

## Ombudsman's Determination

Applicant	Mr T
Scheme	Tailsman Personal Pensions Plan ( <b>the Plan</b> )
Respondent	Royal London ( <b>RL</b> )

## Outcome

1. I do not uphold Mr T's complaint and no further action is required by RL.
2. My reasons for reaching this decision are explained in more detail below.

## Complaint summary

3. Mr T's complaint is that RL reduced the terminal bonus payable under the Plan.

## Background information, including submissions from the parties

4. RL wrote to Mr T on 2 May 2017 to tell him that it had taken the decision to reduce his terminal bonus from £5,341.51 as at 24 March 2016 to £3,599.33 as at 24 March 2017.
5. Mr T emailed RL on 15 June 2017 to complain that:-
  - The Plan does not permit new plan-holders, and additional contributions cannot be paid in. As such, the liabilities of the Plan cannot have increased.
  - Over 20% of the funds were invested in shares. For the most recent Plan year, the FTSE had increased by over 20%.
  - 70% of the funds were invested in bonds; whilst these may not have achieved a substantial increase in value, a key feature of bonds is that they are relatively low risk investments which will have risen in value over the last Plan year.
  - RL had not provided him with any evidence that the investments had gone down in value over this period.
  - He could not see how the liabilities of the Plan could have increased; the investments appeared to have grown, and as such, the surplus must have risen.

- In view of this, there can be no justification for such a substantial reduction in the terminal bonus.
6. In its final response letter dated 4 July 2017, RL made the following points:-
- In early 2016, a new set of European Union (**EU**) regulations for insurers and pension providers came into force, entitled Solvency II.
  - Solvency II is led by two main concepts. The first is the “prudent person principle”. The second is that pension providers have to hold the required capital against the assets invested in the pension funds which they manage.
  - The “prudent person principle” requires RL to manage investments in such a way that:-
    - The risks presented by the assets can be properly identified, measured, monitored, controlled and reported on.
    - Assets are invested to ensure the security, quality, liquidity and profitability of the portfolio overall.
    - The availability of assets is ensured.
    - Assets are invested in the best interests of plan-holders.
    - The portfolio is diversified, so as to avoid producing a concentration of risks.
  - The main risks within the Plan are associated with Guaranteed Annuity Rates (**GARs**). Interest rates have fallen recently, increasing the cost of meeting these guarantees and requiring RL to hold more capital. As a result, RL has had to reduce the terminal bonus for claims during 2017, to 106% of Mr T’s asset share.
7. RL also provided Mr T with a link to its January 2016 report to the Financial Conduct Authority concerning compliance with Solvency II, for his further reference, as well as a link to information on how it operates the Plan.

### **Adjudicator’s Opinion**

8. Mr T’s complaint was considered by one of our Adjudicators who concluded that no further action was required by RL. The Adjudicator’s findings are summarised briefly below:-
- A decision by a pension provider to increase or decrease a terminal bonus involves the legitimate exercise of its commercial judgment.

- Notwithstanding this, RL gave Mr T an explanation as to why it took the decision to reduce the terminal bonus payable under the Plan, referring in particular to the introduction of Solvency II and the sustained reduction of interest rates.
  - RL provided Mr T with links to further information with respect to how it manages the Plan.
  - There was no evidence of maladministration by RL.
9. Mr T did not accept the Adjudicator's Opinion and the complaint was passed to me to consider. Mr T provided his further comments which do not change the outcome. I agree with the Adjudicator's Opinion and I will therefore only respond to the key points made by Mr T for completeness. In summary, these are:-
- RL gave three reasons as to why the terminal bonus was reduced - broadly, a reduction in surplus capital, poor investment performance and the need to comply with Solvency II regulations; he considers this calls its credibility into question. However, the Adjudicator's Opinion does not acknowledge this and only refers to the last explanation.
  - None of the links provided by RL give any specific information relating to the Plan surplus. It is necessary to have this data in order to properly inspect how RL is administering the Plan.
  - One of the links provided by RL in its final response letter was to its Solvency and Financial Condition Report 2016 for the year ended 31 December 2016, which included the following text on page 6:-

“Our capital position is well in excess of the Solvency Capital Requirement, meaning that even in an extreme scenario that occurs once every 200 years we would be able to settle claims and pay-outs for all of our policy-holders. Along with our strong capital cover ratio above, this underlines our financial strength and ability to look after our policy-holders, through unexpected future events”.
  - Mr T reasoned that if the capital buffer was well in excess of the Solvency II requirements on 31 December 2016, it is unreasonable to use these regulations as a justification for the reduction in the terminal bonus only three months later.

### **Ombudsman's decision**

10. I note Mr T submits that the fact RL provided three reasons as to why the terminal bonus was reduced in March 2017 calls its credibility into question. Accordingly, I have reviewed the correspondence RL sent to Mr T during the complaint process. Having done so, I note that on 12 April 2017, RL wrote to Mr T with the following explanation:-

“This Terminal Bonus rate does not fluctuate on a daily basis, the rates are worked out by our Actuarial Department, who monitor the With Profits funds and compare the investment with the liabilities (this is if we had to pay a claim on the life of every policy-holder). The bigger the surplus after these liabilities have been deducted the bigger the bonuses that we can apply. If this surplus reduces, unfortunately this means we are not able to maintain the terminal bonus and we have to reduce the bonuses we can pay”.

11. After Mr T requested further details, RL wrote to him on 2 May 2017 making the following points:-

“Bonus levels, particularly those for final bonuses, are declared regularly and determine the actual pay-out levels received when you take your benefits. These pay-out levels are not determined purely by reference to asset shares, but are *smoothed* to reduce the volatility from which pay-outs would otherwise suffer. This smoothing is made possible because of the free assets held. These allow pay-outs to be higher than asset shares would justify in terms of falling markets. In rising investment markets these free assets would normally be replenished, but the recent recovery in investment markets has not been sufficient to bring asset shares above pay-out levels for most policies”.

12. Then in response to Mr T’s email of 15 June 2017, in which he requested data about the performance of his individual Plan, RL issued its final response letter on 4 July 2017. In this letter, RL explained the reasons behind the decision to reduce the terminal bonus in greater detail:-

“At the beginning of 2016, a new set of Europe-wide regulations for insurers and pension providers came into force. Solvency II is the new set of prudential regulatory requirements for almost all insurers and reinsurers established in the EU. Broadly, the effect of Solvency II is that we need to hold more capital for the risks within the fund. The more capital we have to hold, the lower the amount of Estate we can distribute.

Solvency II is led by two main concepts. Firstly, we must comply with the “prudent person principle”. Secondly, we are required to hold the required risk capital against the assets we have invested.

The prudent person principle requires that we invest so that:

The risks of assets are able to be properly identified, measured, monitored, controlled and reported on.

Assets are invested to ensure security, quality, liquidity and profitability of the portfolio overall.

The availability of assets is ensured.

Assets are invested in the “best interests of policyholders”.

The portfolio is diversified to avoid risk concentration.

When we set bonus rates at the start of 2016, we set a target pay-out of 118% of your asset share. We expected that we may have to reduce this target when the final impact of Solvency II became clear, and in our annual update leaflets, we flagged that pay-outs would be likely to decrease. The final impact was even bigger than we had expected, and we subsequently had to reduce the target pay-out to 112% in July 2016.

The main risks within the fund are associated with guaranteed annuity options. These are provided in many of the pension policies held in the fund. Following the Brexit vote, interest rates have fallen, increasing the cost of meeting these guarantees and requiring us to hold even more capital. We have therefore had to further reduce the target pay-out for claims during 2017, to 106% of your asset share.

We are working to reduce the level of risk in the fund so that we can increase the level of Estate distribution again. We have a proposal that we are going to test with our pension plan-holders with guaranteed annuity options in the coming months. If the proposal is successful, we won't have to hold as much capital, and we should be able to increase pay-outs again.

However, if the proposal is not successful, or if the position of the fund deteriorates further, then we may have to reduce Estate distribution to zero. This would be likely to reduce the value of your Plan from its current level".

13. Having carefully examined this correspondence, I do not agree with Mr T that the fact RL has provided three explanations as to why the terminal bonus was reduced in March 2017 points to any lack of credibility on its part. RL has simply provided differing levels of detail with each piece of correspondence. The letter dated 12 April 2017 described how the actuaries determine the level of terminal bonus, taking into account the level of surplus capital, and the letter dated 2 May 2017 went into the smoothing process. The final response letter dated 4 July 2017 then went into more detail concerning the regulatory backdrop and the need to meet obligations to plan-holders with regard to GARs. I see no inconsistency in RL's correspondence to Mr T.
14. Turning to Mr T's complaint that RL has not provided him with figures specific to the Plan; any decision by a pension provider to alter a terminal bonus concerns the legitimate exercise of its commercial judgment. It is not required to provide plan-holders with sums relating to their individual Plan. RL has explained the reasons for the reduction in the terminal bonus and given Mr T links to further information to enable him to research further. In my judgment, RL has responded to Mr T's concerns appropriately. I see no reason to require it to provide Mr T with further information.

15. Mr T's other point is that the RL Solvency and Financial Condition report reveals that, as at 31 December 2016, RL's capital position was well in excess of Solvency II requirements. Mr T submits that, as such, the reduction in the terminal bonus in March 2017 cannot be explained in terms of the need to comply with Solvency II regulations. However, the capital requirements of Solvency II form only one part of RL's explanation as to why the terminal bonus dropped in March 2017. Other factors which RL went into in its correspondence with Mr T included the impact of low bond yields, low interest rates and the need to have sufficient capital to finance GARs. It is all of these variables, taken together, that led to the decision to reduce the terminal bonus.
16. Overall, I find no evidence of maladministration by RL.
17. Therefore, I do not uphold Mr T's complaint.

**Karen Johnston**

Deputy Pensions Ombudsman  
6 December 2017