

complaint

Mr J's complaint is about the calculation The Prudential Assurance Company Limited ("Prudential") carried out to work out the cash value of a pension policy he held with it. Mr J's complaint, in essence, is that Prudential did not act fairly when calculating the value that was paid to him in relation to the policy.

background

Mr J held a number of pension policies with Prudential. The cash value of these was transferred to a drawdown arrangement, also provided by Prudential, in 2017. The Independent Financial Advisor (IFA) who advised Mr J to make this transfer is bringing the complaint on his behalf. The complaint is focussed on Prudential's valuation of one of the policies that was transferred into the drawdown arrangement.

On 18 January 2017 Prudential issued a quote relating to the policy in question. That set out what annuity (income) would be payable from the policy, and also provided a cash value of £222,204. It seems Prudential provided a number of further cash values for this policy at later dates. When the transfer of the value of this policy to the drawdown scheme finally took place, on 18 May 2017, Prudential paid £207,790. The complaint is about this fall in the transfer value.

When making the complaint, the IFA said he felt the transfer value had been reduced on the whim of Prudential's actuaries. In short, he didn't think the reduction in the value was a fair reflection of the market.

In response to the complaint Prudential said it was satisfied that it had correctly calculated the value of the policy. When explaining the fall in value, it referred to a revision to its bonus rates made on 1 April 2017. It later referred to a change in annuity rates, which were a factor in calculating the cash value of the policy (in short, a higher rate would mean the cash value was less due to it costing less to buy the income the policy offered).

One of our adjudicators looked into the cash valuation, and concluded that the complaint should not be upheld. He said, in summary:

- The policy is a with-profits deferred retirement annuity contract. It is annuity based, rather than fund based. In other words, Mr J's contributions bought parts of a basic annuity, instead of building up a fund to use later to buy an annuity.
- The contributions secure an annuity which is based upon the number of contributions paid, the specified retirement date and the age and sex of the policyholder at commencement. Annual bonuses are then added, with reference to the basic annuity.
- In its annuity quote dated 18 January 2017, Prudential confirmed that the pension value was £222,204. The letter accompanying that quote said that on 18 February 2017 Prudential anticipated the pension value to be the same. However that was not guaranteed.
- Prudential says the transfer value is calculated by multiplying the pension benefit (yearly annuity) by a factor which reflects the policyholder's life expectancy in retirement and the annuity rates expected post retirement. The pension benefit and

the transfer value could go up or down, individually or both, if the quotation date or claim date is within a different bonus period. Transfer values calculated in future bonus periods could continue to fluctuate.

- Prudential was not obliged to keep the earlier valuation and apply it to the transfer. As its letters stated, that value was not guaranteed and could change.
- The policy was transferred in order to facilitate a drawdown. In other words, no annuity or open market option took place. As such, the transfer value could change on a daily basis.

The adjudicator also provided a breakdown of the various elements that made up the cash value, which had been provided to him by Prudential. In relation to Prudential's calculation, the adjudicator said:

- He was satisfied that Prudential did not do anything wrong in respect of the reduction in the transfer value. Bonuses are dependent on the underlying fund performance and are allocated to with-profits policyholders as a share of the returns for their investment in the with-profits fund. The changes to bonuses paid are a matter for Prudential's commercial discretion. And with-profits fund providers, like Prudential, do have significant discretion about how they operate this type of fund.
- The industry regulator, the Financial Conduct Authority (FCA) has set out principles and rules that businesses such as Prudential need to follow for the way in which they manage with-profit funds. With-profits providers such as Prudential are required to publish how they manage their with-profits funds, and they are accountable to the FCA
- He was not aware of any concerns the FCA has about Prudential's management of its fund or how it operates its with-profits annuities.
- The value of the plan was subject to a periodic revision including when Prudential updated its bonus rate to reflect the most recent performance of the fund, on 1 April 2017. As the bonus rate went down, this meant a lower additional bonus in the form of annuity added to what had been accrued. There was also a change to the annuity rates used to convert the annuity to a cash value. The combination of the two factors led to the reduction in the transfer value.
- It is a feature of with-profits funds that bonus rates are adjusted on a regular basis – on this occasion on 1 January and 1 April each year. Annuity rates also change, even more frequently than this.

The IFA, on Mr J's behalf, did not accept this view. He said, in summary:

- He is well aware that bonus rates can move up or down. Prudential has never provided him with any detail of such a reduction. Surely this should be in the public domain in respect of such contracts.
- After initially referring to bonus rates Prudential reverted to other reasons for the reduction.

- The fall in value was not due to a bonus reduction but an alteration in the annuity rate used by Prudential to purchase the required guarantees. The annuity rates used by Prudential increased significantly between March and May 2017. This must be down to manipulation of the annuity rates by Prudential's actuaries, as the open market annuity rates did not alter much over this period.

The IFA later added the following, in summary:

- The application for the drawdown arrangement was sent at the end of March 2017. He then received no communication whatsoever from Prudential. He had to phone it some six weeks after sending in the application to find out what was going on.
- He was advised of a reduction in overall value of £11,000 and the reason given was a reduction in bonus rates, which apparently took place on the 1 April 2018, five days after he had sent the application form to Prudential. But he now knows that there was not a reduction in bonus rate but a decision taken by Prudential to amend its own annuity rates, thus reducing the overall value of Mr J's arrangement.
- It is clear from the open market annuity rates available that Prudential made the decision to alter its annuity rates against the rest of the market. It is also interesting to note that Prudential had already declared at this time that it would no longer be writing annuity business.

my findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

The main point of complaint is the calculation carried out by Prudential in relation to Mr J's retirement annuity contract. But, in his latest submissions, the IFA has also referred to Prudential's processing of the application to transfer that policy. So I'll look at both these things.

Prudential's processing of the application to transfer Mr J's policy

The available evidence shows the application form was signed by Mr J on 22 March 2017, but sent to Prudential on 8 April 2017 – the covering letter from the IFA sent with the application form carries that date. Prudential says it received the form on 12 April 2017.

The available evidence also shows that the IFA contacted Prudential for an update on 9 May 2017 and was told at this time that an Appropriate Advice Declaration was needed in relation to the retirement annuity contract. This was because the policy contained safeguarded benefits and had a value of more than £30,000. The rules in place at the time required providers such as Prudential to obtain a declaration from an authorised advisor before transfers could take place in relation to such policies. The Appropriate Advice Declaration was sent on 9 May 2017, and the transfer was made on 18 May 2017.

In these circumstances, I do not think it would be fair to say Prudential should pay Mr J a transfer value from an earlier date. I think the IFA is right to say Prudential's communication could have been better – it could have let him know sooner that the Appropriate Advice Declaration was needed, for example. But I also think there was some responsibility on his part to follow things up. And I think it fair to expect him to have been aware of the rules

relating to the transfer he was advising, and to have taken steps to ensure Prudential was provided with the documents it needed. Once Prudential had the documents it needed it completed the transfer out of the retirement annuity contract within a reasonable timescale.

Prudential has paid £300 compensation to Mr J for the overall failings in its service. I'm satisfied that its poor communication formed part of those overall failings and that the compensation paid is fair, in the circumstances.

So I do not think the complaint about Prudential's processing of the application to transfer Mr J's policy should be upheld. It was fair for Prudential to pay the value of the retirement annuity contract as of 18 May 2017, and it has already compensated Mr J fairly for the failings in its service.

Prudential's calculation of the cash value of Mr J's retirement annuity contract

Prudential has provided the following breakdowns of the values it quoted to Mr J.

29 March 2017:

Transfer Value	£223,697.80	%
Basic annuity	£134,039.57	59.92
Guaranteed bonus	£87,260.14	39.01
Non-guaranteed Bonuses	£2,398.08	1.07

18 May 2017:

Transfer Value	£207,790.40	%
Basic annuity	£125,780.84	60.53
Guaranteed bonus	£81,883.68	39.41
Non-guaranteed Bonuses	£125.88	0.06

I do not agree that these breakdowns show the fall in value was not down to a reduction in bonus rates. But they do show it was only *partly* down to such a reduction. There was also a fall in the value of the annuity offered by the policy. So I've considered the reductions in relation to both the annuity and the bonus rates.

The level and type of bonuses declared by Prudential on its with-profits fund is a commercial decision taken by the directors of Prudential acting on the advice of its actuaries. What annuity rate is offered is a similar commercial decision.

Here, I have not seen sufficient evidence to show that the fall in value has come about as a result of anything other than investment performance and the legitimate use of Prudential's commercial judgement.

With-profits funds have historically attracted criticism for their complexity and perceived lack of transparency – it can be very difficult for policyholders to understand often complex and lengthy documentation and to be satisfied that they are receiving their proper entitlement under the terms and conditions of the particular product. But those difficulties do not necessarily mean that the provider of the with-profits fund has done something wrong or is not acting in accordance with its regulatory obligations.

The bonuses that attach to Mr J's annuity are linked to the performance of Prudential's with-profits fund. Due to the long term nature of with-profits investment funds and the requirement to treat all policyholders fairly, bonus rates may not immediately reflect the prevailing investment climate. In particular, the process of smoothing, whereby profits in good years are held back to compensate for lower returns in other years, can lead to an apparent significant mis-match between bonus rates and investment returns when looked at on an annual basis only.

The industry regulator (previously the Financial Services Authority (FSA) and now the Financial Conduct Authority (FCA)) recognises that with-profits fund providers have a considerable amount of discretion about how they operate their with-profits funds. That said providers are accountable to the regulator for the way in which these funds are managed.

The regulator's Principle 6 requires that regulated firms "*...must pay due regard to the interests of its customers and treat them fairly*". Furthermore, the Conduct of Business Sourcebook (COBS), and specifically COBS 20, contains specific rules and guidance for businesses on the operation of their with-profits funds.

COBS 20.2.1 states:

(1) With- profits business, by virtue of its nature and the extent of discretion applied by firms in its operation, involves numerous potential conflicts of interest that might give rise to the unfair treatment of policyholders.

And COBS 20.2.3 states:

A firm must have good reason to believe that its pay-outs on individual with-profits policies are fair.

Prudential is accountable to the regulator for the way in which it operates its with-profits fund and the regulator monitors the management of with-profits funds. Businesses are required to appoint a with-profits actuary and the regulator provides rules and guidance on their duties. An independent with-profits committee is also required – its remit is to protect the interests of the with-profits policyholders and to ensure that they are treated fairly. I am not aware of the regulator having any concerns about the operation of this fund.

Prudential had over-arching regulatory obligations in relation to its calculation of annuity rates too. I think it had considerable amount of discretion in using its commercial judgement when setting annuity rates. In this case, I note the IFA's points about other rates available on the market. But I do not think it would be fair to say that Prudential deciding to increase its rates when some other providers were not amounts to anything more than a legitimate use of its commercial judgement. The rate Prudential offered was not so far out of line with the wider market that it would be reasonable to say that it was a mistake, or unfair to Mr J.

Given my above findings, I am not going to ask Prudential to do anything else.

my final decision

For the reasons given, I do not uphold the complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr J to accept or reject my decision before 17 January 2019.

John Pattinson
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