

complaint

Mr D's complaint is about the reduced income he has been receiving from his With-Profits annuity since it was transferred from his former provider to The Prudential Assurance Company Limited ("Prudential"). He is concerned that eventually his income will be reduced to zero.

background

In 1995 Mr D took out a With-Profits annuity with a provider who subsequently experienced financial difficulty. In resolving these financial problems that providers annuity contracts, including Mr D's, were transferred to Prudential. Although Prudential honoured the original guarantees that were applied to the plans, the bonuses they declared each year could not support the level of income Mr D had been receiving.

Our adjudicator wrote to Mr D setting out his reasons for not upholding the complaint. He explained:

- The situation that arose at Mr D's original annuity provider meant that Prudential took over the plans. However no changes were made to the existing terms and conditions. Prudential had to make a commercial decision on how to incorporate their bonus allocation with the guarantees already in place on the annuities.
- Prudential operates a policy of 'smoothed' bonus returns. This led to a general reduction in the overall income Mr D had been receiving.
- The general economic downturn of 2008 meant that bonuses were not sufficient to improve Mr D's income.
- This performance had affected Mr D's policy but this was a commercial judgement that Prudential had the right to make to safeguard all of their With-Profit policyholders and was not a matter for the Financial Ombudsman Service to pass comment on.

Mr D disagreed with the adjudicator's assessment raising the following additional points:

- The original sale of the annuity was unsuitable as his original annuity provider was insolvent at the time.
- If Prudential knew the payments were unsustainable they should not have taken on the commitment from Mr D's original annuity provider.
- Prudential should not be clawing back income from policyholders to make up for any overpayments they believed the original annuity provider had paid.
- By stating that they would honour existing terms and conditions Prudential would end with the same problems as had occurred in 2001 before the transfer.

The adjudicator responded and in summary said:

- Mr D's complaint here relates to Prudential having reduced Mr D's annuity income. A complaint of mis-selling the original With-Profits annuity would be a new complaint by Mr D against the adviser and company that made the recommendation.
- The allocation of bonuses by the Prudential was a matter for their legitimate commercial judgement and was not something the Financial Ombudsman Service could comment on.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. Having done so, I have come to the same conclusion as the adjudicator and for the same reasons.

I acknowledge that Mr D did not request that his annuity be transferred to another provider and may not have chosen Prudential if he had wished to transfer. I also have noted the difficulties that annuitants such as Mr D have faced as a consequence of the financial problems experienced by the original annuity provider.

Whilst I appreciate that these business decisions have affected Mr D's annuity income and that he has seen a reduction in income since Prudential took over the management of his plan. I have also been made aware that his income halved whilst he remained invested with his original annuity provider. This performance reflects the fact that irrespective of the provider such products can see a fall in their income as well as a rise.

While I appreciate Mr D's frustration that his annuity has continued to fall, this is due to the terms and conditions of the annuity he selected and the unfortunate decrease in bonus rates. In those circumstances, I do not believe Prudential has acted in an unreasonable manner in declaring bonuses applying its legitimate commercial judgement or that it is not acting in accordance with the terms of Mr D's annuity, notwithstanding it was originally taken out with a different provider.

I have referred to the illustration dated 4 December 1995, in particular the paragraph under 'purchase price' which says *"if future bonuses increase the guaranteed benefits by 4.5% p.a. the gross annuity will be level throughout. (This is the equivalent of anticipating an announced overall rate of return of 8.1575% p.a)"*.

This shows that for the annuity to at least maintain its value there had to be an overall rate of return of 8.1575% per annum. While I appreciate these rates of return may have been achieved in the 1990's, there has subsequently been a significant fall in investment returns and therefore the return on with-profit policies has fallen also, in line with falling markets.

I understand that Mr D has said that his annuity, whilst having increased significantly in the first few years, reduced drastically up to the point Prudential took over payment, and has subsequently continued to reduce.

The fundamental reason for the decrease in the annuity payable is the terms and conditions of the original agreement. The annuity was set up speculating that a rate of return would be achieved throughout its life time. Whether or not this was a suitable recommendation is not something I can consider in the context of this complaint as the advice to enter into the policy was not provided by Prudential.

I note that Mr D has also expressed concern at the way in which Prudential manages its with-profits fund and that the level of declared bonuses does not correlate to overall market performance. Although I consider that the final response letter from Prudential to Mr D in March 2013 gave a clear and comprehensive response to these concerns, it may be helpful if I make some additional comments.

Prudential manages its With-Profits fund in accordance with its Principles and Practices of Financial Management (“PPFM”) document which is in the public domain.

The industry regulator, (previously the Financial Services Authority (‘FSA’) and now the Financial Conduct Authority (‘FCA’)) recognise that the managers of with-profits funds have significant discretion about how they operate their with-profits funds. Notwithstanding that, the regulator’s Principle 6 requires that firms “...*must pay due regard to the interests of its customers and treat them fairly*”. Furthermore, the Conduct of Business Sourcebook provides specific rules and guidance for fund managers on the operation of their with-profits funds including:

“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 “A firm must have good reason to believe that its payouts on individual with-profits policies are fair.”

Prudential is therefore accountable to the regulator for the way in which it operates its with-profits fund; it must ensure that it does so in accordance with its PPFM document and all other relevant regulatory obligations.

The regulator monitors the management of with-profits funds in a number of ways. These include a requirement for with-profits fund managers to appoint a with-profits actuary for whom the regulator provides rules and guidance on their duties and responsibilities. There is also a requirement to appoint an independent with-profits committee whose remit is to protect the interests of the with-profits policyholders and ensure that they are treated fairly.

I have also noted Mr D’s concern about the lack of transparency as to how bonuses are allocated and that he feel the bonuses credited to his policy are not in line with the underlying performance of the fund. However, it is not within the remit of this service to carry out an in depth audit of Prudential’s management and operation of its with-profits fund. As explained above, it is the regulator that monitors the management of with-profits funds and if consumers consider that they have not been treated fairly they are of course at liberty to approach the FCA directly.

However, this service having approached the FCA to ascertain if there are any concerns about the way in which Prudential is operating its with-profits fund, I can confirm to Mr D that no such concerns were expressed.

The amount of bonus paid each year, if any, is determined by Prudential’s investment objective, consistent with its regulatory obligations, to allocate bonus amounts as fairly as possible to all its investors in its with-profits fund with the aim of providing a competitive return at the end of the term.

Bonus rates take into account various factors; these include not just current or recent investment performance but also how Prudential expect the fund to perform in the future, as well as the fund's liabilities in respect of the guaranteed benefits applicable to all plans.

As explained by the adjudicator it is normal for with-profits fund managers to employ 'smoothing' in determining the level of bonuses it pays. This means that it does not pass on all the returns received on the funds in good years so that it can pay a bonus when returns are not so good. Such a process is fundamental to the way with-profit funds operate; details of the process are documented in the PPFM.

I understand Mr D's disappointment at the level of bonuses that have been paid to his policy and that the income he is receiving is below his expectations. However, for the reasons set out above, I have concluded that it would be neither fair or reasonable to conclude that he has been treated unfairly by Prudential.

my final decision

I do not uphold Mr D's complaint against the Prudential Assurance Company Limited.

Terry Connor
ombudsman