

complaint

Mr H complains about delays and changes to the valuation factors used by The Prudential Assurance Company Limited when transferring away from his Retirement Annuity Contract.

background

The background to this complaint was set out in my provisional decision, a copy of which is attached and forms part of my final decision. In summary I concluded that:

- Mr H and his Independent Financial Adviser (IFA) were told that the amount payable would be calculated on the 'date of payment'. That would likely have meant the IFA in particular was aware that this older-style policy was valued differently than more modern policies.
- It didn't appear they were aware of how much of Mr H's pension entitlement was formed of a non-guaranteed final bonus, so they might reasonably have expected that the transfer value could go up or down from what they were previously quoted when Prudential reviewed its bonuses on 1 April each year.
- Prudential didn't itself cause a material delay that resulted in Mr H's returned paperwork missing an opportunity to obtain the pre-1 April transfer value.
- As Mr H wasn't entitled to any particular 'fund' from his policy but rather a guaranteed pension, Prudential had discretion in how it calculated the transfer value.
- Nor did Prudential's decision to introduce a 30-day guarantee in *future* cases affect the situation at the time Mr H transferred away – or suggest that in attempting to balance the interests of both remaining and departing policyholders at that time, Prudential wasn't treating Mr H fairly.
- Mr H had cancellation rights he was able to exercise if he hadn't been satisfied with the final transfer value offered
- Prudential's management of the fund is supervised by the FCA and Mr H's experience is a matter his IFA is entitled to bring to the FCA's attention.
- I wasn't satisfied it should make more than the £50 payment it had offered for its poor handling of the complaint.

Mr H's IFA didn't agree with the provisional decision. His key points were:

- No reasonable decision maker could have come to my conclusions. Whilst it was a matter of opinion what date was correct for Prudential to value the transfer, the method of calculation was not.
- Prudential had clearly stated the rate was calculated "*by using our annuity rates (the rate at which we buy your pension income)*" which has a clear meaning.
- Prudential couldn't excuse this by accepting this was "misleading terminology". It was a fundamental principle that Mr H should be compensated for being misled.
- He could see from the bonus information given by Prudential that the underlying policy "value" [in fact, the annual income entitlement] dropped by 2.18% and that would be a fair reduction to make to the transfer value.
- The conversion factor Prudential used to convert this income to a transfer value was "an artificial construct of their own making".
- A company should act according to its stated policy, not another one only it seems to know about.
- The stated policy of relating to annuity rates, and the very small element of non-guaranteed bonus on the policy had lulled Mr H and his IFA into a false sense of security that the transfer value could only vary a relatively small amount given what was happening in the annuity market at the time.

- Mr H needed the tax-free cash to settle his mortgage, so the option of exploring cancellation rights was irrelevant.

Prudential had no further comment to make other than confirming it paid the £50 sum to Mr H in May 2017.

my findings

I've reconsidered all the available evidence and arguments, including the new points Mr H's IFA has made to decide what's fair and reasonable in the circumstances of this complaint.

It appears Mr H's IFA considers my decision to be unreasonable because Prudential's admission to an error ("misleading terminology") guarantees Mr H compensation for financial loss. In my view that would only be the case if there were further contractual terms created by the undertaking Prudential gave to "*use our annuity rates (the rate at which we buy your pension income)*" when it valued Mr H's pension at any given time.

I haven't found that this was an express or implied contractual term. Prudential did use the rate (or cost) of securing Mr H's pension income to determine the transfer value, but it didn't bear a direct relationship to the rate Mr H's IFA was expecting it to use – namely the rate Prudential quoted for new annuity business.

Whilst this is an unfortunate misunderstanding which wasn't helped by Prudential's use of an internal phrase to external customers, I'm not persuaded this gives Mr H an entitlement to have a transfer value calculated on the new annuity business rate. Prudential didn't specifically refer to this rate in a way which gave Mr H a contractual entitlement to have a transfer value based on it, but I think this is rather a case of Mr H's IFA assuming there was a direct linkage to this rate. Indeed as discussed in my provisional decision the contract gives Mr H no strict entitlement to a transfer value at all.

The factor Prudential applied was one which, in its view, reflected the cost to it at that time of funding the future pension entitlement Mr H was giving up. Market annuity rates may be priced to attract – or alternatively discourage – new business, and may remain the same based on that business model even if the underlying cost of providing the pension changes. By contrast the cost to Prudential of meeting a liability it already had was down to its actuaries to determine – under the oversight of the FCA as I outlined in my provisional decision. There are valid reasons, as I explained, for why the cost of providing this existing guarantee might change in the actuary's opinion – and in a way which wasn't exactly mirrored by Prudential's market annuity rate.

If a mistake has been made, the remedy of that mistake is not to put the consumer in the position mistakenly indicated, but to consider whether Mr H would have acted differently but for the mistake. I appreciate his IFA's comments that they do feel they were misled into not acting before 1 April 2017, because the IFA felt market annuity rates would not move significantly. But I remain of the view that no guarantees were given, and the rate or factor Prudential used could change at any time (not just 1 April) – even if (in the IFA's view) not by much. A significant transfer value was at stake, and even a slight change in the annuity rate could have moved thousands of pounds in Mr H's favour or against him.

I still don't have the impression that Mr H or his IFA acted with particular urgency during March 2017 and, in accepting the risk that the transfer value might change it unfortunately moved against them. It's possible of course they were acting to the timescale of repaying the mortgage, rather than necessarily obtaining the pension proceeds as soon as possible. So

I haven't found that clearer information from Prudential on exactly how the factor was determined would likely have made any difference to this timing – as ultimately Mr H and his IFA would still have been looking to repay the mortgage, but wouldn't have been able to predict with a great deal of accuracy whether the factor would go up or down.

I don't disagree with the point that this factor was an artificial construct, for the very reason that Prudential was having to grant Mr H a transfer value from a policy which didn't allow such a transfer. This amount was at the discretion of Prudential's actuaries – bearing in mind that many of those policyholders were staying in the fund to receive a regular income and were equally entitled to their fair share of the fund's returns.

So Prudential was essentially having to carry out a balancing act and, if it decided that previous conversion factors it had used would now value the transfer too highly it had the discretion to change them. With-profits funds have tended to become less popular because this discretion is not always welcomed by investors – but it's an inherent part of the way the fund is managed that they have this discretion.

Finally, I appreciate Mr H may not have had the option of waiting for the transfer value to recover. But under his original policy, taking the tax-free cash would have necessitated taking an income at the same time. Mr H still had the right to take this income if the lower transfer value now made it more attractive as an alternative. However if he ultimately preferred the flexibility to take tax-free cash without taking an income, this would always have necessitated taking a transfer value to a more modern plan. Unfortunately the Prudential plan was never set up to provide this, and so I can't retrospectively require it to apply guarantees to the flexible option Mr H chose to take.

my final decision

As Prudential has already settled the £50 compensation, I do not uphold Mr H's complaint and make no award. I appreciate my decision will come as a considerable disappointment to Mr H and his IFA.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr H to accept or reject my decision before 29 June 2020.

Gideon Moore
ombudsman

Provisional decision of 14 May 2020

background

Mr H's plan was a retirement annuity he took out in 1984, originally under s226 of the Income and Corporation Taxes Act 1970. The benefits under the policy are on a with-profits basis comprising a basic annuity amount, to which annual bonuses and potentially a final bonus are added (again as annuity amounts).

At the time transfers between different pension providers weren't legislated for, and so there wasn't provision under the contract for a 'fund' value to be payable. This was enabled under the Government's March 1988 Budget and Prudential says a general Inland Revenue endorsement would have applied to all such policies permitting a transfer. However that would say nothing about the basis on which transfer values would be calculated.

In November 2016 I gather the transfer value of Mr H's policy had been about £95,000. Mr H's Independent Financial Adviser (IFA) wrote to Prudential on 1 February 2017 requesting policy information. Prudential replied shortly after issuing two letters. The first (addressed to Mr H) gave the then current transfer value of about £117,000 and explained:

'When calculating the value available, we have to convert the plan's total benefits (the basic annuity and attaching bonuses) into an equivalent lump sum. This is done by using our annuity rates (the rate at which we buy your pension income) which are applicable at that time.'

A covering letter to the IFA set out the income guarantees which applied to Mr H's plan and the bonuses added. In this context Prudential clarified *'Traditionally our rates are updated on 1 January and 1 April each year, however, the company reserves the right to update its rates at any time.'* That letter didn't refer to the transfer value or how it was calculated.

The IFA then asked for transfer forms in a request which Prudential received on 27 February. On 6 March Prudential quoted the transfer value again – it had increased by about £30. Above where Mr H needed to sign the quote it read (with my emphasis):

*'The above values are not guaranteed and are based on the assumption that the last premium was paid on 1 March 2017. The amount payable will be calculated **at the date of payment** and may be higher or lower than the amount shown in A and B above.'*

The IFA says the quote arrived 'mid-March' and Mr H signed it on 20 March. Prudential didn't receive this and other documents, sent under cover of the IFA's letter of 23 March, until 28 March. I presume that the IFA had separately contacted the receiving scheme. Prudential awaited contact from that scheme as transfers are made on the online system 'Origo options' – it received this on 31 March.

On 1 April Prudential revised its bonus rates applying to the contractual annuity amount, and factors used to calculate the non-contractual transfer value. I've asked it to retrospectively provide the breakdown in annuity amounts and transfer values on 31 March and 8 April (when the transfer value was actually paid):

31 March 2017				
	£ p.a.	Conversion factor	Transfer value £	%
Basic Annuity	3,557	x 18.77 approx	66,758	57.1
Annual Bonus	2,495		46,817	40.0
Non-G'teed	180		3,384	2.9
Total	6,232		116,959	100.0

8 April 2017				
	£ p.a.	Conversion factor	Transfer value £	%
Basic Annuity	3,580	x 17.40 approx	62,309	58.7
Annual Bonus	2,511		43,697	41.2
Non-G'teed	4		65	0.1
Total	6,096		106,071	100.0

Mr H and his IFA complained that Prudential took a month to provide transfer forms. They said but for this, all documentation could have been completed and returned in time to complete the transfer without any reduction. They thought the significance of the change in valuation on 1 April should have been flagged up in advance. And in the circumstances, Prudential should honour the higher valuation on 31 March – when it did have all its requirements. They also complained that the service received from Prudential in investigating the complaint was poor.

Prudential said it produced all documents in a timely manner and couldn't be responsible for postal delays. It also noted that it wasn't feasible to complete a transfer on the same day as a request is received. It confirmed to our adjudicator that it had a turnaround time for transfers of five working days. It added:

'Unfortunately, the investment returns that we had received to date were not sufficient to justify the amount of non-guaranteed bonuses that we had previously incorporated into our quotations and, as a result, they were reduced.'

Changes in the non-guaranteed bonuses and adjustment to reflect current market conditions resulted in a lower transfer value which you have noticed. Although these changes also affected the pension benefits, an alteration in the interest rates underlying our annuity quotations meant that the overall affect was a greater proportional decrease in the transfer value. The main factors causing the interest rate volatility during 2016 were the market conditions following the results of the EU referendum.'

While it's not recorded in any terms and conditions, the adjudicator agreed five working days was a fair turnaround time. And as Mr H didn't receive the best service from Prudential when he raised a complaint, its offer of £50 compensation was fair and reasonable.

The IFA responded that Prudential should honour the value on the date it originally received the documentation. And that there was nothing in the information Prudential supplied pre-transfer to explain there was a 'bonus deadline' of 1 April 2017. A previous ombudsman asked Prudential about this, as it is indeed the case that the majority of pension products are priced for transfer, fund switches etc based on the date of receipt of the instruction.

Prudential clarified that the transfer in this case was on non-contractual terms, and the information supplied pre-transfer did make it clear the valuation basis was on date of processing the transfer. It didn't agree it was the 'industry norm' to value on date of receipt of the instruction, as this varied from policy to policy.

The ombudsman reached a provisional decision to uphold this complaint. In brief, her findings were:

- Prudential responded to the IFA's requests within reasonable periods of time.
- The pre-transfer letters made clear figures weren't guaranteed, so giving a 'deadline' might have confused the position and given the impression there was a guarantee.
- It wasn't however fair to Mr H in the circumstances of this case that the transfer value dropped in a way he wouldn't have been expecting.

- He had no knowledge of the change in bonus policy, whereas Prudential did – and this produced a much worse outcome for Mr H.

Mr H's IFA accepted the provisional decision, but Prudential didn't agree. It said it would amount to treating Mr H more favourably than other investors in its with-profits fund, from which Mr H's transfer value had been paid. It had used the process of applying conversion factors to the guaranteed pension plus bonuses to obtain transfer values for thirty years. In common with how other non-guaranteed components (such as final bonuses) could be revised to ensure departing investors left with their fair share of the fund, it was applying this approach to the non-guaranteed (and non-contractual) transfer value.

The timing of the provisional decision coincided with a management decision Prudential took to begin providing 30-day guarantees on transfer values in future. It was unwilling to consider applying this retrospectively in Mr H's case, again because of the matter of equal treatment with other policyholders. Mr H's transfer value was paid at a time when it was not taking this approach for him or any other policyholder in his situation.

As agreement could be reached, and the previous ombudsman is no longer in a position to decide this complaint, I've reviewed it entirely afresh and come to my own conclusions.

my provisional findings

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

I asked the investigator to write to both the IFA and Prudential with some questions. Regarding the IFA's belief that no information had been provided about a 'bonus deadline', we pointed out both the letter advising that the rates would be 'updated' on 1 April, and the quote advising that the policy would be valued on the date of 'payment'. We asked the IFA to explain how, given the delivery of the transfer documentation to Prudential at the very end of March, he expected Mr H's policy to be valued using March's rates.

The IFA agreed that the transfer value quoted on 6 March was not guaranteed and it was a 'matter of opinion' what date Prudential used to value the payment. However in his view that wasn't the issue – it was actually one of Prudential treating with-profits policyholders fairly under Financial Conduct Authority (FCA) rules. The IFA suggested that 2017 experienced benign market conditions, so a 'cliff edge' drop in the transfer value wasn't reasonable.

In addition he thought that Prudential's reference to rates updating on 1 April related to bonuses on the with-profits pension – specifically the final bonus (as all other bonuses were guaranteed). The factor converting this pension to a transfer value was stated to be based on Prudential's *'annuity rates which are applicable at that time.'* As a result, the IFA had looked up gilt yields between March and April 2017, on which he expected Prudential's annuity rates to be based.

The cost of gilts increased by about 2.3% over the month, so he agreed there would be a small reduction in transfer value – but counteracting this, the value of Prudential's investments based on gilts would have increased, and shares were also rising that month. The IFA also attached an article from February 2018 in which Prudential had celebrated the strong performance of the with-profits fund that year. So none of that, in the IFA's opinion, squared with the reduction in Mr H's transfer value.

We put these comments to Prudential. It explained that because the bonus updates for this type of policy typically only take place twice a year, the value of the benefits can get 'out of sync' with the policy's share of the with-profits fund's underlying assets. It provided the figures set out above, which show that the non-guaranteed final bonus was cut significantly (almost eliminated) on 1 April. But the main reason for the change in transfer value was a cut in the conversion factor applied to Mr H's pension per year.

Prudential asked its technical team to comment on the IFA's observations about the 'annuity rate'. They said this *'may be down to using misleading terminology'*, because the annuity rate was a term used internally for the transfer value conversion factor applying to this type of policy – and it had no relation to Prudential's market rate for annuity purchases. They explained the conversion factor is designed to ensure that a departing member of the with-profits fund leaves with no more than their fair share of the underlying assets.

I've carefully considered what Prudential and Mr H's IFA have said. Whilst I note that the IFA has moved on from the argument over *when* the policy is valued, this has formed part of the original complaint and it's relevant for me to give my opinion on this. And that extends to whether Prudential caused a delay which contributed to the valuation being carried out after 1 April in any event. Lastly, I'll consider the question of *how* the policy is valued.

When should the policy be valued?

I think it's significant that Mr H's policy was taken out before daily priced funds became more common. This was a traditional with-profits investment where the premiums Mr H paid in guaranteed him a pre-determined pension amount, to which bonuses were then added. So there wasn't an issue with valuing the fund on a particular day to determine the bulk of the benefits Mr H's premiums secured.

It was only on taking benefits or transferring out that knowledge of how the plan would be valued might have made a difference. And in my view there was no particular reason the fund *had* to be valued on the day Prudential received a particular instruction, providing Prudential made this clear in any quotes provided.

On the quote of 6 March Prudential said that the amount payable would be calculated at the date of 'payment'. I think this is clear, particularly as I expect Mr H's IFA – who was acting on his behalf – would have been familiar with how more modern policies do value plans on the date of receipt of the necessary transfer paperwork. So this wording would reasonably have put him and his client on notice that this policy was valued differently.

Separately, Mr H and his IFA were told that Prudential updated its bonuses on 1 April. I accept the IFA understood the conversion factor to simply be a market annuity rate, but equally I haven't seen that he was aware of precisely how much of Mr H's benefits were the non-guaranteed final bonus. I think it's fair to say that based on this information, anyone might have expected that the transfer value could go up or down. In fact, noting that there had been a recent increase (by some 23% over a few months), there was arguably more potential for there to be a correction in the other direction at the 1 April bonus review.

So notwithstanding the confusion over the term 'annuity rate', I think the disclosures Prudential made in its documentation were sufficient to highlight that Mr H and his IFA would need to work to a tight timescale during March 2017 if they wanted to avoid risking the *possibility* of a lower transfer value. Of course they wouldn't have been able to rule out the transfer value going up as well, so without the benefit of hindsight I can see why they might not necessarily have been particularly concerned at that time.

Did Prudential cause a delay resulting in the valuation after 1 April?

As the policy is valued on the date of payment, I understand there might be a concern that Prudential is effectively has some control over whether Mr H obtains the pre- or post-April value. However I'm satisfied that this isn't in fact something Prudential would set out to do, as it also holds itself to a five working day service standard.

If all of Prudential's requirements had been met more than five working days before 1 April, but it failed to meet the service standard, I think it would then have considered giving Mr H the pre-

April valuation – otherwise Mr H would have been able to complain about the five day service standard. So Mr H could still eliminate the risk of getting the value after Prudential had reviewed its bonuses. He would effectively need to ensure that he got the forms to Prudential before the final week of March.

The timeline doesn't bear out that Prudential took 'a month' to provide transfer forms. The quote of 6 March was posted to the IFA who arranged for Mr H to sign it on 20 March and returned it on 23 March. There may have been post delays (for which Prudential can't be held responsible). But it wouldn't be unusual to take a few days to deal with paperwork in a busy office. I think it's also probable that Mr H and his IFA weren't acting with the haste that, with hindsight, they might now wish they had done. They could have been in a position to expedite the return of the documents more than five working days before the end of March.

How should the policy be valued?

Payments at maturity from with-profits pension plans benefit from the underlying guarantees, and this does apply to Mr H's *pension* per year (with the exception of the final bonus). However as Mr H's transfer value isn't guaranteed, I think the calculation is more similar to a transfer of the fund value from a more modern with profits policy *before* maturity, where that value is also not guaranteed and market value reductions may apply.

With-profits providers need to balance the interests of those remaining in the fund with those leaving it, and I think the conversion factor in this case achieves a similar thing. The terms for transferring out of Mr H's type of plan were not guaranteed, only the annual pension he could receive if he drew benefits directly from the plan. But Mr H had decided to access his benefits flexibly instead.

Subsequent to this complaint, Prudential has decided to guarantee transfer values for 30 days on Mr H's type of policy. But that doesn't mean I can require it do so in Mr H's case. Introducing the guarantee is likely to mean that the bonuses and conversion factors are set more cautiously in future, and Mr H's transfer value of 6 March 2017 wasn't calculated with that in mind.

In determining a complaint I must consider what's fair and reasonable, and Mr H's IFA has referred to the FCA rules on treating customers fairly. But in a with-profits fund there are more customers than just Mr H. I can't ignore that Prudential has the right to assess the asset share of those departing the with-profits fund and adjust transfer values at that time (by use of the conversion factor) to ensure that they weren't departing with more than their fair share. I don't doubt Prudential's commentary that factors such as Brexit affected its actuary's view of asset share in the fund at that time.

I understand the IFA's concern that Prudential later reported a strong year for the with-profits fund, but I have to note that Mr H's transfer value still increased overall from about £95,000 to £106,000 (about 11.5%) despite this fluctuation. And benefits being taken on contractual terms, which is what Prudential would be reporting in such an article, wouldn't have experienced quite the fluctuation Mr H did in his transfer value.

Prudential's compensation payment

I'm aware Prudential paid compensation of £50 into Mr H's bank account for its poor handling of his complaint. I've carefully considered whether the 'misleading terminology' to which its technical team referred would warrant me making a higher award. But ultimately, I don't think the timing of Mr H's application was based on knowledge that Prudential's market annuity rates weren't changing.

Ultimately, the transfer value was never guaranteed, and the cause of Mr H's disappointment is the decisions Prudential made in its management of the with-profits fund. I haven't found grounds to say these decisions were unfair in terms of Mr H's asset share versus other fund members.

Prudential's management of the fund is supervised by the FCA and Mr H's experience is a matter his IFA is entitled to bring to the FCA's attention. Although the FCA may act on feedback it receives, it won't necessarily be able to respond directly.

The drop in Mr H's transfer value was just below a threshold of 10% where life companies will often check if the policyholder still wishes to proceed. However it would have been open to Mr H and his IFA to explore using their cancellation rights if the change in transfer value materially affected Mr H's decision to access his benefits flexibly at that time.

my provisional decision

I intend to conclude that Mr H's complaint shouldn't be upheld in respect of anything other than the £50 compensation payment, in the event this hasn't credited Mr H's account.

Gideon Moore
ombudsman