

## **complaint**

Mr W's complaint is about the level and type of bonuses that The Prudential Assurance Company Limited (Prudential) is declaring on its with-profits annuity contract. He is unhappy that since taking out the plan the regular bonuses being paid have significantly fallen and are being declared at a level well below the performance of the fund. As a result the pension he has been receiving has also fallen.

Mr W also argues that Prudential should have a minimum income guarantee as a base level below which his pension can't drop. This will mean that he won't be dependent on them declaring additional bonuses to maintain a reasonable pension in the future.

## **background**

Mr W's complaint was investigated by one of our adjudicator's. In summary he said:

Mr W was advised to set up a with-profits annuity in 1999 with an anticipated bonus rate (ABR) of 5.5%. If the regular bonuses declared fell below this level then the "regular annuity amount" (his pension without the "additional bonus") would also fall. The higher the assumed ABR the higher was the initial annuity amount.

In the first year of Mr W's plan the regular bonus was 5.5%. After this it had fallen and in each of the last four years had only been 0.25%. But the total pension Mr W received the "total benefit amount" also included an "additional bonus". Since 2005 this was an increasing part of his total pension.

Mr W said that if Prudential decided not to allocate the additional bonuses (as they did in 2003 and 2004) he would only receive the regular annuity amount. This has been falling since 2001.

It was the adjudicator's view that the complaint shouldn't be upheld. He said providers do have a considerable amount of discretion about the way they operate their with-profits fund. But the regulator's Conduct of Business Sourcebook (COBS) set out rules and guidance for businesses about the way they operate their funds.

COBS 20.2.1 (1) states:

*"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...."*

COBS 20.2.3

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

A business has to operate its with-profits funds in line with its Principles and Practices of Financial Management (PPFM). And there is an independent with-profits committee to protect the interests of the with-profits policyholders to ensure they are treated fairly.

The adjudicator responded to Mr W saying that Prudential had effectively altered the basis on which it allocated bonuses after he had set up the plan. He noted it had reduced the level of regular bonuses below the ABR the year after the plan was taken out. But the fact it may have been paying higher regular bonuses before didn't mean it was under any obligation to continue. And as Mr W knew there was no guarantee about the level of any future annual or final bonuses Prudential would pay.

Mr W did question the fairness of their approach. In response the adjudicator said that unlike regular bonuses, granting additional bonuses didn't expose the with-profits fund to a continuing liability going forward. With the historically low interest rates the adjudicator said he could understand why it may be seen as prudent for Prudential to restrict the level of this type of bonus. So whilst he understood why Mr W was unhappy he didn't feel Prudential had acted unfairly.

The adjudicator referred to Prudential saying that:

*“Over time, the value of the income payable from our With-Profits Pension Annuity Plans will average 100% of the unsmoothed value. We intend that the difference between the smoothed and unsmoothed value of the plan will rarely be more than 20%...”*

This, the adjudicator said was broadly saying that he should receive his fair share of the return that the with-profits fund is making. While he appreciated the complexities of the operation of the with-profits fund, he said he had no reason to believe that this has not happened. He also said he was not aware of the regulator having any concerns about the operation of Prudential's fund.

Prudential had agreed to offer him the option of converting his with-profits annuity to a guaranteed pension annuity, albeit at a significantly lower level than his current pension. Mr W also asked Prudential to offer a base line below which his pension couldn't fall.

However Prudential had said that it wouldn't agree to this as it wasn't an option on the plan when it was taken out. And the adjudicator agreed it wouldn't be reasonable to require Prudential to make it available to Mr W.

Mr W responded to the adjudicator's view. He said that he didn't feel he was being treated fairly in comparison with investors who had a minimum income guarantee on their with-profits annuities. He said that it appeared that the investors with these guarantees had them without cost. He therefore asked the adjudicator to reconsider his view.

The adjudicator did not change his view explaining that in setting the level of initial income the Prudential's actuaries would have taken account of the cost of any minimum income guarantees.

As Mr W remained dissatisfied he asked that the case be referred to an ombudsman to review.

## my findings

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

It is important to realise that with-profit providers now have to publish full details of how they manage their with-profits funds. The documents are called Principles and Practices of Financial Management (PPFM). They are very technical and many with-profits providers (including Prudential) publish user friendly versions for people who are not actuaries. These documents are available on their website.

The with-profits actuary at the Prudential will carry out an annual valuation where they determine the value of the benefits that need to be provided in the future on all its with profit policies and then the value of the assets that are attributable to the with-profits fund. The difference between these two amounts is the actuarial surplus that is used to provide bonuses on the with-profits policies. The shareholders in the business also receive a small share of the actuarial surplus.

The with-profits actuary will normally put forward a number of proposals to the Board of Directors at the Prudential and they will then decide based on the guidance that they have received the bonuses to declare.

It is a fact that after the problems at Equitable Life the regulator has required that with-profits providers should hold assets that more closely match the liabilities of the with-profits fund. This means that any guaranteed benefits or annual bonuses declared which are guaranteed will need to be matched by low risk assets that historically produce lower returns. The remaining funds can be invested in higher risk assets such as equities. These assets are expected over the longer term to produce higher returns than gilts but this is not guaranteed.

The Directors of Prudential will also declare additional bonuses. These are defined by Prudential to be:

*"This is a bonus that we expect to add to your Plan each year. The value of this bonus changes each year and if the investment return has been low over the lifetime of your Plan, an additional bonus may not be paid. Additional bonuses may be reduced or removed and are not guaranteed until the time that the additional bonus comes into payment."*

As the adjudicator has stated The Prudential Assurance Company Limited has an independent with-profits committee that employs independent experts to ensure that the rights of the with-profits policyholders have been protected. If this committee is unhappy with the decisions taken by the directors it may refer the matter to the regulator.

Whilst it is the case that some with-profits contracts that Prudential offers do have Minimum Income Guarantees, the policy that Mr W has bought does not offer such a guarantee. I, as an ombudsman, cannot force Prudential to offer the Minimum Income Guarantee to other with-profit annuity policies.

I have seen no evidence that The Prudential Assurance Company Limited has done anything wrong.

**my final decision**

I do not uphold this complaint against The Prudential Assurance Company Limited and I make no award.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 2 March 2017.

Adrian Hudson  
**ombudsman**