DRN-4664443

The complaint

Mr G is unhappy with the way Phoenix Life Limited trading as Standard Life (Standard Life) dealt with his requests to cash in his annuities.

What happened

Our investigator set out the background to the complaint and his findings in his letter of recommendation. He didn't think Standard Life needed to do anything to put things right. Mrs G acting on behalf of Mr G didn't agree. I've set out a summary of what happened and what's been said up to this point below:

Initially Mr G made a complaint to Standard Life, following this complaint it let Mr G know it would allow an offer of encashment on the smaller of his annuities held with it.

Standard Life called Mr G about cashing in his annuities on 26 July 2023. Mr G had two annuities with it, one was worth £189 p.a and another approximately £1,000 p.a. The call handler said that it had taken a business decision to look at offering in some circumstances (such as financial hardship) the opportunity to cash in annuities. And he said he would send Mr G an offer of just over £2,000 which Mr G was very happy with.

The call handler explained that the calculation process wasn't simply the purchase value of the annuity minus the payments made so far, it was far more complex. And he said it related to what it deemed a fair value for the remaining annuity – and this included factors such as annuity rates, gilt prices, life expectancy and age. The call handler also stated that he'd done a quick calculation looking at Mr G's tax code and it looked like he wouldn't pay tax on the offer amount. Mr G asked about how quick the payment would be made and would he still get the £189. The call handler said he could wait until after the annuity payment was received and then accept the offer, it was up to him. But once the offer was accepted he wouldn't continue to receive the £189 going forward.

In relation to the larger annuity the call handler said he couldn't make an offer for that as it was over the legislative value of £10,000. He explained it was probably worth around £13-14k. But this could go down in the future as Mr G got older or if annuity rates changed, so it may be worth getting in contact in future about it.

Following this call Mr G sent an email to the call handler asking about the tax he would pay as he'd calculated that he would in fact pay tax.

The call handler later made two further calls to Mr G – these were made from his personal mobile and so no recording is available. There is some dispute about what was said in these calls. The business has said the calls were made to correct some information about the tax Mr G may pay – following the email from Mr G. But Mr G says the calls were made to discuss the imminent opportunity of cashing in the second larger annuity once the next annual payment was made. And this is what Mr G is unhappy with.

Mr G is also unhappy about the following:

- Standard Life should've made it clear if he waited a few weeks he could receive his annuity payment of £189 and then the encashment offer.

- Standard Life has refused to divulge its calculations in relation to how the annuities are valued.

- Mr G wasn't asked any questions about his health before the offer was made.

- He's been advised the the larger pension pot couldn't be cashed in as the business told him it was worth more than £10,000. But it hasn't explained how this was calculated. He believes it is worth less than £10,000 based on his own calculations.

Mrs G has also been involved in the complaint process, acting on behalf of Mr G and she spoke to our investigator and said in addition that the process for encashment of the smaller annuity had happened very quickly. She felt this was suspicious and it had been rushed without looking into Mr G's circumstances.

Our investigator looked into matters and said in summary:

- The Standard Life call-handler did make reference to the fact Mr G could wait until his annuity payment had been received before accepting the offer. Therefore Mr G was aware that he could have waited until after his annual payment was made.

- However Mr G chose to take up the offer which was posted out to him in a letter dated 26 July prior to the anniversary date. He said he couldn't hold the business responsible for Mr G's decision on timing about when to accept the offer for the smaller annuity.

- The call handler had explained in the recorded call that the value of the larger annuity was in the region of £13-14,000.

- He said there was some uncertainty as to what was said in the unrecorded call but Mr G had previously been told the value of his policy was around £14,000 by the same person and Mr G had confirmed this back to him in an email. And that Standard Life had admitted the call handler shouldn't have called from a personal mobile or at least explained it wouldn't be recorded but in the context of the complaint about whether it could be cashed in – this was not a material factor.

- He felt Standard Life's explanation that the calculation of the replacement cost included factors such as its pricing model, charges and life expectancy assumptions. And that some of this information is commercially sensitive so it wouldn't share this with Mr and Mrs G, was fair.

- He said Standard Life had explained that the questionnaire that Mr G was going to return for the smaller annuity was simply designed to help the business determine whether they should make an offer of cashing-in. In other words, the answers to the questions wouldn't impact on the value of the offer itself. As Mr G's value was marginally over £2,000 the business decided that they wouldn't need to receive this questionnaire. The investigator felt they had used its discretion fairly.

Mrs G on behalf of Mr G didn't agree with the investigator's findings. In summary she said:

- The call handler made two calls from a private number with the sole intention of discussing the annuities privately and not being recorded.

- She believed a questionnaire, including questions about health, was important and that this would affect the pension pot value.

- The offer had been made very quickly and to pacify Mr G without proper explanation.

- Our investigator had just sided with the insurance company and one that had a history of misleading customers.

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 G and Mrs G have provided us with lots of information and detailed submissions about this complaint, but I've only summarised the points that I think are key to deciding the complaint. I don't mean this as a disservice, this is just a reflection of the nature of our service. Whilst I have taken into account everything they have told us, it is part of my role to identify the core issues I need to address in order to reach a fair outcome. This means I might not cover everything they have said, but I will comment on everything that I think makes a difference to the outcome of the complaint.

Before I continue, I'd like to say I was sorry to hear of the recent health issues that Mr G has suffered.

Mr and Mrs G are unhappy with what they see as a lack of clarity about the process of cashing in annuities and the values derived for Mr G's annuities. They believe the value of the larger policy is below £10,000 and that Standard Life should make them an offer. They have made reference to the original purchase price of the annuity, what he's received so far and what they think the remaining value is. However, as Standard Life has explained this is not relevant to the calculation made in relation to making an offer of encashment.

Once Mr G took out his annuities, his policy no longer had a value. Annuities were designed as a contract to pay a particular amount for the rest of a person's life with the pot value exchanged for the ongoing payments. Mr G when he purchased his annuities, sold the money that he invested with Standard Life and in place bought the two annuities. This began a separate contract(s) from that of the pension. This contract was to pay the annuities for the rest of his life and the purchase value became obsolete.

However, subsequent legislation allows businesses at their own discretion to offer an amount in place of the ongoing annuity in certain circumstances. But as I'll set out it did not define how this value should be derived.

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.

<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 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 G'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.

Did Standard Life act fairly in its offer to Mr G regarding the smaller annuity?

When Mr G took out his annuities, he didn't have the option to take the pension benefits as a lump sum. His option was largely restricted to taking out an annuity.

Since then legislation around annuities has changed and providers can now offer customers the opportunity to take the whole fund as a lump sum rather than taking an annuity. But this legislation didn't say that annuities already in payment could be taken as a lump sum.

The government looked at introducing a secondary annuity market, where customers would be able to cash in their annuities. But, after consultation, the government didn't carry this forward, mainly because of concerns that it wouldn't be in consumer's best interest to cash in annuities. And because of the complexities around valuing this and whether this would provide fair value to customers.

So, as explained above the current rules generally don't allow a customer to cash in an annuity and take a lump sum payment. However, in instances where the value of that annuity is less than £10,000, it can be cashed in but only if the provider chooses to offer this.

Some providers have chosen not to offer this option to their customers. However, Standard Life has chosen to make offers in certain circumstances. It's explained it has made offers to some customers with annuities worth less than £2,000 dependant on their circumstances. And this is what Standard Life has done here. It made Mr G an offer, although his annuity was slightly over £2,000, but it said as a gesture of goodwill it would do so. And it also said he didn't need to fill in the questionnaire it had sent him to determine whether it would make an offer. Mr G chose to accept that offer on that basis.

Mr and Mr G want to know how this value was calculated. I don't think it is unreasonable that Standard Life hasn't shared the calculations with Mr and Mrs G as this will contain sensitive commercial information. However, at a very basic level, Standard Life's offer of just over £2,000 for Mr G's annuity equated to roughly ten and a half times the value of the annual payment. This doesn't seem unreasonable having looked at Mr G's age at the time and the national statistics for life expectancy. This is not to say this was how the offer was calculated but broadly the cost of providing an annuity has a strong correlation with life expectancy.

Mrs G has commented on the speed at which the offer was made and believes it was made to placate Mr G and essentially make him go away. She also believes more information should've been collated to make this decision. However, the process of offering encashment isn't comparable to that of when an annuity is purchased. This was not a new actuarial decision based on the particular circumstances of the customer such as any health conditions. Firms have told us that to do so would make this a costly process and was among the reasons given by providers as to why a secondary annuity market shouldn't proceed. And why firms have chosen not to use their discretion to offer encashment. Instead, it is a calculation based on what the cost of providing the annuity already in place would cost.

Standard Life initially asked Mr G to fill a questionnaire about his circumstances but it has explained that this was only about whether it would make Mr G an offer and not to determine the value. It later decided that Mr G didn't need to fill this in and made him an offer based on its usual process for valuations. I don't think it did anything wrong here, Mr G chose to accept this offer and he hasn't said now that he'd rather have kept the annuity – which was his only other option.

With regards to the complaint point that Standard Life should've advised Mr G to wait until his next annuity payment was received and then complete the offer process, I note the adviser did tell Mr G he could do this but it was up to him. He also told Mr G if he was to accept the offer promptly, it would be processed quickly and before the next annuity payment was due. Mr G then chose to accept the offer before his next annuity payment was due. This was his decision and I don't think I could fairly say Standard Life should be held responsible for this.

The larger annuity which Standard Life says it cannot make an offer on.

Whilst I can understand why Mr G would like a lump sum instead of an annuity, as has been explained Standard Life have discretion about whether to make an offer. And only if the value of the offer is under £10,000.

I appreciate it may seem somewhat unsatisfactory that how an annuity already in payment is calculated and valued isn't defined. But legislation says a payment cannot exceed £10,000 and businesses are required to treat customers fairly. It seems that Standard Life (and other providers) have taken the position that it will only make offers for annuities worth (by their own particular calculation basis) less than £10,000. This doesn't seem unreasonable, and I think it is an example of good practice.

Standard Life says Mr G's larger annuity is worth more than £10,000 and so it will not make an offer. Having done some basic calculations of my own, I think it's likely the cost of purchasing Mr G's annuity would be more than £10,000. So, I don't think it has acted unfairly in not making an offer for this annuity. The call handler did say this may go down in the future as Mr G ages and if annuity rates change, and he could ask again in the future.

Mr and Mrs G are also not happy that the call handler made subsequent calls following the initial discussion, using his personal mobile phone. I note that what it is said the call handler told Mr G, isn't too far removed from what was said in the recorded call. He said then it had a value of around £13-£14,000 but this could drop in the future but this would depend on annuity rates and other factors. So if he did give a more optimistic view of this in the follow up call, it still does not change the fact that Standard Life says at this point under its calculations an offer for the annuity would exceed £10,000 and so it cannot make an offer. So whilst I accept it wasn't good practice for the call to have been made on a personal mobile phone, I don't think what Mr and Mrs G have told us was said makes any material difference to whether Standard Life has acted fairly in its position that it will not make an offer.

Conclusion

Standard Life made an offer which Mr G accepted to cash in his smaller annuity. This was allowed under legislation at its discretion which it chose to use. I don't think it used its discretion unfairly here – and I note there has been no suggestion that Mr G would in fact had preferred to keep the annuity. In relation to the larger annuity, after looking at the evidence I accept Standard Life's position that any offer would be in excess of £10,000 and therefore under the legislation that applies it cannot make this offer.

My final decision

For the reasons explained above, I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr G to accept or reject my decision before 28 May 2024.

Simon Hollingshead
Ombudsman