA) with the Prudential Assurance Company Limited have more than doubled and he is 12 years older, yet he was projected to receive virtually no increase in income. Prudential had miscalculated the income limits at the last four triennial reviews. He believes that he has either been mis-sold a product that has not delivered on its promise, or he has been a victim of Prudential's serious financial mismanagement.

What happened

In November 2008 Mr J was advised by his financial adviser (then acting as an appointed representative of another firm) to take out the Prudential FLA. He was aged 50. At around the same time he also bought a conventional annuity with Legal & General. He specifically chose Prudential's FLA because it allowed him to draw less income in the years before his wife retired (which she subsequently did in late 2020 aged 60), and he was then expecting it to maximise his income thereafter. The initial amount invested into the FLA was £233,438 after an initial fee paid to his adviser.

Mr J initially selected a self-managed strategy involving a 50/50 split between the Invesco Perpetual Managed fund and M&G Managed Growth fund. He was required to select an income between a minimum and maximum level, which was recalculated by Prudential every three years. On the initial quotation, the minimum income was exactly 50% of the maximum income. 100% of the annuity was to be payable to his wife if he predeceased her.

Mr J withdrew the minimum income in ten of the first twelve years, the only exceptions being at the outset when he moved house and when he incurred care home costs for his mother in 2018). The past income history is as follows (all the figures in this decision omit pence):

November 2009	£14,592 (first payment annually in arrears, at maximum)
November 2010	£ 7,296 (minimum)
November 2011	£ 7,296
November 2012	£ 9,400 (recalculated minimum)
November 2013	£ 9,400
November 2014	£ 9,400
November 2015	£11,053 (recalculated minimum)
November 2016	£11,053
November 2017	£11,053
November 2018	£13,500 (chosen level, above recalculated minimum)
November 2019	£11,819 (recalculated minimum)
November 2020	£11,819

Over this period, in 2010 Mr J had switched from his original investment funds into three new funds: Invesco Distribution, Janus Henderson Cautious Managed and Blackrock Absolute Alpha. And in 2013 he consolidated the Blackrock investment into the other two funds. Prudential adds 0.25%pa of new units into the plan on a monthly basis for the adviser's give-up of ongoing commission, as well as lifetime bonuses to reflect the mortality cross-subsidy from other annuitants dying early with funds that aren't used for dependants.

Mr J started to see problems with his FLA when Prudential gave the outcome of the triennial review with a new minimum income of £6,894 in late October 2020. Whereas this minimum had dropped 41% from the last minimum, the maximum – which Mr J had been most interested in – had only dropped by 16%. This was at a time when there had only been a 10% fall in the value of the policy since the last triennial review.

After making several phone calls, Mr J's IFA raised concerns with Prudential on 7 December 2020. They made the point that taking the mid-point of the two income limits, Mr J would need to live to more than age 100 to recoup the current value of the plan – even assuming zero investment growth. The IFA had sight of a leaflet Prudential had provided which set out the factors it took into account in its income limits calculations:

- Client's age [& dependant's age]
- Value of the investment
- Expected investment returns (*"Prudential's assumptions on what we think investment returns will be during the rest of your client's lifetime and their dependant's lifetime if they chose the joint-life option. If they invest in funds that have a higher yearly fund charge we will set a lower maximum income limit. This is because investment growth will be reduced by these higher charges."*)
- Current conventional annuity rates, which allowed for:
 - Gross interest rate (*"determined and set by Prudential taking into account market conditions at the time of our calculation. This rate is reviewed monthly, with a higher rate resulting in a higher maximum income limit."*)
 - Mortality assumptions (*"Prudential's current experience of mortality and our assessment of general life expectancy, i.e. how long we expect your client [or dependant] to live."*)
 - What provision is chosen for a dependant on death

Mr J and his IFA were concerned because the leaflet also said Mr J's policy incorporated a clause that meant he might be converted to a conventional annuity if the level of income that was deemed sustainable fell to 50% of the maximum income when the annuity started.

Prudential responded on 8 February 2021 that of the above factors, the two main drivers were the fund size and current annuity rates; as in effect the maximum income was set as the annuity that could be bought using the fund value at the review date. And there had generally been a decrease in annuity rates over the past few years – at that time fund values needed to increase by 5-6% per year just to offset the impact of falling annuity rates.

However Prudential did become concerned that the minimum income on Mr J's plan should usually be 50% of the maximum (*"taking into account a statutory minimum"*), and as that had not been the case at any of the 2011, 2014 or 2017 triennial reviews it asked its actuarial team to investigate. It observed that if the minimum income limit in these years should have been lower, Mr J had in effect taken more income than he needed and this would have lowered today's fund value more than necessary.

As Mr J didn't hear further from Prudential, he wrote to its CEO on 13 April 2021 reiterating many of his previous points. He noted that his wife's standard life expectancy was 87 years, not the 100 years Prudential had assumed (with zero growth on his plan). If that was correct he was now projected to receive less income than if he had taken out a conventional annuity at the outset – with the L&G annuity he'd bought in 2008 as proof of this.

Whilst Prudential acknowledged Mr J's message it doesn't appear the CEO's office responded until 11 June 2021, by which time it had recalculated the past income limits on his policy. The new minimum incomes were all exactly 50% of the maximum incomes.

Prudential further advised that it had based these limits on a recalculation of the fund values (which it also supplied) as if Mr J had taken the lower minimum income – rather than the actual amounts he took each year. The figure it gave in its table for the 2020 fund value had a typographical error, reading £438,881.93 instead of the figure Prudential had actually calculated of £438,811.93. (It has since clarified that the latter figure, which appears on Mr J's reissued annual statement, is correct.)

It's evident that Mr J became very anxious at Prudential's inability to explain why its previously quoted income limits had been wrong and why the recalculated maximum income still appeared to be too low considering his wife's life expectancy. He's referred to an email he sent on 7 July which I haven't seen but to which evidently he didn't receive a response. This led him to email the CEO's office at 4am on 18 August saying, amongst other things:

“...this should be treated with the same seriousness as a mis-selling complaint that I believe it to be...The product I bought has failed me and I am even forced to consider whether I will need to switch to a more straightforward product unless I can have renewed confidence that Prudential/M&G should not continue to make repeated errors.”

Prudential brought all the issues Mr J had raised together in one final response which it issued on 25 August 2021. In summary:

- It accepted that it hadn't resolved matters within a reasonable timescale.
- To ensure he had not been disadvantaged, it had now retrospectively added extra units to his policy, at the point immediately before his most recent triennial review was carried out (23 October 2020).
- The value of those extra units at that time was £18,622 and ensured the fund value was what it would have been had he taken the correctly calculated minimum income following previous triennial reviews.
- It meant that the probability of Mr J needing to transfer to a fixed annuity at a later review point hadn't been increased.
- The new minimum income was £7,556 (slightly more than at the outset in 2008). It said Mr J would receive his first payment of that amount in the current triennial period (because they are annually in arrears) in November 2021.
- The new maximum income was £15,113 (again slightly more than at outset).
- It was not aware there would be any tax implications from these actions and asked Mr J to provide evidence if he disagreed.
- There were occasions when Mr J hadn't been able to get through to the right person on the phone, so Prudential offered him £500 for the upset this had caused.

In respect of the mis-selling aspect to Mr J's complaint, Prudential commented, *“...we are unable to comment on your choice to purchase a Flexible Annuity with Prudential. However, if you evidence to show this was not the case, please send this in and this can be reviewed.”*

Whilst I would have to note this is a very unclear statement, Mr J has told this service that he also spoke to Prudential and it offered to open up a separate complaint for him about the mis-selling of the annuity. He's said, *“After the unacceptable delays of the original complaint (which in my view clearly included mis-selling) I had no wish to delay resolution even further but I believe my communication has always made it clear that this comprised a mis-selling complaint...”*

Mr J told Prudential that he had no more a basis for accepting its new calculations than he should have trusted the old valuations. He exemplified this by the increase in the fund value from 2008-2011 being 50% but the new increase in income limits only 13%. And from 2011-2014 the fund value increased by 19% but the income limits only 6%. He didn't think worsening annuity rates adequately explained this disparity.

He considered Prudential's £500 offer for distress and inconvenience derisory. He thought the tax implications of these issues meant he was expected to bear the risk of complications arising with his Lifetime Allowance which might also affect the other pensions he gets. He'd referred to an email from his tax consultant which he'd already forwarded to Prudential but which Prudential hasn't subsequently commented on (and which hasn't been provided to this service by either party).

For reference, I'm aware that Mr J's IFA requested a conventional annuity quote from Prudential in October 2021 (on the same basis as his FLA), which was £15,630pa – i.e. in the region of his current maximum income.

In late 2021, Prudential also wrote to Mr J to inform him that they were no longer allowing either of the two externally managed funds he was using. As he didn't choose anything else, Prudential informed him he would be switched into the two closest Prudential choices (Risk Managed Active 3 and Risk Managed Active 2).

On 8 November 2021, Prudential notified Mr J that he was going to receive a payment of £6,984 later that month, which he then received – this hadn't been corrected to the new minimum payment. He had to contact Prudential again to tell them this. The 2020-21 annual statement he then received erroneously showed £16,654 as the income he'd received that year when it should have been £11,819. He also had to tell Prudential about this.

Our investigator didn't uphold Mr J's complaint, but as a result of Mr J highlighting these ongoing errors, another investigator obtained Prudential's agreement that it would arrange for a one-off payment of £572 before tax to be sent to Mr J in respect of the underpaid November 2021 minimum payment, and ensure the November 2022 payment is reset to the correct level.

On 14 December Prudential wrote to Mr J about the additional income of £4,835 reported on his 2020-21 annual statement that he hadn't received. The income falling in this statement period had been determined under the previous triennial review period where the minimum income level of £11,819 (which Mr J received) has now been determined to be £4,835 too much. From what I can see Prudential had tried to re-code what Mr J had received on its system as the correct minimum income plus an extra £4,835, unaware that the system was still treating it as the old minimum income plus £4,835. Recalculated 2020-21 and 2021-22 annual statements were then sent to Mr J and I confirmed with him that the figures were as expected (notwithstanding his other concerns at how income limits are determined).

Mr J disagreed with the investigator and clarified his points further in other exchanges with me. They fell broadly into the category of the FLA not being 'fit for purpose', and whether the compensation is adequate.

Not 'fit for purpose'

- Prudential "sold" him the FLA through the literature it provided and shouldn't be 'passing the buck' on this.
- As he and his wife have aged 12 years since 2008, this should have produced a more than 20% uplift in the annuity rate. The KFD (which says as a retail client he will be given information "*in a more straightforward way than a large financial services company*") doesn't say he will be at the mercy of declining annuity rates in the market.
- The product performed in a way which is totally at odds with the 2008 illustration at the 9% growth rate (which happens to correspond to his fund value in 2022). He believes the income he can now expect to receive should be in line with that illustration.
- The promising growth he achieved in the past may not be repeated now Prudential has removed both his choices of externally managed fund from its selection, contrary to the

KFD originally promising a “range of funds [which] enables you to spread your investment risk between... different fund management houses and styles”.

- He understands the law and structure of annuities means they are not transferable, but the FLA is no longer fit for purpose. Prudential had likely taken £50,000 in charges.

Whether compensation is adequate

- Prudential had already told him no calculations were available for him to check. The burden of proof should be on Prudential to demonstrate unequivocally that its calculations are correct, and it has not done that either for him or this service.
- The unilateral payment of further funds into his FLA without prior consultation with him was unacceptable and denied him the opportunity to negotiate. It was unclear if the higher investment returns he should have had were taken into account.
- The point that Prudential allowed him to retain the excess income taken should be discounted, as there was not a basis in law for it to request those sums back. The fact the errors lay unnoticed just meant he had a greater shock in 2020.
- He expected a significantly higher payment for the huge amount of time and stress involved in identifying Prudential’s mistakes over the last 2+ years. They would never have been discovered without his personal intervention.
- I should listen to all his phone conversations with Prudential. Its complaint handling had also been poor.

Before I issued my Provisional Decision, Prudential also clarified the following:

- A full unit transaction history for Mr J’s policy since outset. I then checked with Mr J that the gross income paid and fund switches correspond with his records. It also shows that Prudential has treated the policy as if it still paid out the incorrect minimum income levels, but added £18,622 back to his policy as at 23 October 2020 to compensate for this.
- Prudential is unable to provide this service with the raw data for assumed future investment returns, interest rates and mortality assumptions used in setting the maximum triennial income level as these are classed as sensitive actuarial calculations. However, it’s confirmed that once these assumptions are used to set the maximum income level, the minimum income level is then set at 50% of this.
- There is a further check to ensure that the income limits comply with the *Registered Pension Schemes (Prescribed Manner of Determining Amount of Annuities) Regulations 2006*. Under those regulations, Prudential has to ensure that the maximum is **no higher** than 120%, and the minimum **no lower** than 50%, of any level annuity available for purchase on the open market from Prudential with the same features as Mr J’s (or otherwise, the average of three current market rates). But it is not otherwise bound by these other limits.

My Provisional Decision of 10 March 2023 addressed Mr J’s concerns as follows:

Not ‘fit for purpose’

Mr J’s mis-selling argument has evolved into this following my earlier comments to him that because the FLA was a complex product I would normally expect to find that there was an advisory relationship between the customer and the IFA. Prudential's role at the time would have been limited to making available the terms and conditions, key features document (KFD) and illustration (all of which Mr J has been able to provide me with) for the IFA's use in the sales process. The adviser would ultimately bear responsibility for any deficiencies in

the sales process – whether that was in the advice and/or explanations provided as to how the product worked.

However, I've carefully considered all of Mr J's points about whether the product has been working in the way Prudential said it would at the point of sale. I'm going to refer to the KFD which Prudential was expected by the regulator to produce to give 'straightforward' information to retail clients. However I do still have to take into account that Mr J had an adviser, whose obligations to ensure that Mr J understood how the product worked weren't limited to simply passing on the KFD or going through it with him.

The adviser would have been expected to review all of the available information, including the longer policy document, to fulfil their responsibility to explain how the product works, what risks are involved and as a result, whether they think it is suitable for their client. However if they were satisfied of that, they would typically draw Mr J's attention mainly to the KFD as it's designed to be accessible to the customer. And it would be reasonable not to expect key information to be missing from this document (as its name suggests).

Mr J says that neither the KFD nor the illustration properly explained the key point that annuity rates (or the interest rates underpinning them) could change in future in a way that reduced his long-term income. However, there are two lists of factors in the KFD:

- One entitled '*What affects the value of my annuity investment?*' lists: the income taken, investment performance, what lifetime bonuses are added, what charges are taken, and the investment strategy. I think it's reasonably clear that this is explaining what determines the fund value of the FLA at any given point.
- The second list entitled '*How will my income be affected by the 3-yearly reviews?*' lists: the fund value, '*What we think investment returns will be during the rest of your lifetime (and your dependant's if you choose the joint life option)*' and '*How long we expect you to live (and your dependant if you choose the joint life option)*.'

I consider 'investment returns' is referring to both the anticipated returns of the funds Mr J is investing in, *as well as* on the government bonds (gilts) which underpin the guaranteed income Mr J's FLA will eventually become at age 90 at the latest. The broad nature of the statement makes it unnecessary to distinguish between the two. Funds and gilts are both investments. As Mr J couldn't be in investment funds by age 90, it couldn't just be a reference to those funds. And the final factor above is referring to the changes in mortality experience which is the other key element of annuity rates.

The KFD also makes clear that '*Once your annuity starts, you are committed to receiving an income from Prudential for the rest of your life. You will not be able to exchange your annuity for a different one with us, or anyone else*'. I appreciate Mr J hasn't suggested otherwise, but I refer to this to underline the point that the very situation he's concerned about – the inflexibility of being subject to interest rate and mortality changes in future – wasn't concealed from investors or their advisers.

It is essentially the same risk that applies to anyone who is deferring the ultimate purchase of an annuity. I note the KFD mentions that Prudential offers a drawdown option, which would retain access to the whole of the annuity market at a later date. But this product worked in a different way, and it was in the remit of Mr J's adviser to consider which option was preferable for him.

The illustration itself includes a reference to mortality on page 1: '*Final benefits: They could be higher or lower than our examples depending on investment conditions at the time you actually invest, the investment returns made by your chosen funds, our charges, rates of*

taxation and any changes in our mortality basis.' And in the 'Important information' on page 7, with my emphasis: *'The amount of guaranteed income we pay you will depend on actual annuity rates at the time we convert your investment-linked income to a guaranteed income.'*

I'm not persuaded that there was any overall impression given by these documents that market conditions couldn't move against in Mr J in future. Or that if his fund achieved the growth at one particular projection rate, resulting in the income limits steadily increasing, this would ensure that the annuity eventually payable would be able to continue at those high rates. A high fund growth illustration will have involved making a similarly optimistic assumption of future gilt returns. Both these assumptions were set by the regulator, but weren't guaranteed to move in tandem in future.

The conventional annuity Mr J bought at the same time from a similar purchase price 'locked into' Legal & General's annuity interest rates and mortality experience in 2008. So it was never directly comparable with the ongoing performance of the FLA. I gather Mr J has used the Moneyhelper website to arrive at the conclusion that a 12 year age increase should increase the annuity rate by 20%, but this is comparing two rates for two differently aged people on the same day. Interest rates and mortality experience now are not the same as they were in 2008.

Mr J says that what he is looking for from this complaint is *"conversion into fixed annuity equivalent to what would have been offered in 2008 with compensation for all the loss of income from my drawings on the Prudential flexible annuity"*. That is why I've said to him that he should look to the adviser who sold him the annuity if he was given the impression that it would perform in the same way as the conventional annuity he bought for a similar amount at that time. I haven't changed my view on that matter.

I've also looked into Mr J's concerns about the fund selection available. I take his point that the KFD did emphasize that the Self-Managed Investment Strategy *'offers a wide range of different investment funds'*, and that it allowed access to different fund managers. I don't think Prudential has broken that commitment, as according to its website amongst 37 funds in total the FLA currently offers:

- Two Artemis funds
- Three Blackrock funds
- Three Invesco funds
- One Janus Henderson fund
- One JP Morgan fund
- One Schroder fund
- One Stewart investors fund
- One Wellington fund

When Prudential removed some of Mr J's fund choices it said it did so *"when our confidence in how consistent returns will be produced in the future is reduced"* or *"where we have other similar funds available"*. Clause 1.3 of the funds appendix to the policy document gives Prudential the right to close any of the funds, including those linked to external managers, and unless instructed otherwise switch the units to another fund with the most similar investment objectives. It goes on to say:

"We will only change, close or wind up a Fund for important legal or commercial reasons and we will aim to be fair and reasonable in the way that we do so, having regard to our duty to protect both the interests of other policyholders and, if applicable, the solvency of the Fund."

That is what Prudential has done here, having given Mr J notice and the option to choose an alternative. In my view the reasons given at the time for removing these funds fall within the scope of having commercial reasons to do so, and it has treated Mr J fairly given that there remains a broad enough range of alternative choices, including externally managed funds.

The charges for this product are taken as part of the declared unit price of the funds Mr J invests in – but reduced by a 0.25%pa rebate which is showing monthly on the transaction statements and on Mr J's annual statement. The charges for each fund were shown on the original illustration and as part of the literature available on Prudential's website. So, I haven't found evidence that the charges taken weren't as agreed at outset, or that it isn't fair for Prudential to continue to collect those charges up to such point as Mr J has converted to a guaranteed income.

Whether compensation is adequate

Prudential has accepted that it made repeated errors in calculating Mr J's maximum and minimum income limits. I share Mr J's astonishment that the errors went on for so long and his concern that had it not been for his and his adviser's questions in 2020, they might have continued to go undiscovered. But I won't be considering what the wider impact of this might have been on other customers in this decision as that is the role of the regulator. I'm considering the impact of Prudential's actions on Mr J.

There is something important to point out here, which is that even though Mr J did take too much income overall as a result of Prudential's errors, every unit in his policy is still accounted for – not only in terms of the actual income he has benefited from, but also an £18,622 injection of units into the policy as of 23 October 2020 to put matters right.

When the investigator said Mr J had received £6,338 too much income, it looks to me that he was only counting the triennial review years and not the interim years in which Mr J also received the extra income. So the total amount of income Mr J didn't want to receive, but Prudential is allowing him to keep, is much more than £6,338. I'll assume that Prudential has taken into account that Mr J did need the amount of £13,500 for care home costs in November 2018, but that still leaves the following excess income:

November 2012-4	£ 9,400 instead of £8,410	gives	£ 990 x 3 =	£ 2,970
November 2015-7	£11,053 instead of £8,909	gives	£2,144 x 3 =	£ 6,432
November 2019-20	£11,819 instead of £8,615	gives	£3,204 x 2 =	<u>£ 6,408</u>
				£15,810

Prudential says this translated into a fall in the policy value of £18,622. As Prudential would have run a hypothetical policy value with these different deductions through its systems, buying and selling different numbers of units to determine the difference, it would be a difficult calculation for it to provide, and it's unfortunate the investigator didn't appreciate this. However as an informal dispute resolution service, we wouldn't automatically look to check every calculation a business carries out, even if it could be provided. We would look to see whether the calculation was plausible, and if there was a reason for it to be investigated.

The above overpayments will have experienced lost growth within Mr J's funds between November 2012 and November 2020, a period of eight years. For almost all of that period he in the Invesco Distribution and Janus Henderson Cautious Managed funds. For both of those funds the main years their unit prices were markedly lower on the date the income was taken out of the fund, compared with when Prudential put it back into the fund in October 2020, were during 2012-16. Most of the overpayments (by value) happened after that point.

So the overpayments didn't cause much extra loss of investment growth to the fund – my rough estimate is that they made another £1,000 difference to the basic total of £15,810 I arrived at above. So as well as taking the higher investment returns into account, I suspect Prudential may have treated part of Mr J's £13,500 income in 2018 as an overpayment too. I appreciate Mr J is upset that Prudential didn't discuss the amount with him before applying it. However I can't see that there is any realistic possibility of concluding that Prudential hasn't topped Mr J's policy up by enough.

I've considered Mr J's point that there is no basis in law for Prudential to request the overpaid income from him. But the law doesn't always allow the beneficiary of a mistake to keep the benefit. For this strictly to apply Mr J would need to have a 'change of position' defence, which essentially means that he had already spent the erroneously high level of minimum income in such a way that his financial position was irretrievably worsened as a result. I think that's unlikely to apply in a case where Mr J had set out to take the minimum level of income and a main tenet of his complaint is that he would have wanted to take less (except in two years), because that was always the plan while his wife was still working.

In any event, the law is only one of the things I must take into account. I must also decide what I think to be fair and reasonable in the circumstances of the case, even if (in the event that I'm wrong on the above) it involves departing from the law. The usual approach of this service is to put the complainant back into the position they would have been in, but for the respondent's errors. As Mr J wouldn't have wanted to take most of the extra income, resolving this complaint could reasonably have involved Mr J paying that back, in order for Prudential to then correct the value of the policy.

I'm saying this before commenting on the wider impact of Prudential's actions on Mr J personally, which would separately need to be addressed. But Prudential's choice was to address that wider impact by allowing Mr J to retain the extra income, which otherwise it wouldn't have been unreasonable for it to ask to be repaid. So I'm not approaching this complaint on the basis that Prudential hasn't done anything by way of compensation. In being fair and reasonable I can't ignore the fact that Mr J is £15,810 better off (before tax) than if Prudential hadn't made that gesture at all.

Mr J previously mentioned that there might be tax implications. As his FLA is a type of annuity, one test was made against the Lifetime Allowance – when he bought it in 2008. As far as I'm aware, only drawdown arrangements have any further tests against the Lifetime Allowance. My understanding is also that Prudential is able to amend the value of the policy to correct an administrative error without any tax implications. The overpayment it made to Mr J in error is also treated by legislation as an authorised payment¹.

I'm next going to consider Mr J's concern that he can't now be confident that even Prudential's recalculations of his income limits are correct. The detail of those calculations won't normally be provided to each customer at the time of the triennial review as they involve the judgement of Prudential's actuaries on future investment conditions.

In light of Prudential's reply to this service I've decided whether it's necessary for me to expect Prudential to provide me with more information in the circumstances of Mr J's case. I appreciate that the judgements actuaries make on individual data are to some degree commercially sensitive, and I'm already approaching this case from the position that Mr J is significantly better off financially from the gesture Prudential has made.

I've decided to take a step back and look at how the recalculated maximum income Prudential has set for each triennial period compares with the Government Actuary's Department (GAD) published rates for maximum income from a capped drawdown plan:

- These rates vary monthly with UK gilt yields
- GAD says they're "*designed to provide a measure of the annual amount of lifetime annuity income that the drawdown pension fund could generate*"
- "...[This] will generally be related to the member's age and to the yields available on gilts (UK government bonds), which are the main investments usually used by insurance companies which sell lifetime annuities"

¹ <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062800>

- They assume a level income with no guarantee or dependant's provision, with the current tables in use based on mortality (with projected improvements) from 2011
- They make a 4% assumption for the insurance company's expenses (but don't dictate what actual annuity rates might be offered on the open market).

What I found was that despite Mr J's increasing age, gilt yields fell progressively (and substantially) from outset to the 2020 triennial review. (There may be some better news for Mr J this year as gilt yields have currently improved to 3.75%.) The extent to which gilt yields have fallen have outweighed the improvement in the GAD rate which would otherwise happen with age. And in fact, the drop in the maximum income Prudential has quoted for Mr J has broadly followed the same trend (comparing the two bold columns):

Date	Fund	Max income	Rate	Mr J's age	Gilt yield	GAD rate	
Nov-2008	£236,993	£14,952	6.31%	50	4.75%	6.72%	(120% ²)
Nov-2011	£357,330	£16,821	4.71%	53	3.00%	4.6%	(100%)
Nov-2014	£424,584	£17,818	4.20%	56	2.25%	4.4%	"
Nov-2017	£467,065	£17,231	3.69%	59	1.75%	4.4%	"
Nov-2020	£438,881	£15,113	3.44%	62	0.50%	4%	"

I'm not therefore persuaded that I need to scrutinise Prudential's calculations any further. Given the discretion its actuaries have I can't say on the evidence here that they have unreasonably used that discretion. And in any event, what Mr J doesn't take out of his fund is left to grow. So the critical calculation (which Prudential hasn't needed to carry out yet) is what rate it uses to convert Mr J's fund to a guaranteed income, if that happens.

What I'm left with deciding therefore, is whether Prudential letting Mr J keep £15,810 of overpaid income, having adequately topped up the value of his plan, and offering a further payment to him of £500, is fair and reasonable compensation for all the distress and inconvenience its actions have caused. I don't underestimate how upset Mr J will have been, and clearly has evidenced he was through his written correspondence with Prudential.

I think it took Prudential longer than it could have done to get back to Mr J with details of how it should put things right, although I'm mindful that this was not a typical complaint with a straightforward solution. That can be seen from Prudential not properly anticipating that the solution it had put into place would cause a knock-on effect with two of Mr J's income payments. It isn't always possible for members of staff who didn't design a computer system to anticipate how it will behave when it's retrospectively altered. But this, and the typographical errors Prudential made, added to Mr J's distress – and I can see why it caused him to doubt the seriousness with which it should have been treating his problem.

Mr J asked me to listen to the phone calls he had with Prudential, and I can see from everything he's said – both to Prudential at the time and me now – how upset he was about things. However the difficulty I have is that however long I now spend looking into the complaint, the awards this service typically makes even for considerable distress and inconvenience aren't anything like as much as the amount by which Prudential is allowing Mr J to benefit overall. Our awards aren't designed as a punishment or fine on the respondent business, as we don't carry out the same function as the industry regulator.

We give case studies of payments for distress and inconvenience on our website³, and I hope Mr J will be able to see from this that Prudential has still been generous overall in putting this matter right for him. I don't know the extent to which Prudential weighed this up at the time, so I appreciate it might just seem convenient to Mr J that this has happened. But that doesn't change that it wouldn't be fair or reasonable for me to expect Prudential to do

² Before the GAD tables were rewritten in 2011, the maximum had been 120% of the GAD rate

³ <https://www.financial-ombudsman.org.uk/businesses/resolving-complaint/understanding-compensation/compensation-for-distress-or-inconvenience>

anything more.

Responses to my Provisional Decision

Prudential accepted my findings. Mr J asked for it to provide a quote for conversion to a conventional annuity, which it's also since provided. He also confirmed he had already received Prudential's £500 payment for the distress and inconvenience caused.

In summary, Mr J's main comments in response to the Provisional Decision were as follows:

- The two key issues for him were, firstly, that my interpretation of the law of mistake was incorrect, given the special circumstances of this case which involved repeated errors over ten years. I am not able to depart from the law in deciding what is fair and reasonable.
- Secondly, that Prudential originally promised to review its limits and provide a written explanation. It did the former and not the latter. He has never received a written explanation of how the new limits have been determined.
- The process in reaching the Provisional Decision was flawed because, after asking Prudential to provide an explanation in 'understandable terms' I had also allowed Prudential to 'wriggle out' of answering that key question.
- His KFD says that he is entitled to straightforward explanations as a retail client.
- Prudential told him it fully understood his reluctance to accept the new calculations, so it is still for Prudential to justify the fairness of its multiple corrections. It cannot hide behind a 'commercial sensitivity' excuse.
- My attempt to do Prudential's work for it in looking at how the GAD limits changed, has only exposed that Prudential was calculating lower income levels than those limits.
- Did Prudential's original figures actually comply with the Registered Pension Schemes (Prescribed Manner of Determining Amount of Annuities) Regulations 2006, or were they operating contrary to the regulations?
- Whether he has benefited by Prudential allowing him to keep the extra income is irrelevant in terms of whether the calculations can be said to be fair and reasonable.
- He included these in his annual tax returns, so it would be disingenuous to suggest that Prudential would have any legal basis whatsoever for reclaiming them, or even recalculating them.
- The only reason he is having to consider conversion to a fixed annuity is because of all Prudential's errors, which might persist in future. He would have to give up the flexibility this offers (which he has paid for through voluntarily taking less income to date) and the compensation should take that into account.
- Although he understood annuity rate movements (i.e. gilt yields) would have some impact on triennial reviews, this was not due to Prudential's KFD which made no prominent mention of these, only referring to investment returns in general.
- It was 'outrageous' that the higher investment growth projections from 2008 also involved higher assumptions of future gilt yields.
- Although annuity rates have reduced over the long-term, so has mortality by about six months.
- His IFA never gave the impression that the FLA would perform like a conventional annuity – he is not looking to be put back into the position as if he had the latter.
- The real motivation for Prudential closing externally-managed funds which were performing well in Mr J's view, was to capture more in-house business.
- I had given insufficient weight to how time-consuming it has been for Mr J to grapple with the multiple mistakes Prudential has made and the mental impact this has had.
- The number of changes of investigator he's had, has impacted the outcome of his case.

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 appreciate the way Mr J has clearly set out why he disagrees with my Provisional Decision, but I haven't found a reason in what he's said to revise my opinion on this complaint. I also don't agree that the changes in investigator has had any bearing on the outcome, as I'm not bound by anything any investigator has said. I also reviewed the entire complaint afresh and issued a Provisional Decision to allow Mr J a full opportunity to comment. I'll look first of all at the two main reasons Mr J has for disagreement.

On the law of mistake, I need to make very clear here that the Financial Ombudsman Service is not bound by the law to the exclusion of all other considerations. The way I consider complaints is set out at DISP 3.6.4R in the FCA handbook (available online). This says I will consider the law (amongst a number of other factors) as part of determining what is fair and reasonable. For an answer that was determined solely by the law, Mr J would have needed to take his dispute to court.

However I should also point out that this is not a dispute where Prudential is seeking to recover past overpayments of income such that I'm required to determine whether it is entitled to do so. It's made clear that it won't be doing that. What I'm looking at is slightly different here. In determining what's fair and reasonable, I think it is right to take into account that Prudential's method of ensuring that all future income calculations from Mr J's FLA are based on the right fund value, has involved injecting a sum of some £18,622 into his plan – even though he's benefited from the income that reduced his plan's value by that amount.

I appreciate that this was probably the only way of ensuring Prudential won't keep running into problems in the future (without repeated manual calculations having to be done) – and that income calculations won't fall foul of the *Registered Pension Schemes (Prescribed Manner of Determining Amount of Annuities) Regulations 2006*, because the fund value on which the income is based would otherwise be too low.

Like Mr J, I can see why it would have been counter-productive for Prudential to try to ask for that money back, given it resulted from a series of compounded errors. But I don't think the fact that Mr J had already paid tax on the income necessarily matters, as the fact that he has nonetheless received a *net* benefit can be taken into account when reaching a fair and reasonable conclusion.

I also understand Mr J's second main point that he has still not had the detailed explanation about what was wrong with the income limits, and how Prudential can ensure that this has been rectified. On the original limits applying to his plan, the minimum income was more than 50% of the maximum income at the 2011, 2014 and 2017 reviews. So, it looks to me that Prudential's interpretation of the above-mentioned legislation at the time of those reviews was that the maximum and minimum income limits needed to be moved closer together.

In its recalculated figures, the minimum income *is* exactly 50% of the maximum, so that suggests to me that Prudential is now taking a less cautious approach to how the legislation impacts his plan. So that in turn makes it unlikely in my view that Prudential allowed Mr J to draw income in the past that fell *outside* the legal limits – if anything, it was the other way around. But I do understand that this might now invite the question of whether, if Mr J now intends to draw the maximum income in the future and this is higher, what confidence can he have that Prudential is still observing the legislation correctly.

I appreciate Mr J may well be concerned because of the errors Prudential made in the past. But, a suspicion on Mr J's part still does not give me a basis for saying that Prudential's calculations are still wrong. The standard income limits and the further legislative restrictions that apply to these are, in the end, *both* determined by Prudential's view of what income Mr

J's plan can support in the future – either as a flexible income or (in terms of the legislative limits) an open market annuity. So as I expect Prudential to already be determining its income limits prudently, if it's acting as a responsible provider in the way I would expect, I'm not particularly surprised if the legislative restrictions have no further impact.

This service does not generally provide a checking service for each and every calculation a business carries out - and that's especially true for calculations that depend heavily on commercial judgement. As I've already observed that the changes in income limits on Mr J's plan have been following the market trend, I don't have a basis for substituting Prudential's view of a sustainable level of income with my own. I'm not satisfied a *suspicion* that because Prudential made mistakes in the past it will do so again, gives me a reasonable basis for disbelieving the judgement of Prudential's actuaries – who on becoming aware there was a problem, have now re-checked what the correct limits should be on Mr J's plan.

I think I can usefully reiterate two points I made in the Provisional Decision here. Firstly, in terms of him potentially suffering an overall financial loss while the FLA is operating, I can't reasonably say that will happen as every penny in Mr J's plan is accounted for – if he takes more income his fund value reduces more, and vice versa. And secondly, if Prudential overpays income because of a genuine mistake then it doesn't amount to an unauthorised payment under the tax rules.

It's a generally accepted market practice with reviewable plans like the FLA, or a drawdown plan, that whilst the provider sets the income limits these will act as an opportunity for discussion between the client and their IFA. The IFA can advise Mr J on how much income to withdraw (if both parties wish that to happen), whereas Prudential cannot do so. Mr J may therefore find it helpful to review the level of income he should be taking with his IFA. Even where it is calculated correctly Prudential cannot guarantee that taking the maximum income level (for example) will be sustainable if its assumptions are not borne out in reality. And Mr J or his IFA may legitimately take a more cautious view of the future than Prudential has done.

Mr J was promised straightforward explanations in his KFD, but I don't think this equates to a breakdown of each triennial review calculation. Prudential did explain in the KFD and another factsheet Mr J's IFA received what *factors* go into setting the income limits, which I think is more aligned with a straightforward explanation. Given that these are ultimately a matter of actuarial opinion, and even though I invited Prudential to share any further explanation it was willing to give to satisfy Mr J's greater needs, I'm not persuaded that Prudential is bound to provide the explanation he's seeking.

I take Mr J's point that the wording in the KFD could have been improved. However I can't say that its reference to future investment returns *in general*, either fell foul of providing a reasonable explanation, or that it ultimately impacted Mr J - who says he had anticipated that gilt yields would have an impact on income limits. The 2008 projections used assumed investment returns and annuity interest rates that were both prescribed by the regulator. Whilst Prudential had no alternative, I also can't agree with Mr J that they are irrational. When interest rates are higher, long-term stock market returns also tend to be higher. So I think it would have been more problematic for a projection which used a variety of assumed returns on stock markets, to stick to a single assumption for the annuity interest rate.

The purpose of providing the GAD figures in my Provisional Decision was not to suggest that Prudential's income limits have to correspond exactly to these figures. I was using the drawdown limits, which are set differently, to illustrate the overall *trend* in the marketplace. It is still possible to deplete a drawdown pot too rapidly in an ill-advised fashion by over-relying on the max GAD rate. So, I'm not surprised if Prudential set more conservative limits for the FLA, not least because drawing an excessive income could then trigger inbuilt provisions to restrict the policyholder's options to a with-profits investment or fixed annuity if the income

dropped below a certain level. Prudential had a responsibility to manage the product with that restriction (which doesn't apply to drawdown) in mind.

I understand Mr J's comments about the externally-managed funds closing when he thought they were doing well. Ultimately I'm not able to dictate which external managers Prudential should use and as I indicated in my Provisional Decision, I think there would only be a problem on which I would have to comment, if Prudential significantly reduced access to external funds (of any provider). I haven't found that has happened in this case.

The rate implied by the fixed annuity conversion quote has increased significantly from the last quote Mr J received. The slight improvement in mortality he's mentioned may well be taken into account, but I have to acknowledge that the exact rate Prudential's willing to grant is a matter for its commercial judgement. I appreciate the nature of the product means that Mr J is tied to Prudential for providing the annuity, but he does not have to accept this quote. He can continue with a flexible income that exploits the maximum limit if he wishes to do so.

Should Prudential make errors in future, I would expect these to be corrected as they have been here. Whilst I would very much hope that this doesn't happen, I'm not able to give an absolute guarantee that it won't, just as it would be unwise for Prudential to do so. The Financial Ombudsman Service stands ready to assist if Mr J isn't able to resolve any future dispute with Prudential. So, I don't agree Mr J is being forced by this complaint into taking a fixed annuity that he otherwise might not want.

My final decision

I uphold Mr J's complaint on the basis that Prudential did make errors (including whilst the complaint was with our service) that it has had to correct. But I'm now sufficiently persuaded that Prudential has taken appropriate steps to put Mr J's plan back into the position it should have been in at the present time, if it had not made those errors. This has included allowing Mr J to keep the benefit of at least £15,810 of additional gross income, which I've also taken into account when deciding if it's reasonable to expect Prudential to provide further redress.

Prudential sent Mr J £500 to compensate him for the distress and inconvenience it caused. I've thought again about what Mr J has said about the mental impact and time he's had to spend making Prudential put these issues right. But in the round, I'm still persuaded that Prudential has done enough given the past income Mr J has benefited from and the fact he received another £500 in his pocket. I referred Mr J to the typical awards this service makes for distress and inconvenience in my Provisional Decision, and I'm not persuaded that there are grounds for me to increase that award.

I know Mr J is disappointed by this, but I won't be requiring Prudential to do anything further than it has already done to put things right for him. Under the rules of the Financial Ombudsman Service, I'm required to ask Mr J to accept or reject my decision before 26 April 2023.

Gideon Moore
Ombudsman