

## **complaint**

Mr C complains that The Prudential Assurance Company Limited has failed to provide an understandable explanation of why his pension made a loss over a 10 year period when the underlying fund appears to have made a significant profit.

## **background**

The adjudicator wrote to Mr C by letter in September 2012 with her assessment of the complaint. The background and circumstances to the complaint were set out in that letter which was provided to both parties. The adjudicator did not recommend that the complaint should be upheld. In summary she considered that:

- Bonuses had been added to Mr C's plan. In her view, Prudential had not done anything wrong by adding smaller bonuses to Mr C's plan in comparison to the performance of the with-profits fund.
- In her experience with-profits providers were not currently offering bonuses at the same level as previously, due to the decline in stock markets over a significant period.
- Prudential's with-profits fund used a process called smoothing.
- Mr C's plan had guaranteed annuity rates (GARS) between the ages of 60 and 75.
- The values Prudential listed in its final response letter to Mr C were the transfer values and not the fund values.

Mr C disagreed with the adjudicator's findings. He said:

- His main complaint was that Prudential had failed to explain to him in a way he understood why his pension plan over the ten year period had made a loss.
- He did not expect the full 80.6% to be added to his fund, however, in reality, nothing had been added in 10 years.
- The adjudicator referred to smoothing in her letter. Interest rates were higher in the 80s and 90s which was surely the time smoothing would have meant gains being held back. Since that time interest rates had fallen substantially. This is when gains held back would be reintroduced. This would make the 80.6% even higher. Smoothing was designed to take out ups and downs in the short term performance.
- Total bonuses and benefits between December 2000 and 2010 showed his fund value had increased less than his premiums.
- If the total bonus and benefits had no relation to the value of his plan, this should be made clear to him.
- The adjudicator had failed to mention that Prudential somehow lost a record of the telephone call in August 2011, which left him waiting three months for a reply.

Mr C subsequently said that he wanted the ombudsman to focus on the following points:

- Finding in favour of Prudential implied that this service fully understood from the information provided why his plan appeared to have gone down in value over the ten year period whilst he had been told that Prudential had made profits of 80.6%.
- He had asked us twice if his understanding of smoothing was correct. As he had not been told otherwise, he presumed his understanding was correct. He wanted this to be confirmed.

- Did the value of total bonuses and benefits have any bearing on the plan's worth? If so, what was the relation to that and transfer values as in his view there was no relation.
- Did smoothing really explain where 80.6% had gone?
- Had his plan gone down in value, taking into consideration his annual contributions?
- If it is true that his plan had gone down in value whilst Prudential had made 80.6% returns, was it right that none of the profits went into consumers accounts?

Prudential confirmed that it had nothing further to add.

### **my findings**

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

With-profits funds have attracted criticism for their complexity and lack of transparency, and I accept that it is very difficult for policyholders to understand their operations (in particular the basis of how bonuses are calculated), to satisfy themselves that they have received what they are entitled to under the terms of their investments. That does not mean, however, that the business has got something wrong.

I think the starting point is that this policy guarantees to provide at least a minimum amount at retirement date. Bonuses may be added to the policy each year, and once they are added they cannot be taken away. And a further bonus *may* be added when the benefits are taken at retirement date (called terminal bonus).

So when the policy was first arranged in 1983, it guaranteed to provide a sum significantly higher than the premiums paid into it over its term. The with-profits fund is invested in a variety of asset classes, such as equities, fixed interest and property, and the proportions invested in each will change over time. During the 1980's and 90's, returns from both equities and fixed interest assets were significantly higher than they are today. So the bonuses awarded annually during those years were added to the guaranteed amount that was already provided, and these could not be taken away.

The process of smoothing effectively means that there is no direct correlation between the fund performance and the bonuses added over a set period. When returns are higher, bonuses do not fully reflect this as some value is held back to award in years when returns are lower or negative.

I note that Mr C is particularly concerned about the 10 year period when it appears the fund increased in value by approximately 80%, yet this was not fully reflected in the bonuses added. He has also said that given returns in the earlier years were healthy, and so some of this investment return held back, it follows that it could have been used in these subsequent years to boost the bonuses.

The difficulty here is that Mr C is only using a certain time period to assess whether he has received his share of the profits. Ultimately, he is entitled to his fair share of the profits over the full period of the policy. Future returns are not known, so it would clearly not be prudent for the firm to award annual bonuses (which it should be remembered cannot be taken away), that fully reflected the returns to date, because there may be a future period when returns are negative. If for example, there were several years of negative returns before Mr C took his benefits, the value of the fund could fall and have a material impact on the

previous 80% return over 10 years – in another five years, the overall return over a 15 year period could be significantly less – or in an extreme case negative. But the plan would still be required to provide at least the guaranteed amounts.

All this is speculation. Clearly it is not possible to know now, or during the term of the plan, what the return will be overall when Mr C takes his benefits. So as well as its annual bonuses, the firm *may* award a terminal bonus on the policy when benefits are taken at retirement date. At this time Mr C will be entitled to his fair share of the fund, however during the term of the policy it will be difficult for him to reconcile the fund performance over a certain period with the bonuses added during that period as there is no direct correlation.

So whilst I understand Mr C's concerns about his own plan's performance, it is its nature, in particular that it provides a guaranteed amount from outset, and bonuses are added to that, which makes it difficult to determine the performance during its term. So "smoothing", as explained in the firm's literature and by the adjudicator, does mean that the fund's headline performance during a period will not necessarily be reflected in the bonuses added.

It is therefore difficult to address the question about whether the policy value has gone down in value over this period. Although the annual bonuses may not reflect either the additional premiums paid or profits made over the period, they *may* ultimately be reflected in a terminal bonus, but this is not guaranteed. The policy already provides a guaranteed amount if premiums are paid for the term, so this will also be taken into account in determining what Mr C's fair share is at retirement date.

The industry regulator, (previously the Financial Services Authority (FSA) and now the Financial Conduct Authority (FCA)), recognises that firms have a considerable amount of discretion about how they operate their with-profits funds and firms are accountable to the regulator for the way in which they 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*". And the Conduct of Business Sourcebook (COBS 20) provides specific rules and guidance for firms 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 (in accordance with its Principles and Practices of Financial Management document) and the regulator monitors the management of it. Businesses are required to appoint a with-profits actuary and the regulator provides rules and guidance on their duties. Prudential also has 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 am not aware of the regulator having any concerns about the operation of this fund.

I note that Mr C has expressed concerns about the firm's failure to reply to his telephone call in August 2011. Whilst I accept that this likely caused Mr C a degree of inconvenience, this

appears to have been limited, and I am not persuaded that it would be reasonable to award financial compensation in the circumstances.

I understand Mr C's concerns about his plan. However the matter is not straightforward, and in my view Prudential reasonably attempted to provide an explanation (as did the adjudicator) – albeit I appreciate the matter may still not have been clear. In all the circumstances however, I have not been persuaded that there are reasonable grounds on which to uphold Mr C's complaint.

**my final decision**

Accordingly, my final decision is that I do not uphold this complaint and make no award.

David Ashley  
**ombudsman**