PO-13315

Ombudsman’s Determination

Applicant	Mr S
Scheme	Royal London Retirement Annuity Plan (**the Policy**)
Respondent	Royal London

Complaint Summary

Mr S has complained that Royal London has incorrectly interpreted the terms of the Policy in respect of the benefit payable to him. Specifically, Mr S says the Policy clearly states that, from age 60, it would pay an annuity per year of £2,127, “exclusive of profits”. He takes this wording to mean that profits would be added to, and therefore increase, the basic annuity. He disagrees with Royal London’s interpretation that the Policy provides him with a fund which can be used to purchase a pension either through Royal London or on the open market and the basic annuity is a promise that he will not receive less than the £2,127 per year guaranteed under the Policy.

Mr S has also complained that information supplied to him has not been clear and Royal London has failed to properly explain the rationale for how it proposes to pay his benefits. He needs to make decisions about his retirement; he has no regular income and is still paying pension contribtions to the Policy.

Summary of the Ombudsman’s Determination and reasons

The complaint should not be upheld because:

- Royal London has correctly interpreted the terms of Mr S’ Policy; and
- Although information provided to Mr S has been deficient, this is not the reason why he has been unable to access his retirement benefits.

Detailed Determination

Material facts

Policy documentation

1. Mr S effected the Policy in December 1983. It is a “retirement annuity contract” or “s226 policy” ie a policy operated under Section 226 of the Income and Corporation Taxes Act 1970. In the Policy schedule, details specific to the arrangement are set out:

   > “…in consideration of the payment to the Society of a first premium of the amount shown in the said Schedule and provided that renewal premiums where payable be paid to the Society as set out in the said Schedule during the life of the Annuitant until the expiration of the Term…the Society will pay the Annuity shown in the said Schedule”

   - The “Annuitant” is Mr S;
   - The “Term” is between 32 and 47 years, depending on the age at which the annuity starts. For example, if the annuity comes into payment at age 60, the Term of the Policy is 32 years;
   - The Amount of the “Annuity” is “as set out in the Benefit Schedule with profits”; and
   - The “Annuity” in the Benefit Schedule is a specified amount of annuity, per annum, and described as being exclusive of profits. For example, at age 60, the annuity is £2,127 per year.

2. The Policy provides a death benefit as follows:

   > “Should the death of the Annuitant occur before the first instalment of the Annuity becomes payable the whole of the premiums paid in respect of this Policy (together with interest at 4% per annum compounded annually) shall…be paid…”

3. The Policy conditions form part of the Policy. These include provisions for variations to the Policy, by application to Royal London, for example:

   - increases in payment of the annuity or to provide survivor benefits on death in payment ;
   - commutation of some of the Annuity for a cash sum; and
   - election to receive an open market option, being a lump sum representing the cash equivalent of the whole of the Annuity payable. The basis of the calculation of this lump sum “shall be determined by the Society at the time of payment”.

Leaflet issued to Mr S

4. A leaflet was issued to Mr S by the agent who sold him the Policy, giving generic information about the Policy. Mr S' copy is one page long and gives a brief summary of the benefits.

5. Under the heading "How your money will grow" is the explanation, "Your contributions will be invested and will earn interest."

6. The leaflet does not specifically refer to the Annuity. Under "How you can draw your benefits", it says:

    - "A straightforward level pension as long as you live.
    - A tax-free lump sum with a reduced pension.
    - A pension which starts lower and builds up each year.
    - A pension payable for as long as either you or your wife or husband at retirement is alive.
    - We will even let you take a lump sum on retirement and buy a pension from another authorised insurance company."

1984 Leaflet

7. I have seen another version of a sales leaflet which gives a more comprehensive explanation. Royal London say this version dates from 1984.The application form (which has a version date of 4/83) for the product is an integral part of the leaflet, as demonstrated by the page numbering. The 1984 Leaflet post-dates the commencement of the Policy and Mr S claims not to have seen it, or anything similar, but it provides some insight into how the Policy works.

8. Under the heading "How your money will grow with The Royal London" the leaflet says: "Your regular contributions will be invested. Interest will be added on a regular basis and the total will be converted into a pension when you retire."

9. In an "Additional Notes" section, this explanation is expanded, and a further explanation appears about the guarantee:

    "<u>Personal Fund</u>

    Contributions less the flat rate charge will be credited with interest from time to time. We anticipate that the interest rate will be competitive even after allowing for expenses incurred. Thus a separate 'notional' fund value will build up in respect of each policy.

> Interest Additions
>
> The current interim interest rate is 12% p.a. compound. It must be emphasised that future interest additions cannot be guaranteed since they depend on future profits.
>
> However, once additions of interest have been made they are guaranteed.
>
> Rate of Pension
>
> The balance of the personal fund after taking any cash option will be used to buy a pension…at The Royal London's pension annuity rates at that time.
>
> Guarantees
>
> A Royal London Personal Pension Policy incorporates guarantees of the minimum amount of pension which will be payable in the event of retirement at each of the possible ages. However, it is to be anticipated that the addition of competitive interest rates to the personal fund will result in the ultimate pension benefits being greatly in excess of the guaranteed levels."

Quotation

10. Prior to effecting the Policy, Mr S was provided with quotations. For example, one of these sets out the likely benefits from a monthly contribution of £20 as being, at age 65:

    - A Guaranteed Minimum Pension of £1,616.60 per year;
    - Estimated Retirement Benefits, being a Notional Personal Fund of £138,797 which could provide a pension of £22,770 per year, or cash of £45,780 and a reduced pension of £15,260 per year.

Rate Book in force 1984 – 1987

11. Royal London has provided extracts from its Rate Book (internal policy information) which came into force in 1984. This post-dates the commencement of the Policy but indicates how Royal London considered the Policy to operate at that time.

12. Under "Notional Personal Fund" the Rate Book says:

    > "All pension contributions are credited to the individual policyholder's "Notional Personal Fund" after the deduction of the flat rate charge…At the chosen retirement date the Notional Personal Fund, including interest additions, is converted into pension benefits"

13. In respect of the guaranteed pension, the Rate Book contains the following:

> "*Guaranteed pension*
>
> The policy incorporates a series of guaranteed pensions for all the possible retirement ages. It is to be anticipated that, with the addition of interest in future years, the actual pensions payable will be considerably in excess of the guaranteed levels."

Statements and benefit illustrations

14. Regular statements were issued to Mr S by Royal London. These changed format over the years but typically provided:

    - Confirmation of the interest applied since the last declaration. For example, the statement for 1989 said "Your personal fund at 31st December 1988, and your contributions, net of flat rate charges, due and paid during 1989, have been allocated a guaranteed interest addition at the rate of 9% compound per annum in respect of the calendar year 1989";
    - An explanation as to how benefits accrue within the Policy, for example:

      "Each contribution paid, less a flat rate charge is notionally credited at the due date to your personal fund. From time to time, the personal fund is increased by the addition of guaranteed interest. At the chosen retirement date, the personal fund plus non-guaranteed interim interest for the period since guaranteed interest was last added, is converted into pension benefits. A vesting bonus may be payable at retirement on the pension and cash sum options, but the rate cannot be agreed in advance."
    - Confirmation of the amount of the "notional personal fund";
    - A projection of possible benefits from the Policy at retirement (included up to the early 1990s). The benefits were based on the projected notional fund plus the vesting, or terminal, bonus being applied to policies maturing/vesting at the statement date;
    - The Policy's transfer value (included from 2001 onwards);
    - In very few statements (around 2000/2001), the "final bonus", or terminal bonus, that could have applied at the statement date; and
    - In very few statements (around 2000/2001), the amount of the "Total Fund Value" and an explanation: "This is…made up of the notional personal fund as at…and the final bonus. The total fund value is the amount which would be available to acquire benefits from Royal London on retirement…"

15. From time to time, Mr S asked Royal London for details of the benefits payable from the Policy. The illustrations and accompanying explanations always assumed that the value of the fund under the policy would be used to provide benefits at retirement along the lines of the options set out in the leaflet issued to Mr S at outset. In some of these illustrations a warning was given that the Policy carried a guarantee “that you may receive a higher annuity than one [calculated on] standard annuity rates. You may lose this guarantee if you take the open market option”.

16. After the Policy commenced, Royal London stopped providing annuities. Instead, if the Policy’s fund was to be used to purchase an “in house” annuity, Prudential would provide it. Later, Royal London introduced an Annuity Bureau which has links to a number of providers and assesses the pension options available to customers. These changes were explained to Mr S in some of the benefit illustrations issued by Royal London from time to time, and in later correspondence about his complaint.

Provision of information

17. Mr S reached his 60th birthday in February 2016. In advance of that, he asked Royal London for details of the benefits payable to him. Mr S was not happy with the information provided and asked for clarification on a number of points.

18. In the following months, Mr S received a number of letters from Royal London attempting to explain how the Policy worked. None of these addressed his concerns.

19. On 27 May 2016, Royal London gave the following explanation, expressed as the actuaries’ “understanding of the policy terms and conditions”:

    - The pension payable from the Policy is the higher of the “Guaranteed Minimum Pension” (the Annuity) and the pension calculated using the Policy’s transfer value and market annuity rates;

    - The Guaranteed Minimum Pension is calculated independently of the Policy’s transfer value. It is based on a fund which results from the contributions paid to the Policy, less charges, plus 3% growth per year. The resulting fund was £24,406 and, applying a guaranteed annuity rate to this fund, gave a minimum amount of pension payable to Mr S at 60 of £2,127 per year;

    - The wording on the policy schedule, “Exclusive of profits” means that the fund on which the Annuity is based does not participate in profits; it attracts growth of 3% each year;

    - The Policy has a transfer value which is the notional fund value plus any final, or terminal, bonus that might be added when the Policy is vested. The transfer value on 3 February 2016 was £51,788;

- Applying annuity rates available on the open market to the transfer value gives a pension that is higher than the Annuity. Royal London said this was "not unexpected".

Summary of Mr S' position

20. Mr S says that the Policy Schedule provides for an annuity to be paid to him at age 60 of £2,127 per year "exclusive of profits". He takes this wording to mean that profits would be added to the basic £2,127.

21. Alternatively, Mr S suggests the Policy carries a guaranteed annuity rate (GAR) of £8.717 per £100. If this rate is applied to the value of the Policy, the resulting annuity would be around £2,300 per year higher.

22. In support of his arguments, Mr S points to, for instance:

    - Communications from Royal London which say a vesting bonus might be paid in addition to the notional fund. For example, the 2001 bonus statement showed a "Total Fund Value" saying it was "the amount which would be available to acquire benefits from Royal London on retirement". In Mr S's view, statements like this support his view that the Annuity must participate in profits and therefore should not be restricted to the amount shown in the Policy schedule;

    - The Policy Schedule which says that the amount of the Annuity is "as set out in the Benefit Schedule with profits"; and

    - The death benefit payable under the Policy which is made up of premiums paid plus interest at 4% per annum compound. He says this is more than the value of the Policy that would be paid to him if he survived, which to his mind does not add up.

23. Mr S says that Royal London has not produced evidence to support its position on how it administers the Policy. He considers it has focused incorrectly on explaining how it calculated the guaranteed minimum pension instead of dealing with the real issue of how the benefits are paid.

24. He considers that the policy literature, other than the Policy Schedule and leaflet issued to him, should not be taken into account when looking at how the Policy operates. Other literature post-dates the Policy and therefore is not relevant.

25. Mr S fears that Royal London is forcing him to take his retirement benefits through the open market option so that it will not have to honour the valuable guarantee he has within his Policy.

26. Mr S says that when he entered into the contract, it was on the basis that Royal London would provide his annuity, meaning that he would not have the problems of

shopping around. He fully understood how the Policy was sold to him because, between 1975 and 1978, he had worked as an insurance agent.

27. Mr S considers Royal London's decision to stop providing annuities "in-house" amounts to breach of contract. He now has to take the transfer value, and accept a non-advantageous annuity rate, in order to put the benefits into payment.

28. Mr S also says he is unable to access his retirement benefits because he has not been provided with adequate information to enable him to make choices about his pension. The information he has been given is unclear.

29. He did not accept the offer of compensation from Royal London because he believes it was conditional on him not taking his complaint further. He did not accept the offer to take his benefits and amend them later if necessary, because he believed he would be locked in to an unattractive option or lose the guarantee.

Summary of Royal London's position

30. Royal London says that:

- The literature and statements about the Policy explain how it works;
- A fund will build up under the Policy to which bonuses are added. That fund will be used to buy a pension, and there is a minimum amount of pension that can be paid;
- Royal London has always administered the Policy in this way; and
- Given that the detailed explanation of the Policy was part of the application form, it would be impossible for Mr S not to have seen it.

31. Royal London says that the Policy schedule is perhaps poorly worded in saying the amount of the Annuity is described as that set out in the Benefit Schedule "with profits" but that does not mean the Policy operates in the way interpreted by Mr S.

32. In recognition of some administrative failings, for example not explaining some points about the Policy clearly, Royal London offered Mr S a goodwill payment of £150 in February 2016.

33. Also In February 2016, Royal London offered to set up retirement benefits for Mr S and to amend them later if necessary in the event of him being successful in pursuing a complaint.

34. Royal London had suggested to Mr S that, if he considered he had been given misleading information about the Policy at the point of sale, he pursue a misselling complaint. That would require an approach to the Financial Ombudsman Service. Mr S declined this route.

Conclusions

The Annuity

35. The issue at the heart of Mr S' complaint is the interpretation of the wording in the Policy schedule that refers to the Annuity. Mr S contends that, in saying the Amount of the Annuity is "as set out in the Benefit Schedule with profits", coupled with the words "exclusive of profits" in the Benefit Schedule, the intention behind the Policy is that profits will be added to the Annuity when it comes into payment. That is correct in the sense that the annuity which comes into payment must necessarily be equal to, or greater than, the guaranteed Annuity. If open market annuitisation rates are lower at the time the policy holder retires than is required to realise the Annuity out of the accrued contributions, then the Annuity will have to be paid. But that is not the same thing as saying there is a guaranteed annuity rate which must be applied to the whole fund which has built up. If at date of retirement the fund resulting from contributions is large enough, because of the addition of profits, to secure an annuity in excess of the guaranteed minimum Annuity, the annuity can be bought at current market rates.

36. Mr S says only the Leaflet issued to him, and the Policy documents, should be considered as evidence because other literature post-dates the commencement of the Policy. Mr S appears to be suggesting that the way in which the Policy operates was changed between December 1983 when he effected it, and 1984 when new literature was produced. It is unfortunate that very little contemporaneous evidence still exists from the time when the Policy commenced. But there is enough for me to form a view on the matter. Further, I have seen nothing to suggest that later literature represents a change in how the policy operates; common themes appear in the pre and post 1983 literature. For this reason, I have taken into account the content of later literature where it aids understanding.

37. I see that, before effecting the Policy, Mr S received quotations from the agent who sold it to him. These clearly show the benefits from the Policy as being either a "Guaranteed Minimum Pension" or "Estimated Retirement Benefits" from a Notional Personal Fund. Mr S was therefore made aware of how benefits were paid from the Policy before he applied for it.

38. The Leaflet that Mr S relies on is lacking in detail. But it explains that contributions to the Policy will be invested and earn interest. It sets out a range of possible ways in which retirement benefits can be taken from the Policy and does not refer specifically to the Annuity.

39. In my view, the Policy schedule, and conditions, make it clear that Royal London undertakes to pay an annuity at retirement. The amount of the annuity was agreed at commencement of the Policy and is dependent on the contributions continuing, as planned, throughout the term of the Policy. There is no provision within the Policy's conditions for the Annuity to be increased when it comes into payment. In fact, the

conditions attaching to the Policy require the policy holder to ask Royal London if a variation to the annuity is required.

40. The extent of the guarantee expressed on the fact of the Policy is to pay the minimum Annuity. There is nothing within the Policy to suggest there is a guaranteed annuity rate attached to it. Some information issued to Mr S draws his attention to the existence of a guaranteed benefit but Royal London is required, in certain circumstances, to ensure he is made aware of the guarantee. It does not follow that the guaranteed benefit is necessarily the best option nor that the guarantee is for a particular annuity rate.

41. In effect, the Policy is providing a safety net. Regardless of investment performance, Mr S will receive an income in retirement of not less than the Annuity secured under the Policy, as calculated on commencement.

42. The bonus statements issued to Mr S varied in format over the years but they were consistent in that they:

    - never referred to the amount of the guaranteed Annuity, or made any reference to the Annuity coming into payment with profits or interest added; and

    - conveyed the message that the fund would be used to provide retirement benefits. The statements generally contained a sentence along these lines: “At the chosen retirement date, the personal fund plus non-guaranteed interim interest for the period since guaranteed interest was last added, is converted into pension benefits”.

43. The statements sometimes referred to the addition of a terminal bonus to the notional fund. The statements that referred to a Total Fund Value being available to “acquire” an “in house” annuity are correct. Royal London is simply describing the option to use the value of the fund, including any terminal bonus, to provide retirement benefits that can be structured in a way to suit the policyholder.

44. The retirement illustrations that Mr S received over the years were also consistent in that they did not refer to the Annuity coming into payment. They always assumed that the value of the fund under the Policy would be used to purchase a pension, either with, or through, Royal London or on the open market.

45. Mr S points to the amount of death benefit from the Policy as an indicator that his interpretation of the Policy is correct. But there is no correlation between the amounts paid out on death or retirement. The death benefit is simply the sum of the contributions paid, plus compound interest at 4%. The benefit paid out at retirement is the greater of a) the Notional Personal Fund, ie contributions paid, less charges, plus bonuses or interest, plus any vesting or terminal bonus or b) the Annuity if that is found to be in excess of what the Notional Personal Fund can purchase.

46. The fact that Royal London withdrew from the annuity market does mean that Mr S will need to shop around or use Royal London's annuity bureau. But, because the fund he has built up out of contributions and profits appears to be sufficient to purchase more than the Annuity at current market rates he will not in fact be giving up a valuable guarantee. Royal London has demonstrated that, based on one provider's annuity rates, the fund value can be used to purchase a pension that is better than the Annuity provided under the Policy. But it is for Mr S to decide which option suits him best.

47. Based on all the available information, the only reasonable interpretation of how the Policy operates is that it provides a pot of money at retirement that can be used to provide retirement benefits either through Royal London's annuity bureau or on the open market. This pot of money is made up of the notional value of the fund including bonuses declared during its term, plus any terminal bonus that might be payable. There is a guarantee within the Policy in that it will always provide a minimum pension of a fixed amount but that is the extent of the guarantee.

48. Mr S' complaint in relation to Royal London's interpretation of the Policy is therefore not upheld.

Provision of information

49. Policy documents, terms and conditions are not easy to read and interpret. It is important that policyholders read and understand them but other, supporting communication needs to be clear and unambiguous.

50. The leaflet that Mr S has supplied and says was issued to him at outset of the Policy is not clear. It does not properly explain that there is no relationship between the interest-related fund he is accruing and the guaranteed annuity.

51. Mr S says he never saw a detailed explanation of how the Policy works. Although another version of the sales leaflet exists, and is clearly integrated with the application form, it is by no means clear that Mr S signed a form that was also part of a longer document. There is no page numbering on his application form, unlike the copy of the longer version I have seen.

52. During the term of the Policy Mr S was given a variety of different styles of statements. Although a lot of the underlying information was consistent, the addition, and removal, of some pieces of information make it much more difficult than it should be to ascertain the correct position.

53. Mr S was due to take his benefits in February 2016. When he queried the information he was being given in the run up to his retirement, the letters he received were not clear or consistent. It was not until May 2016 that Mr S received what appears to be a definitive explanation of how the Policy operates.

54. It seems that Mr S was, by this stage, firmly of the view that Royal London had misinterpreted the Policy terms. So despite the offer by Royal London to set up the benefits and amend them later if necessary, Mr S chose to defer taking his benefits until the position had been clarified further.

55. Royal London has acknowledged it could have been clearer in some of its correspondence with Mr S, and has offered compensation for that.

56. If Mr S considers that he was given misleading information about the Policy at the point of sale, that is something which does not fall within my jurisdiction and which he can pursue elsewhere. I have not considered this aspect of his complaint.

57. I find that Royal London could have supplied him with better explanations, sooner. But I do not find it was responsible for Mr S not being able to access his retirement benefits. Royal London was correct in its interpretation of the policy and presented the correct options to Mr S. It also told him that he could take his benefits and top up later if necessary, but he chose not to take them. Therefore I do not consider he can demonstrate that he has been kept out of his money in the manner which he asserts. In the circumstances I do not find maladministration which has caused Mr S has any significant injustice. I consider the offer made by Royal London to be adequate and do not uphold the complaint.

Karen Johnston

Deputy Pensions Ombudsman
21 December 2017