FINANCIAL CONDUCT AUTHORITY

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FINAL NOTICE

To: The Prudential Assurance Company Limited

Reference Number: 139793

Address: 3 Sheldon Square, London W2 6PR

Date: 30 September 2019

1. ACTION

1.1. For the reasons given in this Final Notice, the Authority hereby imposes on The Prudential Assurance Company Limited ("Prudential") a financial penalty of £23,875,000 pursuant to section 206 of the Act.

1.2. Prudential agreed to resolve this matter and qualified for a 30% (Stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £34,107,200 on Prudential.

2. SUMMARY OF REASONS

2.1. The Authority takes this action against Prudential for breaches of Principle 3 (Management and Control) and Principle 6 (Customers' Interests) of the Authority's Principles for Businesses ("the Principles") that occurred between 1

July 2008 and 30 September 2017 ("the Relevant Period") in relation to non-advised sales of annuities to existing customers who were approaching retirement and who may have been eligible for an enhanced annuity, or may have been eligible for a better rate on the open market for either a standard or enhanced annuity.

2.2. By failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, Prudential failed to pay due regard to the interests of its customers and to treat them fairly.

2.3. Prudential's business model for annuities included using telephone calls to maximise sales to existing pension customers. However, Prudential failed to ensure that the documentation used by its call handlers was appropriate, and failed to monitor their calls with customers adequately. Prior to 1 January 2013, Prudential also used large, sales-linked incentive schemes for call handlers and managers which increased the risk of inappropriate customer outcomes. These weaknesses in Prudential's systems and controls, combined with the complex nature of annuities, and the potential vulnerability of customers, led to some customers being treated unfairly and created a significant risk of consumer detriment.

2.4. Prudential failed to take reasonable care to organise and control its affairs responsibly by having adequate systems in place to ensure that appropriate and timely information about retirement options was provided to customers during the course of those sales calls.

2.5. The Authority has taken into account, and given credit for, the following:

(1) On 2 February 2017, Prudential voluntarily agreed to conduct a past business review of non-advised annuity sales in order to identify customer detriment and pay proper redress to customers who are likely to have suffered loss as a result of Prudential's failure to comply with regulatory requirements. Prudential is currently reviewing approximately 183,000 sales of non-advised annuities, where customers may have been entitled to an enhanced annuity. As at 19 September 2019, Prudential had offered approximately £110 million in redress (i.e. including ongoing annuity uplifts) to approximately 17,240 customers.

(2) Based on the provision that Prudential established for the review at the 2019 half-year, the estimated total redress payable for the entire customer

population will amount to approximately £250 million. This total redress figure covers back-payments and interest paid to affected customers to put them in the position they would have been in had they bought an enhanced annuity (with a higher rate than the annuity they in fact purchased) on the open market at the point of retirement. This figure also includes uplifted payments to affected customers at the enhanced rate for the rest of their lives, in accordance with the terms of their annuity policy.

2.6. Prudential has acknowledged its past failings and has sought to correct these by compensating customers who were treated poorly. The Authority has taken this into account as a mitigating factor in determining the level of financial penalty.

2.7. Since February 2017, Prudential has, aside from some limited circumstances, offered non-advised annuities only on behalf of an external panel of service providers. It has otherwise closed its annuity product to new business.

2.8. An annuity is an insurance contract that provides a customer with a guaranteed income for life in return for a lump sum premium, usually paid from a pension policy. It is a complex financial product for which the ordinary customer's need for accurate information is high. The decision on an annuity is final and irrevocable, so it is important that a customer makes the right choice. This choice can have a lasting impact because it affects customers, and sometimes those dependent upon them, for the rest of their lives. This is particularly so in the context of a non-advised sale, where the customer chooses their annuity product based on factual information and does not receive financial advice about which specific product would be most suitable for their individual needs.

2.9. As part of the sales process, firms are required to explain to customers that they may get a better annuity rate if they shop around on the open market, so that they can make an informed decision regarding their choice of annuity product. This is known as the "Open Market Option".

2.10. Where customers have a shortened life expectancy because of specified health or lifestyle conditions, such as a heart condition, high blood pressure or smoking, they may be eligible for an enhanced annuity which would pay a higher income. This is on the basis that the annuity would likely be paid for a shorter period. Therefore, it is important that the firm obtains adequate information from the customer to determine whether they may be eligible for an enhanced annuity, and provides clear, fair and not misleading information about enhanced annuities. The nature and extent of enhanced annuities available in the market changed during the Relevant Period with a broader range of conditions being covered and enhanced annuities becoming more widely available over time.

2.11. During the Relevant Period Prudential failed to:

(1) Implement adequate call handler documentation to ensure that relevant and important information, particularly in relation to the Open Market Option and enhanced annuities, was provided to customers in a consistently clear, fair and not misleading way;

(2) Implement adequate systems and controls to monitor calls between call handlers and customers;

(3) Implement adequate systems and controls to mitigate the risk that Prudential's financial interests, and those of its call handlers, were prioritised above fair customer outcomes; and

(4) Follow up sufficiently on issues identified during the monitoring of calls.

2.12. Prudential failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk-management systems, by using inappropriate (and sometimes high-level) call handler documentation, and failing adequately to monitor calls between call handlers and customers. These failings created a significant risk that during telephone calls with its non-advised customers Prudential would fail to provide them with appropriate and timely information about:

(1) The possible financial benefits of an enhanced annuity;

(2) Their potential eligibility for an enhanced annuity;

(3) The option to shop around for an annuity or enhanced annuity on the open market;

(4) The possibility that different firms may apply different eligibility criteria for enhanced annuities; and

(5) The possibility that different firms may pay more (or less) income under an enhanced annuity.

2.13. During the Relevant Period, Prudential's sales strategy operated on the basis of its understanding that it held a significant share of the UK market in pensions and annuities. Its non-advised annuity business focused on selling annuities directly to existing Prudential pension policyholders as they approached retirement. Prudential knew that these customers tended to buy an annuity from Prudential because it was convenient to do so and because they were considered to be an established brand. However, at the same time, many of them could get a higher income in retirement by shopping around for an annuity, or an enhanced annuity, on the open market. Prudential was aware that the annuity rate it offered existing customers was regularly 10% lower than the best rate available by alternative annuity providers.

2.14. It was therefore important for Prudential to ensure that all existing customers were provided with sufficient information about their right to shop around for the best annuity, even if that made it less likely that they would buy an annuity from Prudential. Prudential failed to do so, and as a result profited from the loyalty and inertia of some customers. It therefore failed to act in the best interests of some of its existing customers during the Relevant Period, and to treat them fairly.

2.15. As existing customers approached retirement, Prudential wrote to them enclosing packs containing information about their retirement options and Prudential's pension-related products. The timing and content of these packs were subject to specific regulatory requirements. They were required to, and did, contain adequate information about the customer's potential eligibility for an enhanced annuity, and about their option to shop around for an annuity on the open market.

2.16. However, as well as sending the required written information, Prudential communicated with many of its customers by telephone, either by proactively calling them or by inviting them to call Prudential. These sales calls were handled across several sales channels. Prudential was required to pay due regard to the interests of its customers, and to treat them fairly. It was required to provide them with adequate and timely information in order to make decisions about their retirement income.

2.17. Between 1 July 2008 and April 2015 Prudential approved and provided documentation for use by call handlers in non-advised telephone conversations with customers which created a significant risk that Prudential would fail to provide them with appropriate and timely information about their retirement income. Whilst some of Prudential's documentation for use by call handlers did not comply with regulatory requirements, the documentation improved during the

Relevant Period such that the degree of non-compliance towards the end of the Relevant Period was lower than at the beginning of the Relevant Period.

2.18. In particular, the call handler documentation created a significant risk that during the course of telephone calls with customers, call handlers would make statements which may have discouraged the customer from shopping around for a better deal on the open market. This was because some of the call frameworks used during the Relevant Period directed call handlers to make statements either before or after referring to the Open Market Option, that may have dissuaded the customer from shopping around.

2.19. For example, in March 2009 a customer contacted Prudential by telephone to discuss taking his retirement options. This was the customer's only telephone call with Prudential, during which the single reference the call handler made to the customer's right to shop around for an annuity on the open market was as follows:

Call handler: "Okay, so there is one last option where you could transfer the funds out to another pension provider, so you said you want to start taking benefits now?"

Customer A: "Oh yeah, well I've got to get something moving from your side basically."

Call handler: "Definitely, I'll definitely arrange for that."

2.20. In May 2009, another customer called Prudential stating that they wished to purchase an annuity. The call handler explained that the customer had the right to exercise the Open Market Option and that this meant they could purchase an annuity from another provider. However, the call handler immediately undermined the verbal statement about the Open Market Option by saying:

"[...] and obviously you do have the right to your Open Market Option, which means that you can buy your annuity from other providers but of course we would like you to stay with Prudential, okay?"

2.21. A call framework used between June 2009 and February 2010 instructed call handlers to provide customers with a shopping around message, and follow it with:

"[...] but of course we would like you to stay with Prudential. We were voted 'Best Annuity Provider' by the independent magazine, Moneywise four years in a row 2004, 2005, 2006 and 2007."

2.22. Frameworks for use between 2013 and 2014 then instructed call handlers to commence their shopping around message with:

"Although you've been a customer of Prudential (since xxxx / a number of years) [...]"

2.23. Further, some of Prudential's sales scripts, used by call handlers at various points between 2010 and 2015, required no mention of the Open Market Option at all. Prudential in some cases omitted or undermined information about the Open Market Option and failed to ensure that call handlers followed the content of call frameworks by adhering to the requirements set out in them.

2.24. During the Relevant Period, Prudential's systems and processes for monitoring telephone calls were inadequate because they failed to:

(1) Consistently monitor a sufficient number of calls with customers across the entirety of the Relevant Period;

(2) Apply sufficiently rigorous criteria to the calls monitored; and/or

(3) Ensure that when problems were identified relating to communication of information to customers on enhanced annuities and the Open Market Option, they were adequately responded to and dealt with.

2.25. By failing to put in place appropriate and sufficient systems and controls Prudential created a risk that customers would not be provided with timely, relevant and adequate information during oral communications with call handlers. This created an unacceptable risk that customers would not be able to make an informed decision about whether to exercise their open market option or explore eligibility for an enhanced annuity either with Prudential or on the open market.

2.26. For example, a customer telephoned Prudential to inform them that they suffered from asthma. The call handler confirmed that Prudential would not offer an enhanced annuity based on asthma but failed to inform the customer that they may have been able to find an alternative provider who might pay an enhanced income based on their medical condition. The call handler also failed to ask questions in relation to lifestyle conditions.

2.27. Between 1 July 2008 and 1 January 2013, this risk was increased by Prudential's use of large, sales-linked incentives for call handlers and their managers. Certain features of Prudential's incentive structures created a significant risk that call handlers might prioritise their own financial interests ahead of appropriate customer outcomes when making a sale.

2.28. For example, the average annual bonus a Prudential call handler could expect between 2009 and 2012 was an additional 37% on top of their base salary. For sales managers, the average bonus they could expect during this period rose to 40% on top of their base salary.

2.29. Between 2009 and 2012, in addition to the sales-related bonus scheme, call handlers also participated in sales-linked incentive schemes called "competitions". Through these "competitions", call handlers who achieved the highest value of sales (while meeting the qualifying compliance criteria) won prizes such as spa breaks or weekend holidays abroad.

2.30. Robust checks and balances were therefore required to mitigate the risks to consumers caused by this pressure to sell. This in turn meant that enhanced monitoring of customer calls was required to ensure that clear, fair and not misleading information was consistently provided to customers and that they were treated fairly.

2.31. The combined effect of the failings created a significant risk of poor outcomes for customers who may have been eligible for a better deal on the open market. Prudential's systems and controls failings created a significant risk that customers would not obtain fair and favourable outcomes. This is particularly serious for the following reasons:

(1) The weaknesses in Prudential's sales and monitoring procedures were systemic, including its management systems and internal controls relating to the sale of annuities;

(2) Annuities are a complex financial product for which the ordinary customer's need for accurate information is high;

(3) The choice of a particular annuity is final and can affect customers, and sometimes their dependants, for the rest of their lives;

(4) Some of the customers purchasing annuities were potentially vulnerable. These customers often depended on Prudential to provide them with appropriate and timely information;

(5) Prudential's conduct created a significant risk that customers would not be provided with appropriate and timely information in a clear, fair and not misleading way, or be treated fairly;

(6) Customers who were eligible for an enhanced annuity may have lost, and in some cases did lose, money as a result; and

(7) The Authority and other industry bodies had published material relevant to the sale of enhanced annuities.

2.32. The Authority hereby imposes on Prudential a financial penalty of £23,875,000 pursuant to section 206 of the Act.

2.33. Any facts or findings in this Notice relating to any function, committee or group of persons should not be read as relating to all the members of that function, committee or group, or even necessarily any particular individual.

3. DEFINITIONS

3.1. The definitions below are used in this Notice:

"ABI" means the Association of British Insurers.

"the Act" means the Financial Services and Markets Act 2000.

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority.

"COBS" means the Authority's Conduct of Business Sourcebook.

"Open Market Option" means the option to use the proceeds of a pension to buy an annuity on the open market.

"Principles" means the Authority's Principles for Businesses set out in the Authority's Handbook.

"Prudential" means The Prudential Assurance Company Limited.

"Relevant Period" means the period from 1 July 2008 to 30 September 2017.

"Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

4. FACTS AND MATTERS

Background

Overview of the corporate structure of Prudential during the Relevant Period

4.1. Throughout the Relevant Period, Prudential was a subsidiary of Prudential Plc and offered life insurance, pension products and pension annuities to its customers.

4.2. Between 1 July 2008 and 30 September 2017 Prudential's business included the non-advised sale of standard and enhanced annuities to its existing pension holders.

4.3. Although annuities were principally sold through Prudential, Prudential Retirement Income Limited ("PRIL") and Prudential Distribution Limited ("PDL") also carried out functions connected to Prudential's sales of annuities. These functions included, for example, writing shareholder annuity business and outsourcing. However, the majority of annuities were sold to customers directly by Prudential.

4.4. Prudential also outsourced activities connected to its annuities business to various third parties. Although these sales were carried out by third parties, Prudential retained responsibility for ensuring that the sales complied with the relevant requirements, including the adequate monitoring of calls.

Overview of Prudential's annuity sales process and strategy

4.5. Prudential offered private pensions to retail customers, who would make regular pension contributions. When they reached retirement, in order to convert their pension into a regular income, customers generally had to purchase an annuity. Existing customers did not have to purchase a Prudential annuity and could shop around for more competitive rates offered by other annuity providers. During the Relevant Period, Prudential was required to make its pension customers (including those who may have been eligible to purchase an enhanced annuity) aware of their option to shop around, which is known as the "Open Market Option".

4.6. In order to do this, Prudential wrote to existing pension policyholders in the run up to their intended retirement dates (which would be either a date that the customer had indicated or their state pension age). These planned written communications, which were regulatory requirements, consisted of:

(1) A "Wake-up Pack" posted to the customer between four to six months before the customer's intended retirement date, which included information on the customer's right to shop around for the best deal on the open market; and

(2) A "Retirement Pack" which was a "reminder pack" posted to the customer six to ten weeks before the customer's intended retirement date. This reminded the customer of their right to shop around and would include a quotation showing the lump sum available in the customer's pension plan.

4.7. If the customer wanted to purchase a Prudential annuity, the sale could be conducted during a telephone call with a call handler. The customer would then receive a "Follow-up Pack" based on the quoted annuity rate.

4.8. Both the Wake-up and Retirement Packs contained written information on enhanced annuities and the right to shop around in line with regulatory requirements at the time. Customers were encouraged in the Wake-up Pack information brochure to telephone Prudential if they wished to discuss taking their retirement. However, the vast majority of customers simply responded to the packs Prudential sent to them with little, if any, further interaction. For that reason, Prudential considered its distribution model for internal vestings to be extremely efficient in terms of maintaining a steady revenue stream in this area.

4.9. Alternatively, when a customer contacted Prudential seeking a retirement quotation before having received a Wake-up Pack, Prudential sent them a "Vesting Pack." This contained an information brochure and other materials, as well as the requested quotes, and an application form.

4.10. The sending of these packs could result in further communications between Prudential and its customers; for example, if customers telephoned Prudential after receiving one of the three packs described above.

4.11. Prudential also telephoned some customers proactively, particularly those with higher-value pension pots, in order to discuss their retirement options. Accordingly, the extent to which Prudential interacted with customers prior to completion of a sale varied depending on a number of factors, including how much money they had to buy an annuity. For some customers, the interaction was entirely in writing. For others, it included telephone conversations.

4.12. If, after any further interaction with Prudential, the customer completed and returned an application form, the annuity was then set up and the sale was complete.

4.13. Prudential's revenue stream from retirement-income business was fed substantially by its very large book of existing pension customers. Prudential's objective was to maintain market leadership in annuities by maximising "capture of internal vestings". There was therefore a strong focus on retaining existing customers so as to convert their pension maturities into annuities with Prudential. Existing customers who vested their pension pots internally with Prudential were seen to be crucial to delivering Prudential's strategy relating to annuities and internal vestings.

4.14. Prudential recognised that many of its existing pension customers were not likely to switch providers. This was because through brand loyalty and inertia they tended to purchase an annuity from Prudential, even if the price might be higher. Prudential was also aware that its customers suffered from "significant information gaps around enhanced annuities" and recognised that "inertia and the size of their pot (i.e. small) are key barriers" to shopping around.

4.15. Prudential was also aware that the proportion of its customers who were either unaware of the Open Market Option, or who bought an annuity without shopping around, was higher than the market as a whole. This meant that many of Prudential's customers may not get the best annuity rate available to them when purchasing a standard or an enhanced annuity.

4.16. Between 2009 and 2011, the annuity rate offered by Prudential to an existing customer in exchange for their pension pot was regularly 10% lower than the best rate available on the open market, as was broadly the case throughout the Relevant Period.

4.17. Despite its lower annuity rates, Prudential's customer retention rate was high. Prudential considered its maturing pensions book to present a significant opportunity to maximise profits and that it represented the mainstay of Prudential's profitability. This dependence on internal vestings meant that Prudential considered the Open Market Option to be a "threat" to maximising its revenue in this area, although there is no evidence that Prudential sought to counteract that "threat" by knowingly breaching the relevant regulatory requirements.

The ABI Code

4.18. In September 2011, the Association of British Insurers announced its intention to introduce a mandatory "Code of Conduct on Retirement Choices". A consultation document and draft version of the ABI Code were published in December 2011 and the final version of the ABI Code was published in March 2012. The ABI Code came into force in March 2013.

4.19. The ABI Code introduced a number of requirements relating to the content of written communications. It also applied several requirements to the sales process, including that:

"Providers must not send an annuity application form to customers in either the wake-up packs or follow-up packs. An annuity application form must not be sent until contact has been made between the customer and a provider."

4.20. Before sending the customer an application form, the ABI Code required firms to obtain from the customer responses to five key questions about the customer's retirement choices, including:

"Whether they have any lifestyle or medical conditions that may mean they are eligible for an enhanced annuity."

Prudential's response to the ABI Code in 2013

4.21. The key objective of the ABI Code was to equip customers with the information they needed to understand their options, shop around and make an informed decision about their income needs in retirement.

4.22. Prudential recognised that complying with the ABI Code presented two main challenges. The first was that it would need to alter a significant number of its processes relating to the sale of annuities. The second was that it would need to alter its approach by engaging with customers earlier, to ensure it minimised the impact of the ABI Code on Prudential's vesting and customer-retention objectives.

4.23. Prudential identified that the key risk posed by the ABI Code was to its vesting sales. In February 2012 Prudential began its "ABI OMO Project." A key objective of the project was designing a customer journey that was both compliant with the Code but which also was intended to minimise the loss of customers between the time that customers received an Open Market Option statement in the Wake-up Pack and the time that they were sent an Open Market Options reminder in the Follow-up Pack as they approached retirement.

4.24. In response to the ABI Code, Prudential altered its sales process in 2013 as follows:

(1) Prudential included a “Declaration” form in the Wake-up Pack, asking the five key questions about the customer’s retirement choices that were required by the ABI Code. This included asking whether the customer had any lifestyle or medical conditions that may have meant they were eligible for an enhanced annuity. The customer was encouraged to complete and return the declaration form. This was preferable for Prudential as it was the most cost-effective way to obtain the necessary responses.

(2) Prudential telephoned its higher-value customers who did not return the form, in order to obtain the necessary responses orally. This is because it was important to Prudential to retain their custom as their larger pension pot was vital to maximising revenue in this area.

(3) Once Prudential had received the customer’s responses, either by telephone or in the declaration form, it included an application form in the Retirement Pack (the reminder pack) that was sent to the customer six to ten weeks before their intended retirement date in accordance with the applicable regulatory requirements.

4.25. The introduction of the declaration form meant it remained possible for customers to complete the purchase of an annuity without interacting with Prudential by telephone.

4.26. Obtaining the customer’s responses to the five questions as early as possible in the sales process was considered to be key to protecting Prudential’s internal vesting rates. Prudential’s primary objective was that an application form be sent to the customer as early as possible in the sales process so as to maximise the probability of securing a sale.

4.27. When a paper declaration was returned or a declaration discussion took place over the telephone, call handlers or back-office staff added a marker to the system to denote that the customer understood their retirement choices. However, there was no safeguard to check that they had actually understood the key points.

4.28. It is particularly important that consumers have access to helpful information that enables them to make well-informed decisions about their retirement options.

Subsequent changes to the sales process in 2014

4.29. Subsequent key changes to the annuity sales process were as follows:

(1) From September 2014, “declaration forms” asking the five ABI Code questions were not included in the Wake-up Pack. This meant that all customers were required either to telephone, or to be telephoned by, Prudential so that the five questions could be asked of them by a call handler.

(2) From March 2015, application forms were not included in Retirement Packs. Customers would only be sent an application form once Prudential had sufficient information to send them tailored personal quotes taking into account their particular circumstances.

(3) From 10 October 2016 to the end of the Relevant Period, call handlers were told that Prudential did not proactively offer to send quotes to customers for customer-initiated sales, unless the customer requested them.

Overview of call handler documentation

4.30. During the Relevant Period, the documentation generally used by call handlers at Prudential as part of the non-advised annuity sales process included:

(1) Call frameworks which set out the topics to cover with the customer as well as the order in which to address them, when discussing the customer’s retirement options by telephone; and

(2) Call standards which set out the criteria that call handlers were expected to meet. These were the criteria against which calls were assessed by managers and others specifically tasked with this role, such as compliance and internal audit.

4.31. Prudential’s “call frameworks” set out wording to cover certain subjects which was described either as “mandatory” or “suggested” wording. The subjects that had to be covered with a customer varied according to the customer’s responses, but included topics such as the Open Market Option and enhanced annuities.

4.32. This meant that the call handler needed to make a judgement call in order to navigate to the appropriate section of the call framework as the telephone call progressed.

4.33. Call frameworks also included wording for call handlers to use regarding the purpose of the calls themselves. For example:

(1) *"explain that as the customer is coming up to retirement they will/may have receive(d) quotes for their pension and that they have lots of things to consider and have some important decisions to make as the pension is for the rest of their life. The reason you are calling is to help explain what the customer has received, the options available, and [sic] ensure the customer is comfortable with what they need to do."*

(2) *"My job today is to guide you through your Pack, answer any questions and give you the facts so that you can choose what suits your needs best. [...] If at any point you're unclear or don't understand any aspect of what I'm saying, please stop me. It's really important to us that you understand what you need to [sic] in order to make your decision. I cannot give you any advice or recommend what would be suitable for you. At the end of this call, you should have everything you need to make an informed decision."*

4.34. The call frameworks changed over time and different call frameworks applied to different groups of customers depending on the types of pension they held. Different call frameworks could also apply depending on whether the customer had already had a previous telephone conversation with Prudential. Prudential has been unable to provide the Authority with a comprehensive record of all the various call frameworks.

4.35. Like the call scripts, the content of the criteria set out in the "call standards" changed during the course of the Relevant Period in response to evolving regulatory or business requirements, such as the introduction of the ABI Code in 2013. The criteria included the Open Market Option and enhanced annuities.

4.36. The call frameworks were used on the assumption that Prudential would train call handlers to appropriately navigate the document and use the mandatory or suggested wording. However, there was no process in place to check whether a customer had properly understood what they had been told. This was particularly important given the type of customer, who may have been vulnerable and possibly overwhelmed by complex financial information and the choices they needed to make.

4.37. There was a risk that, if call handlers did not follow the frameworks, important information, particularly in relation to eligibility for enhanced annuities and the option to shop around, might not be provided to the customer in a clear, fair and not misleading way. This created the risk that some customers who may have been eligible for an enhanced annuity might make decisions based on unclear information that could have a detrimental impact on the income they were entitled to receive during retirement.

What Prudential directed call handlers to tell customers about enhanced annuities

2008 – 2013

4.38. During the Relevant Period, Wake-up Packs and Retirement Packs sent to Prudential customers generally contained information about the advantage of seeking an enhanced annuity and how the customer might be eligible for enhancement. For example, an information brochure sent to a Prudential customer in their Wake-up Pack in 2008 included the following:

"If you suffer from poor health or have a long-term medical condition, you may feel that you will never receive the full benefit of an annuity. However, this is one instance where poor health can actually work in your favour.

If you have an existing medical condition and a total pension fund of £20,000 or more after taking any tax-free cash, you may qualify for an enhanced annuity rate.

[...]

If you have a pension fund(s) of £20,000 or more and you or your partner are suffering from a serious medical condition, you may be able to get a higher than normal pre-tax retirement income.

Medical conditions that may qualify are those that are likely to shorten your life such as stroke, some cancers, diabetes, or disease of the kidneys, heart or lungs. In most cases, you will be provided with [a] quotation using the information collected from your completed medical questionnaire. For more serious conditions, you may need to provide detailed medical evidence. This means that the process will take a little longer, and it will enable you to get the best possible terms."

4.39. Many customers also had telephone communications with Prudential call handlers, sometimes prompted by the information brochure in the Wake-up Pack which encouraged customers to contact Prudential to discuss their retirement income options. If a customer informed Prudential during a telephone conversation that they might have a qualifying medical or lifestyle condition, Prudential sent the customer a medical questionnaire to complete and return.

4.40. Prudential then used this medical questionnaire to decide whether to offer the customer an enhanced annuity, and if so, what annuity rate to offer them. If a customer did not indicate that they might have a qualifying medical or lifestyle condition, Prudential sent them quotes and an application form for standard annuities only.

4.41. It was therefore important that Prudential provided customers with appropriate and timely information during telephone conversations to determine whether the customer might have a qualifying medical or lifestyle condition. Although call handlers were expected to cover the subject of enhanced annuities during these conversations, the quality of call handler documentation dealing with this subject varied during the Relevant Period.

4.42. For example, a call framework in use between October and December 2008 included the following text in relation to enhanced annuities:

[...] Enhancement Option

[...]

If not previously covered on warm up call – Confirm if the customer (or anyone else named on the policy) is potentially eligible for a medical enhancement on their quote.

4.43. This high-level call framework did not adequately set out how the topic of enhanced annuities should be covered, nor did it say what content needed to be covered by the call handler. It did not specify whether the call handler must cover lifestyle factors, as well as medical conditions. It also did not specify whether the call handler was required to explain the advantages of seeking an enhanced annuity and that other providers may pay a higher rate of income (or cover particular health or lifestyle conditions that Prudential did not) on the open market.

4.44. The frameworks for Warm-up and Follow-up calls to customers before and after that main call did not require any mention of enhanced annuities either. This meant that there was a risk that the call handler could place the onus on the customer to decide which medical conditions might be relevant or that the customer would have to volunteer information without knowing what might be relevant.

4.45. Between 2010 and 2012 call frameworks contained the following suggested wording:

"Can I ask if you and your spouse/partner are in good health? If you have any illnesses or lifestyle conditions that may shorten your life expectancy we may offer an enhancement to your Income. Examples include certain types of cancer, diabetes, or High Blood Pressure. Do you think this would benefit you? (If so explain medical process)".

Changes made in 2013 following the ABI Code

4.46. The call frameworks used did not direct call handlers to cover potential eligibility for an enhanced annuity in the context of the Open Market Option, for example that other providers might pay a higher rate or might cover certain health conditions not covered by Prudential.

4.47. In response to the ABI Code the call frameworks changed in respect of enhanced annuities so that call handlers were directed to ask the following question to cover both medical and lifestyle conditions:

"Do you/your partner currently have, or have ever had a medical or lifestyle condition, such as smoking?"

4.48. If the customer disclosed either a medical or lifestyle condition, this was to be noted by the call handler so that it could be followed up in any subsequent telephone conversation. The call handler was then directed to say the following to the customer, before proceeding through the other matters in the call framework:

If Yes: "Thank you for sharing that information with me. You will receive a pack in xxxxx (month) which will not include the information you have told me, as it's really important to us that we have an accurate understanding of your medical/ lifestyle circumstances at the point you are ready to take income from your pension"

"At that time we would like to speak to you again and I'll set up a time and date for us to call you back. I'll do this later in this call. How does that sound?"

"Do you have an email address? I've got some really useful information that I can send to you that will help you. In the meantime have a look at Page xx in the booklet. It will give you more information on the eligibility/whether you are eligible"

4.49. If the customer did not indicate a medical or lifestyle condition they were given a further explanation:

If No: "To reassure you the reason I'm asking is because there are certain conditions which could result in you getting more money, even everyday things like high blood pressure and high cholesterol".

4.50. At the end of the call, the call handler was directed to schedule a follow-up call with the customer if the customer had disclosed a medical or lifestyle condition that might mean they were potentially eligible for an enhanced annuity. If the customer had not disclosed such a medical or lifestyle condition, they were simply encouraged to contact Prudential after receiving a set of quotes.

4.51. Between the declaration call and the follow-up call, the customer was sent a Follow-up Pack. These were referred to internally as "Quote Packs". These packs contained an information brochure, as well as a key features document, annuity quotes, and an application form to complete the purchase of an annuity. These quotes were for standard annuities only, even if a customer had indicated a possible qualifying medical or lifestyle condition during a declaration call. This was mitigated by the fact that customers who had disclosed a medical or lifestyle condition were told not to send off their application form until they discussed with Prudential their potential eligibility for an enhanced annuity.

4.52. "Follow-up" calls (referred to internally as "Quote Pack calls") were then intended to take place after the customer had received a Quote Pack. No quotes for enhanced annuities were generated until after the Follow-up call had taken place.

4.53. Call frameworks for Follow-up calls included the following process for following up on the issue of enhanced annuities:

(1) If the customer had not previously indicated any condition, they were asked if this was still the case. If it was still the case, and their first indication had been during a previous call, the call framework addressed only the option of the customer taking a standard annuity.

(2) If it was still the case, and their first indication had been given on the declaration form, they were to be told the following:

"To reassure you the reason I'm asking is because there are certain conditions which could result in you getting more money, even everyday things like high blood pressure, high cholesterol, diabetes and smoking all the way down to cancer and heart disease.

From what your [sic] telling me this isn't relevant to you – is that right?"

(3) Thereafter, the call handler was directed to proceed through the remaining matters in the call framework.

(4) If the customer had indicated a condition during the declaration call or on the declaration form, or if the customer indicated a condition during the Quote Pack call, the call handler considered this condition against a list of qualifying medical or lifestyle conditions.

(5) If the customer disclosed a qualifying condition, they were sent a full medical questionnaire, and a further follow-up call was scheduled to take place once the underwriting decision had been made.

(6) If the customer disclosed certain lifestyle conditions, the call handler was directed to ask them a short series of questions, and then assess their answers against a given list of outcomes. This process was known internally as "light vetting" to assess potential eligibility for an enhanced annuity.

(7) If the customer's responses to the light vetting questions indicated that they might qualify for an enhanced annuity, the call handler was directed to send their responses to colleagues in Prudential's Central Processing Team in order to make an underwriting decision. A further Follow-up call was then scheduled to take place once the underwriting decision had been made.

(8) If the customer disclosed a condition that did not make them potentially eligible for an enhanced annuity, or if the customer's responses to the light vetting questions indicated that they did not qualify for enhancement, the call handler was directed to inform them of this in the following terms:

"Thanks for sharing that with me. Based on what you have told me, you would not be eligible to get a higher income based on your health."

(9) Call handlers were then directed to proceed through the remaining matters in the call framework. If no further telephone call was required as a result of any pending underwriting decision, the call framework explained that the call handler could offer the customer assistance in completing the application form for a standard annuity. Once the application form was submitted by the customer, the sale of the annuity was then complete and the annuity was set up.

(10) However, if a further telephone call was required as a result of a pending underwriting decision, the call handler was directed not to offer any assistance in the completion of the annuity application form. The call handler was also directed to discourage the customer from completing the application form at that stage, before the further telephone call.

Call frameworks for use during Customer-initiated calls

4.54. Call handlers used different call frameworks for conversations with customers who contacted Prudential seeking retirement quotations before having received a Wake-up Pack (this pack was a regulatory requirement). From January 2013, the first such telephone conversation with the customer was referred to internally as an "Ad Hoc 1" call.

4.55. Call frameworks for these "Ad Hoc 1" calls directed call handlers to obtain responses to the five questions in a similar fashion to the declaration call. In relation to enhanced annuities, call handlers were directed to ask:

"Can I ask, do you (or Mrs xxx) currently have or have ever had a medical or lifestyle condition? Such as smoking?"

4.56. Unlike the declaration call, however, this information was acted on immediately (as it was in a Quote Pack call):

(1) If the customer disclosed no condition, the call handler was not required to take any action.

(2) If the customer disclosed a qualifying condition, they were sent a full medical questionnaire or referred for a telephone medical interview.

(3) If the customer disclosed certain lifestyle conditions, the call handler was directed to conduct the "light vetting" procedure to determine whether they would be sent a full medical questionnaire or referred for a telephone

medical interview. This consisted of asking the customer questions about blood pressure, cholesterol and smoking and applying their responses to a metric in the framework to return a decision.

4.57. If the customer disclosed a condition that did not qualify for enhancement, or if the customer's responses to the light vetting questions indicated that they did not qualify for enhancement, the call handler was directed to inform them of this in the following terms: *"Thanks for sharing that with me. Based on what you have told me, you would not be eligible to get a higher income based on your health."*

4.58. The call handler was then directed to proceed through the remaining matters in the framework and a Follow-up call was arranged for approximately one week later. In the interim, the customer was sent a pack containing quotes for standard annuities only, and an annuity application form.

4.59. These Follow-up calls were referred to internally as "Ad Hoc 2" calls. Call frameworks for "Ad Hoc 2" calls directed call handlers to follow up on the enquiries made in the "Ad Hoc 1" call:

(1) If the customer had disclosed a condition but no underwriting decision was yet available to the call handler, a further Follow-up call was scheduled to take place once an underwriting decision had been made. If the customer was entitled to a higher income, Prudential then sent a new quote with the revised income levels.

(2) If the customer had disclosed a condition and an underwriting decision was available to the call handler, the call handler was directed to inform the customer of the decision and, if successful, of the higher rate being offered.

(3) If the customer had disclosed no condition, the framework did not direct the call handler to raise the subject of enhanced annuities.

4.60. Call handlers were then directed to proceed through the remaining matters in the call framework. If no further Follow-up call was required as a result of a pending underwriting decision, then the call handler could offer the customer assistance with completing the application form. Once the form was submitted by the customer, the sale was complete and the annuity was set up.

4.61. However, if a further Follow-up call was required as a result of a pending underwriting decision, the call handler was directed not to offer any assistance in the completion of the Annuity application form, and to discourage the customer from submitting the application form before their further Follow-up call. This is similar to the position for sales that arose after the Wake-up pack had been sent.

4.62. On further Follow-up calls, call handlers were directed to follow an "Underwriting Decision Framework". This call framework did not direct call handlers to inform customers of their Open Market Option at the point they were given the underwriting decision. They then proceeded through the remaining matters in the framework. This included assisting with completion of the annuity application form as needed. Once the form was submitted by the customer, the sale was complete and the annuity was set up.

2015 to 2017

4.63. Prudential introduced new call frameworks for call handlers from 6 April 2015. These incorporated the new retirement options that became available to their customers from that date as a result of the legislative changes known as "Pensions Freedoms".

4.64. The first call with customers for both firm-initiated and customer-initiated sales was referred to internally as "Pension Options Call 1". The call frameworks for these calls directed call handlers to enquire as to the customer's potential eligibility for an enhanced annuity through a similar process as that used for "Quote Pack" calls and "Ad Hoc 1" calls. Customers would then be referred for a medical underwriting interview, or sent a questionnaire, or approved for enhancement via light vetting.

4.65. Additionally, if a second "Pension Options" call was required because the customer was undecided between buying an annuity or opting for an income drawdown arrangement, Prudential guidelines required call handlers to cover enhanced annuities with the customer again.

Developments in call handler documentation regarding the Open Market Option

2008 to 2010

4.66. From the start of the Relevant Period until April 2010, call handler documentation required call handlers to tell customers about their Open Market Option, but it did not require them to inform customers that by shopping around they might be able to obtain a higher income in retirement from a different provider.

4.67. For example, a call framework for use between October 2008 and December 2008 merely directed call handlers to "*Ensure the customer is aware that they have the right to exercise their Open Market Option".* The frameworks for "Warm-up" and "Follow-up" calls to customers before and after this call did not require any mention of the Open Market Option at all. For Prudential customers, this meant that a single, brief mention of the Open Market Option might be the only reference to it throughout the course of their telephone communications with Prudential.

4.68. This was the case for Customer A, who contacted Prudential by telephone in March 2009 as he was approaching his 65th birthday, because he wished to discuss taking his retirement. The call handler who spoke to Customer A took him through his potential annuity options and stated that he would then immediately issue him with quotes. The only reference to Customer A's right to shop around for an annuity on the open market during the call was as follows:

Call handler: "Okay, so there is one last option where you could transfer the funds out to another pension provider, so you said you want to start taking benefits now?"

Customer A: "Oh yeah, well I've got to get something moving from your side basically."

Call handler: "Definitely, I'll definitely arrange for that."

4.69. Customer A was not told during the telephone call why he might wish to consider shopping around for annuity and that by doing so he might be able to obtain a better income for the rest of his life. Neither was he given information about how he might go about shopping around, or where he might obtain further information about doing so.

4.70. The call handler did not make a reasonable effort to ensure that the customer understood the options available to them during the call, including the option to shop around for a better deal. The call handler also combined mentioning the right to shop around with a question about how soon Customer A wanted to begin taking his benefits.

4.71. The call handler did not make the customer aware that they might be eligible to purchase an enhanced annuity subject to certain health or lifestyle conditions. The call handler also failed to make the customer aware of the potential for an uplift on their retirement income.

4.72. The call handler did not inquire as to whether Customer A had any health or lifestyle conditions, nor inform Customer A of how certain conditions might lead to eligibility for an enhanced annuity and therefore higher payments. This was the only telephone conversation Customer A had with Prudential as part of his purchase of an annuity.

Discouraging the customer from shopping around

4.73. Call handler documentation used on Prudential's primary sales channel from the start of the Relevant Period until April 2010 directed call handlers to make statements immediately before or after the "shopping around" message that could discourage the customer from shopping around, such as by referencing loyalty to Prudential or emphasising the benefits of buying an annuity from Prudential. This also had the effect of undermining the written material that had been provided to customers in the Wake-up or Retirement packs that were provided in accordance with regulatory requirements.

4.74. For example, in May 2009, Customer B called Prudential stating that they wished to purchase an annuity. The call handler discussed Customer B's options and issued quotations following the call. The call handler explained that the customer had the right to exercise the Open Market Option and that this meant they could purchase an annuity from another provider. However, the call handler immediately undermined the verbal statement about the Open Market Option by saying:

"[...] and obviously you do have the right to your Open Market Option, which means that you can buy your annuity from other providers but of course we would like you to stay with Prudential, okay?"

4.75. This also had the effect of undermining the written material on the Open Market Option that had been provided to the customer pursuant to regulatory requirements. The call handler failed to explain that the customer might obtain a higher income by shopping around. The Open Market Option was not addressed during any subsequent calls. The call handler did not ask whether the customer had a medical or lifestyle condition, nor explain that other providers might offer more favourable annuity rates in respect of particular conditions.

4.76. A call framework for use between June 2009 and February 2010 on Prudential's primary sales channel contained the following suggested wording:

"I must make you aware that you do have the right to take your open market option, which means you can buy your annuity from other providers, but of course we would like you to stay with Prudential. We were voted 'Best Annuity Provider' by the independent magazine, Moneywise four years in a row 2004, 2005, 2006 and 2007."

2011 to 2014

4.77. From December 2011, primary sales channel call handler documentation was changed as so to require call handlers to inform customers that by shopping around they might be able to obtain a higher income in retirement from a different provider. In January 2013, these changes were also made to Prudential's secondary sales channel call handler documentation.

4.78. In November 2011 Prudential removed any explicit appeal to the customer's loyalty to Prudential (alongside informing the customer of their right to shop around for an annuity on the open market) from call handler documentation for use in Prudential's main sales channel.

4.79. However, until 2014 call handler documentation continued to direct call handlers to remind customers of the length of the customer's relationship with Prudential immediately prior to informing them of their Open Market Option. This undermined the written Open Market Option information that was provided to customers under regulatory requirements. For example, two call frameworks for use between 2013 and 2014 contained the following mandatory wording:

"Although you've been a customer of Prudential (since xxxx / a number of years), You don't have to take your pension with us. You can shop around, and depending on the choices you make, you may get a higher income elsewhere."

4.80. From November 2013 call handler documentation for use on Prudential's primary sales channel also directed call handlers to reinforce the importance of shopping around if the customer referenced loyalty to Prudential. For example, a call framework in use in March 2014 included the following direction:

"Reactive – if customer references loyalty (for example, "I've always been with Pru":

Thank you, but keep in mind you could get a higher income or have other options if you shop around."

4.81. Between January 2013 and November 2014 call handler documentation on Prudential's secondary sales channel also directed call handlers to remind customers of the length of the customer's relationship with Prudential immediately prior to informing them of their Open Market Option.

4.82. From March 2015 Prudential discontinued this approach so that call handler documentation for use on Prudential's secondary sales channel directed call handlers to reinforce the importance of shopping around if the customer specifically referenced loyalty to Prudential.

Failure to mention the option of shopping around for an enhanced annuity during calls with customers

4.83. Between the start of the Relevant Period and April 2015 call handler documentation used by Prudential in its primary sales channel did not require call handlers to inform customers that different providers apply different enhancement criteria, and that they might therefore wish to shop around for an enhanced annuity.

4.84. For example, in November 2012, Customer C called Prudential stating that they wished to take their pension pot as a lump sum upon retirement. During this call, the call handler discussed Customer C's annuity options and issued C with quotations. The call handler informed Customer C of the Open Market Option, enquired about Customer C's health and explained that "health or lifestyle conditions" might result in a higher income. However, no examples of qualifying health or lifestyle factors, such as high blood pressure or smoking, were provided.

4.85. Two weeks later, Customer C informed Prudential that they suffered from asthma. The call handler confirmed that Prudential would not offer an enhanced annuity based on asthma, whilst noting that Customer C was right to have brought it to the firm's attention. However, the call handler failed to inform the customer that they may have been able to find an alternative provider who might pay an enhanced income based on their medical condition. The call handler also failed to ask questions in relation to lifestyle conditions during this call or the earlier call.

4.86. A draft version of a call framework for use in 2013 included a reviewer's comments as follows:

"Although you've been a customer of Prudential since (xxxx / a number of years), You don't have to take your pension with us. You can shop around, and depending on the choices you make, you may get a higher income elsewhere."

A reviewer then commented: "*Are we comfortable not mentioning that other Co's may offer enhanced terms? (following press complaint)*"

4.87. Call handler documentation in use on Prudential's primary sales channel in 2016 did not direct call handlers to inform customers of their option to shop around for an enhanced annuity when informing them of the Prudential underwriting decision regarding eligibility for an enhanced annuity. This meant that, although Prudential could not offer enhanced terms, they did not explain that other firms might be able to. An internal review at Prudential recommended that this be changed in March 2016.

4.88. Call handler documentation for use on Prudential's secondary sales channel from January 2013 to March 2015 only directed call handlers to inform customers of their option to shop around for an enhanced annuity if the customer's fund value was, or might be, below the threshold for them to be eligible for an enhanced annuity with Prudential. This was because Prudential was keen to retain its customers, particularly those with higher-value pension pots. For example:

"IF VALUE MAY BE LESS THAN £10k AFTER TFC

Prudential may offer an enhanced annuity that will provide a higher income depending on your lifestyle and medical history. Your fund value needs to be more than ten thousand pounds after tax free cash to qualify with us. Other annuity providers may offer this for a lower fund value.

[...]

Value is less than £10K after TFC

As I mentioned before, here at Prudential we can only offer a higher income if you have more than ten thousand pounds after you tax free cash payment. You can take your money with another provider on the open market and they may offer a higher income."

4.89. Call handler documentation for use on Prudential's secondary sales channel between January 2013 and March 2016 did not direct call handlers to inform customers of their option to shop around for an enhanced annuity on the open market when informing them of potential eligibility for an enhanced annuity with Prudential as a result of the "light vetting procedure".

4.90. However, from March 2016 call handlers were directed to inform customers of their option to shop around for an enhanced annuity on the open market if they did not qualify for enhancement with Prudential. For example:

"Thanks for sharing that information with me. Based on what you have told me you would not be eligible to get a higher income based on your health / lifestyle.

There is nothing more we need to do on this call and as my colleague discussed the key considerations on your earlier call, what I will do now is organise for standard quotes to be issued to you to allow you to proceed with taking your pension income.

However, it is important to be aware that different providers may assess your health or medical situation differently, which could mean that other providers could offer you a higher or lower income than what Prudential will offer you. This is why it is important you shop around and obtain comparison quotes to get the best deal for you"

Not mentioning the Open Market Option at all

4.91. Three categories of Prudential call handler documentation required no mention of the Open Market Option at all:

(1) Frameworks between 2010 and 2011;

(2) "Ad Hoc Call 2" frameworks between 2013 and 2014; and

(3) "Underwriting Decision" frameworks between 2013 and 2015.

4.92. The frameworks that were in place between August 2010 and December 2011 were intended for use during the main telephone call with customers, during which call handlers discussed the customer's annuity options. These required call handlers to refer to the Open Market Option if customers indicated a desire to bring additional pension funds from other providers to Prudential. However, unlike frameworks for the same call prior to August 2010, they were not required to inform customers of their option to shop around for an annuity on the open market instead of vesting with Prudential.

4.93. Call frameworks for "declaration calls", "Quote Pack calls", and "Ad Hoc 1" calls did require the call handler to cover the Open Market Option. Research commissioned by Prudential in November 2012 suggested that the shopping around message contained in call handler documentation for the declaration call was clearly received by customers in test versions of the call.

4.94. However, call frameworks used on Prudential's primary sales channel for the "Ad Hoc Call 2" call between 2013 and 2014 did not direct call handlers to mention the customer's right to shop around for an annuity on the open market at all. It was in the course of these Ad Hoc Call 2 conversations that customers were informed of whether they qualified for an enhanced annuity from Prudential, and at what rate. It was once in possession of this information that the customer would have been able to compare the annuity rate being offered to them by Prudential against what was available on the open market.

4.95. Despite this, the Ad Hoc Call 2 call framework allowed call handlers to progress to the point of offering to assist the customer with the completion of the annuity application form, without the customer being reminded of their option to shop around during the call.

4.96. In 2013, Prudential used an "Underwriting Decision" framework for calls informing customers of their eligibility for an enhanced annuity with Prudential following an underwriting decision based on their medical or lifestyle information. This framework did not require call handlers to mention the customer's option to shop around for an annuity on the open market.

4.97. For example, a customer who did not qualify for an enhancement above the standard annuity rate offered to them by Prudential was to be informed as follows:

"When we spoke last week, you mentioned that you have a medical or lifestyle condition which could mean you are entitled to more money. This information was passed to our underwriting team who have given us a decision."

"The decision returned to us showed that in fact our standard annuity rates (for the postcode where you live) gives you a higher level of income than the income you would receive based on your medical/ lifestyle conditions."

4.98. Immediately after that, the call handler could proceed through the framework to the point of assisting the customer with the completion of an application form:

"Now when we last spoke you had (got a clear idea of/ narrowed down) the annuity option(s) that suit(s) your circumstances and the additional features you may like to add. This was / These were [read back customers product summary] So your income would be, as we discussed last week, £xx per year." [repeat for

each option as relevant] "What are you thoughts?" Are you happy to go ahead with this quote?" Listen/ Acknowledge

If yes – Ok that's great. The next step is to complete your application form. Do you have the pack we sent you to hand? [...]"

4.99. A further example arose during a call with Customer D in March 2012, which included discussion of Customer D's annuity options. The call handler failed to mention the Open Market Option and to discuss the customer's health and its possible impact on the level of D's retirement income. This was the final telephone call between Customer D and Prudential. Although annuity options had been discussed during a previous call in September 2011, there was no mention of the Open Market Option or the possible availability of an enhanced annuity during that call either.

Developments in call frameworks between 2016 and 2017

4.100. In 2016 Prudential introduced a mandatory set of Retirement Risk Warnings in relation to both annuities and enhanced annuities and the risk of not shopping around. This provided additional protection to customers. However, Prudential was still required to ensure that customers were provided with appropriate and timely information regarding retirement income during sales calls, prior to the warnings being issued.

4.101. From 12 May 2016 to the end of the Relevant Period call frameworks for use on Prudential's primary sales channel stated that Prudential expected most customers to be able to get a better rate elsewhere:

"If you decide that an annuity is right for you, it is important to know that you don't have to stay with Prudential.

You should shop around for your annuity as depending on the choices you make and also your health, we expect the majority of our customers to be able to get a higher income elsewhere."

4.102. Between February and October 2016, call frameworks for use in Prudential's secondary sales channel also included a requirement to inform customers that Prudential expected most customers would be able to get a better rate elsewhere.

Training of call handlers

4.103. Training for call handlers varied across Prudential's sales channels. From May 2009 to the end of the Relevant Period, call handlers employed in Prudential's main sales channel were required to undergo structured training. This included initial training as part of a formal induction programme; ongoing training required to maintain competence; training to update sales staff on changes to processes, products and regulatory expectations; and remedial training.

4.104. From the start of the Relevant Period until at least 2011, call handlers on Prudential's primary sales channel were told as part of their induction training that they would be individually responsible for hitting specific sales targets. They were also trained to emphasise the benefits of taking an annuity with Prudential. Compliance-related topics were another key part of Prudential's call handler training: Sales staff were required to complete and pass all regulatory / product tests within set timescales, to adhere to compliance process and procedures as outlined in the compliance manual and to adhere to TCF guidelines. From 1 January 2013, Prudential stopped using sales targets for individual call handlers. However, increasing the "vesting rate" of call handlers remained a priority from a training perspective.

Financial Incentives

4.105. Between 5 March 2009 and 31 December 2012, call handlers and sales managers at Prudential were incentivised through:

(1) Bonuses (the size of bonus paid was linked to total value of annuity and pensions sales secured); and

(2) Incentive schemes, called "competitions" where staff could win prizes based on volume of sales.

4.106. The bonus paid to an individual call handler could form a significant proportion of their total annual remuneration. For example, the Authority reviewed the annual fixed basic salaries and the sales-related bonuses earned by Prudential call handlers between 2009 and 2012. During this period, call handlers earned a substantial annual sales-related bonus, receiving on average more than 37% of their basic salary.

4.107. Between 2009 and 2012, in addition to the sales-related bonus scheme, call handlers also participated in sales-linked incentive schemes called "competitions".

Through these “competitions”, call handlers who met all qualifying criteria (which included compliance checks) achieved the highest value of sales won prizes such as spa breaks or weekend holidays abroad.

4.108. Between 2009 and 2012, sales managers, who were responsible for line management of call handlers, were also eligible for substantial sales-linked bonuses. During this period most sales managers earned a substantial annual bonus, receiving on average more than 40% of their basic salary.

4.109. Although there is no evidence that call handlers intentionally disregarded the Sales Standards, the competitive features of Prudential’s incentive schemes created an increased risk of mis-selling and a risk that call handlers might prioritise their own financial gain when making a sale. Nonetheless, these local competitions and prizes continued until 2013. Until that time there remained a strong incentive for call handlers and managers to prioritise and maximise internal vestings (albeit their performance was also being assessed by reference to compliance obligations). This continued from the start of the Relevant Period until Prudential ended the practice of offering sales-linked bonuses and competitions to call handlers and managers on 1 January 2013.

4.110. To mitigate the risk of call handlers failing to meet compliance requirements, bonus payments in respect of sales of annuities were also linked to certain compliance criteria. From the start of the Relevant Period, Prudential call handlers and their managers were required to achieve certain minimum standards relating to call quality, complaints and regulatory compliance, including Treating Customers Fairly, in order to be eligible for a bonus. There is no evidence that sales incentives caused call handlers or managers to breach these minimum standards. Prudential has not been able to provide evidence that it reduced bonus payments in respect of communications involving enhanced annuities and the Open Market Option.

4.111. With regard to the sale of annuities, only the minimum compliance standards had to be met in order to qualify for a bonus. It was therefore possible for a call handler to commit compliance errors without there necessarily being an impact on his or her bonus.

4.112. By contrast, a failure to meet a sales target would have a direct effect on the size of a call handler’s bonus, since all sales above the minimum threshold to qualify for a bonus would automatically affect the size of the bonus awarded. In 2009, this threshold was 70% of a call handler’s individual sales target. This further increased the risk that call handlers might prioritise securing an annuity sale over fully communicating appropriate and timely information to a customer about their options for their retirement income.

Call Monitoring

4.113. Throughout the Relevant Period, Prudential monitored telephone conversations between customers and call handlers in relation to the provision of information about enhanced annuities and the Open Market Option.

4.114. Robust call monitoring was required to mitigate the risks to customers posed by call frameworks which at times during the Relevant Period were high-level and did not always provide sufficiently specific guidance to call handlers as to what they needed to cover during calls with consumers.

4.115. Some call frameworks used during the Relevant Period afforded a discretion to call handlers as to how they covered the topic of the Open Market Option and health and lifestyle conditions, for example. Robust monitoring was also required in order to mitigate the risk that incentives with higher-risk features (that were used by Prudential until 1 January 2013) could encourage call handlers to prioritise their own financial interests over customer outcomes. However, the primary purpose of the call monitoring was to check and ensure adherence to call scripts, albeit that the scripts may not have ensured that customers were treated fairly.

4.116. Throughout the Relevant Period, Prudential monitored telephone communications between call handlers and customers. The nature and extent of this monitoring varied during the course of the Relevant Period and across the different channels through which Prudential sold annuities.

4.117. Routine call monitoring was undertaken by sales managers (who had direct line management responsibility for call handlers), a dedicated first-line monitoring function, and/or a second-line compliance function. Calls could also be monitored as part of specific reviews undertaken by the compliance (second-line) and audit (third-line) functions.

Monitoring Criteria

2008 to 2012

4.118. The monitoring assessment criteria varied significantly during the Relevant Period and at times were inadequate. For example, in a set of call standards from June

2009, call handlers were required to "check if anyone named on the annuity may be eligible to apply for a medical enhancement under current limits". A failure to meet this requirement was regarded as a breach rather than a process error. However, the standards did not specify exactly what a call handler was required to say for the requirement to be satisfied.

4.119. The standards did not require call handlers to ask for information on medical and lifestyle conditions, past and present, for the customer or the customer's spouse (if any). The June 2009 call standards also required call handlers to "explain the Open Market Option to the customer ensuring they are aware of being able to take *[sic]* annuity with any provider". Failure to meet this requirement was also classed as a "breach". However, the call standards did not require the call handler to explain the main benefit of shopping around for an annuity, or to provide any guidance to the customer on how to go about shopping around.

4.120. From 1 January 2010, the call standards for Prudential's primary sales channel were grouped as "Cat A" and "Cat B" criteria in its "Business Quality Framework". Failure to meet all Cat A criteria would result in the call audit overall being classed as a "fail". A "Cat B" fail would be noted but could still result in an overall "pass". Failure to meet "enhancement requirements" was classed as a "Cat A" fail where it created the potential for financial impact to the customer. However, failure to inform a customer of their Open Market Option was regarded as a "Cat B" failure and did not by itself result in a call being classed as a failure overall.

4.121. Where a customer was made aware of their Open Market Option, but it was not explained to them that by shopping around they could obtain a higher income in retirement, a call was nevertheless classed as a pass, despite the failing needing correcting in a follow-up call. Similarly, where a call handler failed to inform a customer of their Open Market Option, but the customer was passed on to a Prudential financial advisor (instead of continuing with a non-advised purchase), the call was classed as a pass.

4.122. From January 2011, a failure to enquire as to the customer's eligibility for an enhanced annuity in relation to the customer's spouse was also capable of amounting to an error, classed as either "Cat A – Major", "Cat B – Minor", or "Quality/Development", depending on whether a medical questionnaire or quotes were also sent to the customer.

4.123. Where errors were detected, they were logged and corrective action by the call handler was required, such as contacting the customer by telephone and covering the relevant material.

4.124. The Business Quality Framework was changed in August 2012 and the monitoring criteria were re-classified as follows:

"Cat A – High Risk – error is likely to cause a significant impact to the customer's buying decision. (Red flags!)

Cat B – Medium Risk – error will have a minimal impact to the customer and the point in question is clearly covered by output the customer has received (providing there has been sufficient signposting to this during the call)

Cat C – Low Risk – very minimal impact to the customer's buying decision. Generally more business related requirements rather than regulatory requirements."

4.125. The pass rate was as follows:

"Cat A – target 80% pass rate"

"Cat B & C– target 70% pass rate"

4.126. The annuity standards from August 2012 included as indicative guidance:

"Cat A

Eligible person not aware that past or present health or lifestyle condition may entitle them to receive a higher income

Customer not informed of the OMO"

"Cat B

Customer informed of OMO but not been made aware that this could potentially give them a higher income"

2013 to 2016

4.127. A new Quality Assurance Framework was introduced in 2013, to support implementation of the ABI Code requirements. It was intended to be straightforward and clear, and capable of use across all non-advised annuity call types. It set out a total of 56 standards that were applicable to particular calls. Calls were then assigned an overall performance score based on the percentage of applicable standards that were achieved, as well as a pass/fail score in relation to treating customers fairly.

4.128. A failure in relation to the enhanced annuity standard would negatively impact the overall performance score and result in a fail on the customer fairness score. The standard was as follows:

"All eligible person(s) are aware that health or lifestyle condition(s) may entitle them to receive an enhancement to the annuity income

The caller is able to make an informed decision on whether this is relevant to their health circumstances"

4.129. A failure in relation to the Open Market Option standard would negatively impact the overall performance score and result in a fail on the customer fairness score. The Open Market Option standard was as follows:

"Customer has been informed of their right to shop around and that by doing so, this could potentially give them a higher income."

4.130. However, in practice it remained the case that a failure to mention the Open Market Option could be classed as a "performance error" only, rather than impacting the customer fairness score. This meant that the standards were not always correctly and consistently applied during the monitoring process. In one example, a customer was considering bringing their pension from another provider to Prudential, and the call handler failed to cover their option to shop around with their Prudential fund. This was classed as a performance error only, rather than impacting customer fairness, despite the customer needing to be re-contacted to correct the failure.

4.131. From September 2014, the Open Market Option requirement was improved to require call handlers to inform customers that another benefit of shopping around is the availability of a greater range of options:

"Customer has been informed of their right to shop around and that by doing so, this could potentially give them other options and potentially a higher income."

4.132. Prudential's call standards were then significantly changed in response to the Authority's 2014 Thematic Review of Annuity Sales Practices. From March 2015 to February 2016, the requirements for the Open Market Option were:

"It is made clear to the customer at regular appropriate points in the interaction that there are other products/options available on the open market option which may be more appropriate to their needs and the customer is encouraged to shop around and informed of how to do this.

The customer is reminded about shopping around throughout the conversation

Where [Prudential] are unable to provide an option or where a customer's health/lifestyle condition is not considered by Prudential, then the customer is reminded that this product/option may exist on the open market.

Where customer provides any objections to shopping around, or references loyalty to Pru, consultant re-emphasis [sic] the importance/benefits of shopping around."

4.133. For enhanced annuities, the requirements for the Open Market Option were:

"Execution Only – relevant only where customer is choosing an annuity option

Info/Help – The customer is informed on when their health or lifestyle can and cannot be considered in the various options available to them. Where considering an annuity all eligible person(s) are questioned on their past and present health and lifestyle conditions and the relevant underwriting route is followed.

The customer is able to make an informed decision on whether their health or lifestyle conditions is relevant to the course of action they wish to take when accessing their pension fund."

4.134. In some cases where call monitoring revealed a failure to meet the assessment criteria in relation to enhanced annuities, this did not necessarily result in a call being regarded as a fail overall. For example, in some instances a call handler should have referred a customer to colleagues who would then have made an underwriting decision based on potential eligibility, but instead told them that their condition would not qualify for enhancement. The call was then still graded as a "pass" overall, even though the customer should have been referred for an underwriting decision on eligibility.

4.135. From October 2015, the enhanced annuity requirement was:

"All eligible person(s) are aware that past/present health or lifestyle condition(s) may entitle them to receive an enhancement to the annuity income

Where customer is undecided on whether to take an annuity or drawdown product, the customer is aware that their health could result in a higher income, but that this would not apply under any income taking [sic] from drawdown.

Where customer is potentially eligible for an enhanced annuity, the consultant takes the correct underwriting route, and asks all relevant questions (e.g. light vetting questions)

[...]

Where appropriate, any enhancement decision is provided accurately"

4.136. The Quality Assurance Standards for annuity conversations on Prudential's primary sales channel from February 2016 required the following in relation to the Open Market Option:

(1) *"The benefits and reason why customer should shop around on the open market is provided (i.e. other providers might be able to offer different products/options that might suit their needs better, or may be able to offer a higher income)*

(2) *The customer is made aware of how they can shop around*

(3) *The customer is recommended/encouraged to shop around at all relevant points in the conversation. For example :-*

a) Where customer specifies an option that Prudential does not offer, the consultant reinforces the shopping around message

b) Where customer has a non-qualifying health condition, the consultant signposts that other providers may consider this and be able to offer an enhanced annuity.

c) Where customer meets our enhanced annuity criteria, customer is informed that other providers may assess/underwrite differently and could offer a higher or lower income, which is why should shop around.

(4) *Where customer expresses loyalty to Prudential, the consultant should reinforce the benefits of shopping around*

(5) *The consultant should not obscure or undermine the importance of shopping around, which could result in the customer believing it unnecessary or would not be beneficial."*

Second-line monitoring – Risk Assurance and Compliance

4.137. Prudential's second-line compliance team conducted a review of operations on Prudential's primary sales channel in August 2009. It monitored a sample of annuity sales calls to assess whether they complied with Prudential's standards in relation to Treating Customers Fairly. The team also compared the results of its monitoring to those of Prudential's dedicated first-line monitors (the "Business Quality Team") for the same calls.

4.138. Prudential's compliance team reported that 25% of the annuity sales calls assessed did not comply with either internal processes or regulatory requirements. Specifically, the review found that in five of the 36 annuity calls reviewed, the call handler failed to disclose all information relating to the Open Market Option and "Full Transfer" found within the "suggested wording" of the call framework. For two of the 36 calls, the review disagreed with the Business Quality Team's decision not to class the call as a fail overall. The review identified changes that were required to add clarity to parts of the call frameworks and standards, as well as the need for increased ongoing monitoring of call handlers.

4.139. Prudential's compliance team reviewed a sample of 20 annuity calls as part of a wider review of operations on Prudential's primary sales channel in 2010. It found that the call handlers "*met the appropriate standards during calls as a part of the non-advised sales process, acted within their remit of providing information that is clear, fair and not misleading and did not give advice to customers"*. It also found that Prudential's first-line monitoring function (the Business Quality Team), *"is operating well within the agreed [business quality] audit criteria, identifying key issues to be fed back to the Sales Consultants and ensuring that customer contact takes place to rectify issues identified"*.

4.140. In November 2011 Prudential's compliance team reviewed the non-advised annuity sales process within its primary sales channel for compliance with internal and regulatory standards. It monitored a sample of 40 calls. It found that calls were generally meeting the required standards and providing sufficient information to enable customers to make appropriate and informed decisions. However, it found that Prudential's first-line monitoring function, the Business

Quality Team, had failed to identify issues in 17.5% of calls monitored as part of the review.

4.141. Prudential's compliance team then carried out a review of customer communications on part of its primary sales channel in March 2012. This particular team conducted conversations with customers to discuss their retirement options, as a "warm up" to then pass the customer on to call handlers on Prudential's primary sales channel. The review reported:

"Regulatory requirements are to make customers aware of the Open Market Option between four to six months before the customers' intended retirement. This is met by sending the customer literature. In the event that the customer seeks advice or to purchase from Prudential, then the OMO is a mandatory part of the sales process. The [team's] policy is to raise the OMO when annuity options are mentioned in conversations. We found that there is inconsistency between [call handlers], with some providing OMO when others, with similar conversations, did not. [Business quality] audit standards are not currently completely clear on this issue with regards to warm up calls."

4.142. Prudential's compliance team reported on verbal communications in relation to enhanced annuities and the Open Market Option on its primary sales channel in March 2013, as the ABI Code was coming into force. It concluded that, as against the standards in place on Prudential's primary sales channel at that time, in 98% of calls the Open Market Option message had been "communicated clearly and effectively" and "for enhanced we demonstrated this in 96% of calls".

4.143. Prudential's compliance team reported on compliance with the ABI Code on its primary sales channel in September 2013. It reviewed a sample of calls that had not been reviewed as part of first-line monitoring. It found that "[a]pproximately 20% of cases fail the [business quality] customer outcome requirement". It recommended improvements to call frameworks, on the basis that "Providing examples of both applicable medical and lifestyle conditions should be mandatory. Also, we found information stated on the eligible conditions was incorrect in one framework".

4.144. In October 2013 Prudential's compliance team then reported again on compliance with the ABI Code on its secondary sales channel. It reported that: *"There are some shortfalls and/or areas where further revisions need to be made to the documented frameworks to demonstrate full compliance with the ABI Code and to ensure the correct customer outcomes are achieved"*. It also reviewed 30 customer calls and found that 5 of these calls did not comply with the ABI Code. One of the recurring problems observed was that "*there needs to be an adequate discussion around the applicable medical and lifestyle conditions with potential for receiving an Enhanced Annuity".*

4.145. In November 2014, Prudential's second-line compliance team reported on compliance with the ABI Code on its primary sales channel. A sample of 82 calls was monitored. Compliance issues were identified on 5 calls, representing 6% of the sample, which required further customer contact to rectify the "customer outcome".

4.146. In November 2014, Prudential's compliance team again reported on compliance with the ABI Code on its secondary sales channel. A sample of 32 non-quality-assured calls was monitored and a sample of call frameworks was reviewed. The report found that "significant changes" had been made following the 2013 review, but that "some areas for improvement in the quality of call handling, call handler competency and call frameworks" remained. The review also found that the reporting of quality assurance results for "ABI OMO calls" was potentially misleading.

4.147. Prudential's second-line compliance team carried out a review of customer communications on Prudential's secondary sales channel in May 2016. This was partly in response to the Authority's Thematic Review of Annuity Sales Practices published in October 2016. The review monitored 30 customer calls, across a range of pension products and retirement options. Its findings in relation to enhanced annuities and the Open Market Option included:

"To establish eligibility for enhanced annuities, customers should be asked about health and lifestyle conditions. In 7 of the 16 calls where this should have occurred, it did not. In 4 calls, incorrect or incomplete information was given which could have affected the customer's understanding and as a result, whether they explored their eligibility for an enhanced annuity.

The Open Market Option (OMO) message for shopping around should have been provided to customers in 16 of the 30 calls. In 5 of these 16 calls, the message was not given and in an additional 6 calls, the OMO message was either weak or incomplete. Customers should also be given information as to how to shop around and where to find this information. In 8 of the 16 calls this did not occur. In 1 call, shopping around was not directly mentioned alongside the drawdown product and *in another call the call handler did not check if the customer had Money Advice Service (MAS) information to refer to."*

4.148. The May 2016 review also found that:

"Generally, calls were delivered to the customer at pace and there was little opportunity for customers to consider the information or to ask questions. Call handlers did not always check understanding and did not re-iterate important messages, for example, shopping around and the implications of taking their entire pension fund as cash"

4.149. In relation to call handler documentation, the May 2016 review stated:

"We identified that the frameworks need improvement to ensure there is sufficient and balanced information about products, features and implications, so customers can make informed decisions about their retirement options. The frameworks also need to include or expand upon questions (for example in connection with health for enhanced annuities) for customers so call handlers can use the responses to provide information to assist customers make informed decisions."

4.150. In January 2017, a further review by Prudential's compliance team followed up on the May 2016 review of customer communications on Prudential's secondary sales channel. It reported:

"Following our report in May 2016 there has been an improvement in the [...] calls where customers discuss at-retirement options and evidence that our recommendations are being embedded [...].

However, we identified some instances where call handlers did not completely follow the framework, did not check sufficiently customer understanding and completed calls at pace. This may have affected the customer's ability to be aware of or to understand at-retirement options and the risks associated with taking cash at retirement."

4.151. As a result of these failings, Prudential's Business Quality team began monitoring 100% of annuity calls across all sales channels from 28 July 2017 onwards with Prudential's compliance team conducting periodic checks of that work, which was further checked by an independent skilled person. The team conducted a review of customer communications in August 2017.

4.152. The review assessed 38 calls with customers from 27 July 2017, which had been the subject of first-line monitoring. Of these calls, 23 were identified as being "significant" annuity conversations. This meant that the key purpose of the call related to selling an annuity to a customer or making a customer aware of the options available to them. The review found that on Prudential's secondary sales channel, first-line monitoring had failed to identify problems related to enhanced annuities and the Open Market Option in six out of 13 significant calls.

4.153. For example, in one case a call handler "did not probe further to establish the relevance or importance of the customer's response to questions about his or his wife's health condition". In another case, a customer was told "that he was not eligible for an enhanced annuity with Prudential due to his age and fund value. He misunderstood this and thought he was unable to have an annuity with Prudential. At this point the call handler should have re-iterated that he could shop around for an enhanced annuity with another provider."

4.154. In this instance the call handler did not make a reasonable effort during the course of the call to ensure that the customer understood the options available to them. This was all the more important given that customer misunderstood what they had been told during the call. By failing to correct the customer's misunderstanding and failing to explain the option to shop around for a better deal on the open market, the call handler undermined the written Open Market information that had previously been provided to the customer in accordance with regulatory requirements.

4.155. The review further assessed that in three calls "the call handlers did not confirm the second life's health and lifestyle where the first life has provided information on his/her health only. When no information was provided on the second life's health and lifestyle, the call handler should have asked again for information on the second life".

4.156. Underlying these problems was the fact that the criteria used by those monitoring Prudential's secondary sales channel did "not clearly cover all areas" which needed to be considered.

4.157. In October 2017, a follow-up review of 35 significant calls in respect of the sale of annuities was conducted by an independent skilled person. The skilled person concluded that as of 30 September 2017, customers were being provided with adequate information in relation to enhanced annuities and the Open Market Option.

Third-line monitoring – Internal Audit

4.158. In November 2016 Prudential's third-line audit team reviewed oversight of sales on its secondary sales channel. The report found that quality assurance standards on its secondary sales channel were less stringent than on its primary channel. In particular, the report stated that not all calls were being audio recorded and call monitoring was random rather than "risk-based".

4.159. In addition, only 1% of calls with customers were being monitored, there was no targeting of important "at-retirement" conversations and there was no dedicated quality assurance team. Finally, the risk warnings that Prudential was required to implement in May 2016 had not been implemented until August 2016.

4.160. A review conducted by Prudential in November 2016 considered the results of the Authority's Thematic Review of Annuity Sales Practices (TR 16/7) on Prudential's primary sales channel. It reported as follows:

"It was evidenced throughout the Telephony Framework (including Risk Warnings) that the importance of Shopping around, Health issues (including serious ill health and lifestyle conditions) are discussed at all relevant interactions with the Customer. The messages are reiterated where appropriate, this includes at the beginning, during and at the end of the telephone journey."

Volume of calls monitored

4.161. During the Relevant Period the volume of telephone conversations between call handlers and customers that was monitored across Prudential's sales channels was inconsistent, and at times very low. This improved during the Relevant Period.

4.162. Between January and October 2009 the percentage of annuity conversations monitored on Prudential's primary sales channel averaged 2.8% of calls per month. Between February 2010 and September 2012 the percentage then increased to an average of 7.66% of calls per month. This average then fell to 4.26% of calls per month between March 2013 and August 2014. The average then rose again to 12.53% of calls per month between September 2014 and October 2016. The average monitoring volume on Prudential's primary sales channel across the Relevant Period was approximately 8%.

4.163. The percentage of telephone conversations, which included annuity conversations, monitored on Prudential's secondary sales channel from May 2011 to December 2016 averaged 0.58% of all calls per month and did not exceed 1% for any month.

4.164. In December 2013, Prudential sought "an academic perspective on what volume of monitoring would be deemed as being 'statistically sufficient'". This was provided by an in-house actuarial specialist. It was based on an estimate that Prudential was conducting 22,000 significant telephone conversations per month through one of Prudential's main sales channels. The conclusion was that monitoring 9.8% of 22,000 calls on that channel each month would result in a 95% confidence level and a 2% margin of error. At that time, Prudential estimated that it was monitoring approximately 11.4% of calls on that channel, through monitoring by sales managers and the business quality team.

Response to failures

4.165. Results from Prudential's first-line call monitoring were reported to Prudential's management. Specific failure rates in relation to coverage of enhanced annuities and the Open Market Option were not reported to management until 2013. However, even prior to 2013 there are indications of potential problems with the amount of information being provided to customers about their retirement income options.

4.166. From July 2008 to August 2008, first-line call monitoring on Prudential's primary sales channel reported only the number of annuity calls that had been classed as breaches. These were not reported as a percentage of annuity calls audited, and did not specify breaches linked to the provision of information about enhanced annuities or the Open Market Option. However, accompanying commentary in August 2008 indicated that a significant proportion of recorded breaches were for breaching "Clear, Fair and not Misleading Requirements" otherwise known as "CFNM" requirements.

4.167. Between September and December 2008, first-line call monitoring on Prudential's primary sales channel also reported the percentage of overall calls audited that had been classed as breaches, and the percentage of overall calls audited that were annuity calls and had been classed as breaches. These included breaches of "CFNM" requirements. The percentage of calls audited overall that were classed as "routine breaches" averaged 10.9% during that period and the percentage of the audited calls which were annuity calls and classed as "routine breaches" averaged 5.3%. The number of "significant breaches" that were identified during this period were much lower; it was often the case that one or no "significant breaches" were identified in a month.

4.168. From January 2009 to October 2009, first-line call monitoring on Prudential's primary sales channel reported the percentage of audited annuity calls classed as breaches. The percentage of audited annuity calls containing breaches averaged 9.86% over that period. Commentary accompanying the results noted that breaches were often being caused by call handlers not supplying customers with adequate information about their annuity options. Again, the number of "significant breaches" that were identified during this period was much lower.

4.169. Results for April 2012 revealed ten errors relating to how call handlers dealt with the Enhancement Process (Cat A – 4, Cat B – 5, Cat C – 6) and listed it as one of three top compliance trends, with the following notes:

"Enhancement Process (10)

Increase on last month (4 to 10)

There has [sic] been no changes made to how enhancements are discussed with the customer. Examples of errors include:

> *Not explaining to customer why we are asking about their health i.e. higher income & just asking "are you in a good health?"*
>
> *Not responding to a comment made by the customer that would suggest there was a lifestyle or previous condition*
>
> *2 were in respect to process errors for not updating all the correct systems meaning risk customer could return and NBS would set-up the annuity without knowing there could be an enhancement.*
>
> *1 Cat A error was for simply not covering enhancement at all"*

4.170. Prudential introduced a new system for monitoring calls in 2013. Prudential began reporting specific failure rates in relation to the requirements of the ABI Code, including in relation to health enhancement and the Open Market Option. At that time, the "risk tolerance" for detected "customer outcome" fails on Prudential's primary sales channel was set at 15%. The "risk tolerance" for "changed customer outcome" fails at that time was 2%. When such reporting was introduced in 2013, problems with call handlers inadequately dealing with enhanced annuities immediately surfaced.

4.171. Results in March 2013 returned an amber rating for ABI Declaration fails, based on 129 of 140 calls passing, and a red rating for customer outcome fails based on 97 of 140 calls passing. Commentary accompanying the report stated:

"No clear themes as to the root cause was [sic] identified and there is no evidence of systemic failure of adherence to process, call scripts or compliance."

4.172. Results in April 2013 reported that Business Quality (BQ) had:

"identified a couple of occurrences where declaration points were not covered in full and also a couple of occasions where the spouse's health had not been fully explored. However, overall BQ have not observed any systemic issues regarding discussing the ABI declaration points."

4.173. Failures observed in relation to the assessment for enhancement were again described as not involving "any systemic failure" in July 2013, but adherence to the health process was said to require improvement.

4.174. Failures in relation to covering the key questions from the ABI Code, which included enhanced annuities, were again described as not material in December 2013.

4.175. Results in March 2014 reported that "[w]hilst still within appetite, there has been an increase in the number of calls where the health assessment or fund consolidation discussion has been inaccurate and not fully in accordance with the code." 4 out of 105 calls audited in that month failed the "customer outcome" score, and the report noted that "3 of the 4 'Health' fails are in respect to missing a potential eligible condition for the 2nd life being added to the annuity."

4.176. Results in August 2014 reported that:

"The main source of outcome fails continue to be 'ABI' related, however there has been an improvement on last month. Health continues to be the main failure point and accounts for 2/3rds of the Outcome fails associated to an ABI related point. However, it is important to note that whilst 'health' is the most common fail reason, the health process is complex and in context of all calls reviewed, there is still a 96% overall customer outcome pass rate on health specifically.

Overall, a positive month, with results back above threshold and no evidence of any systemic failure or material concerns."

4.177. These results were discussed in a monthly "Training and Competence Governance" meeting in August 2014 which noted that "[a]lthough specific trends identified per standard, for ABI Health, [...] general root cause is consultant listening and then questioning skills in reaction to customer information provided." Action agreed in response was "to ensure that health questioning is detailed within [call handler] weekly update".

4.178. Results in January 2015 reported a "*significant increase in calls with issues related to the Health process*. *12 in January, equating to overall 90% pass rate, compared to 5 in December. 10 of the errors were from experienced consultants.*" The Business Quality report also noted that "[e]rrors in relation to OMO continues to be a recurring common trend" in January 2015."

4.179. This was then discussed at a monthly "Training and Competence Governance" meeting in February 2015 which noted that "ABI – 19% (6/31) of all failed calls included 'ABI Health' [...] Health overall quality result remained above target at 96%, three of the 6 health fails was due to not referring customer (or spouse) for underwriting where condition disclosed was either on enhanced list or not featured, either scenario should result in a health referral".

4.180. The April 2015 results showed that 330 out of the 349 calls assessed passed the customer outcome. The results were annotated with "Customer outcome trends" including:

"The main fail point observed was where the consultant did not fully ascertain a customer's health status in order to determine whether there was potential for higher income, examples included not checking if customer smoked and not checking for any past conditions. Although this was the highest fail reason, it is important to understand that overall the customer outcome pass rate specific to the health aspect, was 98% so there are no systemic concerns."

and

"The 4 missed OMO messages was [sic] either in respect to customers looking to add on another dependant or where customer has an ineligible health condition. Potentially meaning a customer could miss out on an option or higher income through not shopping around."

4.181. In June 2015, a specific fail point was identified in respect of call handlers informing customers of their right to shop around upon being informed that they would not qualify for enhancement with Prudential. These detected trends were communicated to call handlers in May 2015 and June 2015 along with further guidance to address health and OMO fails. In August 2015, Business Quality noted in relation to the Open Market Option that "There is no indication of any systemic failings and errors/omissions tend to be isolated in nature". One way of addressing failings in the primary sales channel during 2015 was for a manager to work with a call handler on a 1-2-1 basis in order to address specific issues such as an explanation of the customer's ability to shop around for an enhanced annuity on the open market.

4.182. In March 2016, the position was reported in the following terms: *"The quality on fully informing customers on the importance and benefits of shopping around continues to remain fairly static at 93%. Errors are largely non-material in nature where consultant has not reinforced the shopping around message."* However, a specifically noted problem was the failure to inform customers of their option to shop around "at the point of delivering the enhanced decision".

4.183. Finally, in October 2016, Business Quality considered that while the Open Market Option results had improved compared to the previous month, it remained a recurring point of failure.

5. FAILINGS

5.1. The statutory and regulatory provisions and guidance relevant to this Notice are referred to in Annex A.

5.2. Based on the facts and matters above, the Authority finds that Prudential breached Principles 3 and 6.

Breach of Principle 3

5.3. Prudential breached Principle 3 during the Relevant Period by failing to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems in respect of complex products for which the ordinary customer's need for accurate information is high. These failings in turn meant that some customers were not treated fairly and that information was not communicated to them in a way which was clear, fair and not misleading. This was particularly so in the context of non-advised sales, where the customer chose their annuity product based on factual information provided by a call handler.

5.4. Prudential failed to put in place sufficient controls to mitigate the risk to the interests of its customers and in particular to ensure that its existing customers purchasing pension annuities on a non-advised basis were provided with appropriate and timely information in relation to enhanced annuities and the option to shop around for an annuity on the open market. This included the potential impact on the customer's retirement income.

5.5. In particular:

(1) Prudential approved and employed call handler documentation for use in telephone conversations with customers which:

a) Failed to direct call handlers to provide customers with appropriate and timely information about which medical conditions and lifestyle factors could make them eligible for an enhanced annuity. This created a significant risk that relevant and important information in relation to eligibility for an enhanced annuity, including the right to shop around, might not be provided, and that customers might be discouraged from shopping around for a better deal on the open market;

b) Failed to direct call handlers to inform customers of the possibility that different providers may apply different eligibility criteria for enhanced annuities;

c) Failed to direct call handlers to inform customers of the possibility that different providers may pay more (or less) income under an enhanced annuity;

d) Failed to direct call handlers to inform customers of their option to shop around for an annuity or an enhanced annuity on the open market;

e) Failed to direct call handlers to explain to customers that by shopping around for an annuity or an enhanced annuity on the open market the customer could obtain a higher income for life; and/or

f) Prompted call handlers to make statements before or after referring to the customer's right to shop around for an annuity which may have discouraged the customer from shopping around and therefore potentially undermined the written information that had previously been provided in accordance with regulatory requirements.

(2) Prudential's monitoring regime was inadequate because it failed:

a) To consistently monitor a sufficient number of calls with customers across the entirety of the Relevant Period;

b) To apply sufficiently stringent criteria to the calls monitored;

c) To follow up adequately when problems were identified in relation to the communication of information to customers regarding Enhanced Annuities and the Open Market Option.

5.6. The Authority considers that these amount to serious failings, which have either resulted in, or created a significant risk of, poor customer outcomes and consumer detriment, including that customers have not been treated fairly.

Breach of Principle 6

5.7. Prudential breached Principle 6 during the Relevant Period by failing to pay due regard to the interests of its customers and treat them fairly.

5.8. In particular:

(1) Prudential's call handler documentation meant that call handlers failed to provide some customers with appropriate and timely information, particularly in relation to the Open Market Option and their eligibility for an enhanced annuity. As a consequence, some customers were either discouraged from shopping around on the open market for a better deal on an annuity or an enhanced annuity, or not made aware that doing so could achieve a better rate.

5.9. The Authority has taken into account the significant redress payments made to those customers affected by its failings.

5.10. Having regard to the issues above, the Authority considers that it is appropriate and proportionate in all the circumstances to take disciplinary action against Prudential for its Principle breaches during the Relevant Period.

6. SANCTION

6.1. The Authority has considered the disciplinary and other options available to it and has concluded that a financial penalty is the appropriate sanction in the circumstances of this particular case.

Financial Penalty

6.2. The Authority's policy on the imposition of financial penalties is set out in Chapter 6 of DEPP. In determining the financial penalty, the Authority has had regard to this guidance. Changes to the penalty policy set out in DEPP were introduced on 6 March 2010. As set out at paragraph 2.7 of the Authority's Policy Statement 10/4, when calculating a financial penalty where the conduct straddles penalty regimes, the Authority must have regard to both the penalty regime which was effective before 6 March 2010 (the "old penalty regime") and the penalty regime which was effective after 6 March 2010 (the "current penalty regime").

6.3. The Authority has therefore:

(1) calculated the financial penalty for Prudential's misconduct from 1 July 2008 to 5 March 2010 by applying the old penalty regime to this misconduct;

(2) calculated the financial penalty for Prudential's misconduct from 6 March 2010 to 30 September 2017 by applying the current penalty regime to this misconduct; and

(3) added the penalties calculated under (1) and (2) to produce the total financial penalty.

Financial penalty under the old penalty regime

6.4. All references to DEPP under this heading are to the version of DEPP in force prior to 6 March 2010.

6.5. In determining what financial penalty is appropriate and proportionate to the breaches, the Authority is required to consider all the relevant circumstances of the case. DEPP 6.5.2G identifies a non-exhaustive list of factors that may be relevant to determining the level of financial penalty. The Authority has had regard to the following:

Deterrence (DEPP 6.5.2G(1))

6.6. The principal purpose of a financial penalty is to promote high standards of regulatory conduct by deterring firms who have committed breaches from committing further breaches and helping to deter other firms from committing similar breaches, as well as demonstrating generally the benefits of compliant business.

Nature, seriousness and impact of the breaches (DEPP 6.5.2G(2))

6.7. The Authority has had regard to the seriousness of the breaches, including the nature of the requirements breached and the duration and frequency of the breaches. The Authority considers that the breaches reveal serious weaknesses in the management systems and controls relating to the relevant business area which created a risk of loss to consumers. For the reasons set out in this Notice, the Authority considers that the breaches are of a serious nature.

Extent to which the breaches were deliberate or reckless (DEPP 6.5.2G(3))

6.8. The Authority does not consider Prudential's failings were deliberate or reckless.

Size, financial resources and other circumstances of the firm (DEPP 6.5.2G(5))

6.9. In deciding on the level of penalty, the Authority has had regard to the size of the financial resources of Prudential.

6.10. The Authority has no evidence to suggest that Prudential is unable to pay the financial penalty.

The amount of benefit gained or loss avoided (DEPP 6.5.2G(6))

6.11. The Authority has not identified any financial benefit gained or loss avoided, directly or indirectly from the breaches.

Conduct following the breaches (DEPP 6.5.2G(8))

6.12. Prudential is conducting a comprehensive redress exercise to compensate customers directly affected as a result of the breaches.

Disciplinary record and compliance history (DEPP 6.5.2G(9))

6.13. The Authority has had regard to the fact that Prudential had not been the subject of previous disciplinary action as at 5 March 2010.

Conclusions in relation to old penalty regime

6.14. The Authority therefore imposes a financial penalty under the old penalty regime of £4,000,000.

6.15. The Authority and Prudential reached agreement at Stage 1 and so a 30% discount applies. Therefore, the penalty for the misconduct under the old penalty regime is £2,800,000.

Financial penalty under the current penalty regime

6.16. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

Step 1: disgorgement

6.17. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breaches where it is practicable to quantify this.

6.18. The Authority has not identified any financial benefit that Prudential derived directly from its breaches.

6.19. Step 1 is therefore £0.

Step 2: the seriousness of the breaches

6.20. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm’s revenue from the relevant products or business area.

6.21. The Authority considers that the revenue generated by Prudential is indicative of the harm or potential harm caused by its breaches. The Authority has therefore determined a figure based on a percentage of Prudential’s relevant revenue. Prudential’s relevant revenue is the revenue derived by the firm during the period of the breach from the products to which the breach relates. Under the current regime, the period of Prudential’s breaches was from 6 March 2010 to 30 September 2017. The Authority considers Prudential’s relevant revenue for this period to be £6,021,453,333.

6.22. In deciding on the percentage of the relevant revenue that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%;

Level 2 – 5%;

Level 3 – 10%;

Level 4 – 15%; and

Level 5 – 20%.

6.23. In assessing the seriousness of a breach to determine which level is most appropriate to the case, the Authority takes into account various factors that reflect the impact and nature of the breach and considers whether the firm committed the breach deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered "level 4 or 5 factors." Of these, the Authority considers the following factors are particularly relevant to this case:

(1) Prudential's breaches caused a significant risk of loss to individual consumers. Although the loss to each consumer may not have been "significant" in each case, the aggregate sums offered to approximately 17,240 customers by way of redress are significant.

(2) The weaknesses in Prudential's management systems and internal controls were serious in respect of its sales process documentation, remuneration and incentive schemes and monitoring processes relating to Prudential's sales of non-advised annuities.

(3) Prudential's customers are potentially vulnerable, being at or nearing retirement age, a proportion of whom might have been be eligible for enhanced annuities due to poor health.

6.24. DEPP 6.5A.2G(12) lists factors likely to be considered "level 1, 2 or 3 factors". Of these, the Authority considers the following factors to be relevant:

(1) The breaches were committed negligently;

(2) There is no evidence of any attempt by Prudential's senior management to conceal the misconduct; and

(3) The impact of the breaches, resulting in consumers suffering losses, is in the process of being addressed through a significant redress exercise.

6.25. Taking all of these factors into account, the Authority considers the seriousness of the breach to be Level 3 and so the Step 2 figure is 10% of £6,021,453,333.

6.26. Step 2 is therefore £602,145,333.

6.27. DEPP6.5.3(3)G provides that the Authority may decrease the level of penalty arrived at after applying Step 2 of the framework if it considers that the penalty is disproportionately high for the breaches concerned. Taking all these factors into account, the Step 2 figure is £30,107,267.

Step 3: mitigating and aggravating factors

6.28. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.29. The Authority considers that the following factors aggravate the breaches:

(1) Previous disciplinary record:

a) Prudential was fined a total of £16 million on 27 March 2013 for failing to deal with the FSA in an open and co-operative way and by failing to disclose appropriately information of which the FSA would reasonably expect notice (breach of Principle 11).

b) In a linked case, Prudential's parent company was fined £14 million on 27 March 2013 for failing to inform the UKLA of a proposed acquisition which resulted in a significant risk that the wrong regulatory decision would be made (breach of Listing Principle 6).

6.30. The Authority considers that the following factors mitigate the breaches:

(1) Prudential is conducting a comprehensive redress exercise voluntarily and has contacted over 83% of the customer population since the commencement of the exercise in April 2018.

6.31. Having taken into account these aggravating and mitigating factors, the Authority considers that no adjustment should be made to the figure at Step 2 because the percentages applied cancel each other out.

6.32. Step 3 is therefore £30,107,267.

Step 4: adjustment for deterrence

6.33. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.

6.34. The Authority considers that the Step 3 figure of £30,107,267 does not require an adjustment for deterrence.

6.35. Step 4 is therefore £30,107,267.

Step 5: settlement discount

6.36. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on which a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement.

6.37. The Authority and Prudential reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

6.38. The Step 5 figure will therefore be £21,075,000 (rounded down to the nearest £100).

Penalty

6.39. The Authority hereby imposes a total financial penalty of £23,875,000 (£34,107,200 before Stage 1 discount) on Prudential for breaching Principle 3 and Principle 6.

7. PROCEDURAL MATTERS

7.1. This Notice is given to Prudential under section 390 of the Act.

Decision maker

7.2. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

Manner and time for payment

7.3. The financial penalty must be paid in full by Prudential to the Authority no later than 14 October 2019.

If the financial penalty is not paid

7.4. If all or any of the financial penalty is outstanding on 14 October 2019, the Authority may recover the outstanding amount as a debt owed by Prudential and due to the Authority.

Publicity

7.5. Sections 391(4),391(6) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the Authority must publish such information about the matter to which this Notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

Authority contacts

7.6. For more information concerning this matter generally, contact Dharmesh Gadhavi at the Authority (direct line: 020 7066 5790 / email: dharmesh.gadhavi@fca.org.uk).

Anthony Monaghan

Head of Department, for and on behalf of the Authority

Financial Conduct Authority, Enforcement and Market Oversight Division

ANNEX A

1. RELEVANT STATUTORY PROVISIONS

1.1. The Authority's statutory objectives, set out in section 1B(3) of the Act, include the consumer protection objective.

1.2. Section 206(1) of the Act provides:

"If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act… it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate."

2. RELEVANT REGULATORY PROVISIONS

Principles for Businesses

2.1. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook. They derive their authority from the Authority's rule-making powers set out in the Act. The relevant Principles are as follows.

2.2. Principle 3 (Management and Control) provides:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems".

2.3. Principle 6 (Customers' Interests) provides:

"A firm must pay due regard to the interests of its customers and treat them fairly."

Conduct of Business Sourcebook (COBS)

2.4. The relevant law and regulatory standards applicable to the sale of annuities are contained in the Authority's Principles for Business, and in the COBS section of the Authority's Handbook.

2.5. Throughout the Relevant Period, Prudential had an obligation to comply with the following COBS rules in respect of all communications with its customers:

(1) COBS 2.1.1R requires firms to act honestly, fairly and professionally in accordance with the best interests of its clients;

(2) COBS 4.2.1R requires firms to take reasonable steps to ensure that a communication is fair, clear and not misleading. COBS 4.2.2G explains that the fair, clear and not misleading rule requires a firm to take into account the information being conveyed in the communication as well as the intended recipient. In addition, the requirement on firms imposed by COBS 4.2.1R is not simply to take reasonable steps not to mislead customers; firms must, over and above this, take reasonable steps to ensure that the communication is fair and clear; and

(3) COBS 19.4 sets out the information a firm must provide to a customer to enable them to make an informed decision about their options for accessing their pensions savings on retirement, including information on the Open Market Option.

2.6. The stated rules under COBS 19.4 have been amended at various points over the Relevant Period, including on 6 April 2015 and 10 October 2016 to reflect the fact that consumers had more options at retirement because of the Pensions Freedoms changes. However, Parliament had considered the issue in March 2002 and noted that the regulation governing the Open Market Option statement was "*designed to ensure that consumers are made aware of their right to shop around to get the best annuity deal on offer to suit their circumstances*". Similarly, the Authority noted in Policy Statement 16/12 that the amendments to COBS 19.4 were designed to "*effectively restate our existing expectations on firms…to add guidance to COBS 19.4 to assist firms in complying with the client's best interests rule (COBS 2.1.1R) and the fair, clear and not misleading rule (COBS 4.2.1.R)".*

ANNEX B

PRESCRIBED CONTENT OF WRITTEN PACKS

1.1. From the start of the Relevant Period until 6 April 2015, firms could comply with the requirement to include an 'Open Market Options Statement' under COBS 19.4 in one of two ways.

1.2. The first option was to include an informational brochure produced by the Authority called 'Your pension: it's time to choose', (the 'standard brochure') along with "a written summary of the retail client's open market option, which is sufficient for the client to be able to make an informed decision about whether to exercise, or to decline to exercise, an open market option." In practice this "written summary" was usually a cover letter, in which the firm was expected to re-iterate the message about shopping around and highlight any related points that were specific to the customer.

1.3. The second option was to provide "a written statement that gives materially the same information." In practice, this meant a bespoke brochure produced by the firm, which could include specific information about the firm's annuity products alongside the key information from the 'standard brochure'.

1.4. Prior to the start of the Relevant Period, when the rule was introduced in 2002, it specified that any bespoke brochure was required to include "*an explanation of:*

> (*a) the open market option (including the fact that companies offer different annuity rates and different types of annuity, and that the scheme member or policyholder may get a better deal by shopping around);*
>
> *(b) the financial advantages and disadvantages in general terms of making use of this option when compared with taking a pension annuity with that firm;*
>
> *(c) how the scheme member or policyholder may make use of the open market option should he decide to do so; and*
>
> *(d) the advisability of taking professional advice."*

1.5. However, during the Relevant Period, the information required to be provided was specified only by reference to the standard brochure. The format and content of the standard brochure changed over the course of the Relevant Period. However, it was generally the equivalent of 12-24 A4 pages in length.

1.6. With regards to Enhanced Annuities, the standard brochure included an explanation of how they could benefit someone eligible for them. It reminded the customer, usually in about 6 places, to consider their own eligibility for an Enhanced Annuity. The brochure included lifestyle factors such as being overweight or smoking as potential reasons for Enhancement. For example:

Enhanced and impaired-life annuities

Some companies offer impaired-life annuities that pay a higher than normal income if you have health problems that threaten to reduce your lifespan. You might be able to get an enhanced annuity if you are overweight or smoke regularly. Some companies offer higher rates to people who have followed certain occupations or people who live in certain parts of the country.

Always check whether you may be eligible for either of these options.

1.7. With regards to the Open Market Option, the standard brochure included an explanation of the customer's right to buy an Annuity on the open market, and a dedicated section on why and how to shop around. In total, the brochure made 15 – 25 references to shopping around. It often linked shopping around to the customer's eligibility for an Enhanced Annuity, encouraging the customer to consider enhancement when shopping around. For example:

Research by the Financial Conduct Authority in February 2014 showed that eight out of ten people who bought an annuity from their existing pension provider would have received a higher retirement income by shopping around. And don't forget to check whether you would be eligible for a higher income based on your health or lifestyle.

1.8. In April 2015, the Rule was changed substantially. New requirements were added to the prescribed information, as set out in the text of the Rule.

ANNEX C

INDUSTRY STANDARDS

1.1. As a member of the Association of British Insurers (the 'ABI'), Prudential was expected to follow its guidance on best practice in relation to Annuity sales.

1.2. The ABI's "Good Practice Guide: Improving customers' retirement experiences" was published in July 2008. It repeatedly stressed the importance of providing adequate information to customers in relation to Enhanced Annuities and the Open Market Option.

i) Under a heading marked 'Principle', it encouraged providers to "[d]raw the customer's attention to product features and terms and conditions that may significantly affect benefits."

ii) Under 'Good Practice' in relation to this principle the guidance states that "[i]n quoting all available options draw the customer's attention in good time to particular options that may be to their advantage."

iii) Finally, under possible approaches for this same principle, the guidance states, that "Regardless of whether the information is provided to the customer or IFA, draw attention to options, for example: – the Open Market Option".

iv) It also lists "Enhanced/impaired" as an Annuity option to be explained to the customer.

v) It advises insurers to cover both topics in their wake-up packs and follow-up packs.

1.3. The Good Practice Guide also provides a template cover letter for insurers to use in their packs which included the following headline message, which had to be prominently displayed in exact wording at the top of the letter:

i) "Please read this letter carefully. By shopping around you may improve the income you receive in retirement."

1.4. In the body of the cover letters, insurers were encouraged to use or adapt the suggested wording to be used to cover Enhanced Annuities and the Open Market Option.

1.5. The suggested wording in relation to Enhanced Annuities was:

Do you have a recognised medical condition? Are you a smoker?

If so, you may be able to buy an annuity that pays more because of these factors. They are known as 'enhanced' or 'impaired' annuities

1.6. The suggested wording in relation to the Open Market Option was:

Shopping around – buying an annuity

An annuity is a retirement income product whereby you use some or all of the money in your pension fund to provide you with an annual income in retirement. It is the most popular way in which people ensure they have enough to live on for the rest of their lives. If you have built up several pension funds with separate pension companies, you can usually combine them when buying an annuity.

You do not have to buy an annuity from us. The Open Market Option (OMO) is your right to compare what we can offer you with what other pension companies can provide. If you move to another provider you might get a higher income. This is not always the case, but it is always worth checking before you buy. Once you know what type of annuity interests you, you can then compare the varying levels of income offered by other pension companies. A financial adviser can help you with this.

You can also use the Financial Services Authority's free online annuity tables - www.fsa.gov.uk/tables. See page 8 of the attached booklet for more details.

1.7. The guide also encouragers insurers to ensure that the cover letter sent in the wake-up pack to the customer "inform[s] the customer that a better alternative to their own product(s) may be available under the Open Market Option".

1.8. In January 2011, the ABI published a 'Best Practice Guide for the Retirement Process'. The guide was intended to "help pension providers ensure their communications approaching retirement help customers to make the necessary decisions about their retirement income, and encourage shopping around for the most appropriate and competitive retirement income product." It expanded on the principles and rules set down in the 2008 Good Practice Guide.

1.9. Its guidance included that 'Providers should encourage the customer to shop around for the most appropriate and competitive retirement income product'. In relation to both Wake-up packs and Follow-up packs, these should:

- *"prominently highlight the benefits of shopping around and that different providers might offer a higher level of retirement income*
- *explain the range of annuity options and products available and their impact on retirement income, including the possibility of medical conditions or lifestyle choices leading to a higher level of retirement income through an enhanced annuity*
- *highlight that the provider might not offer the annuity options or product that best meets the customer's needs*
- *encourage the customer to seek further advice and information about how to shop around (see useful links)*
- *explain to the customers how to shop around (see useful links)"*

1.10. It also contained template material which required providers to include in cover letters the following mandatory, prominent wording:

> *Please read this letter. This letter contains important information on how to make the most of your pension savings. It's in your interest to read this letter and shop around - you may improve the income you receive in retirement.*
>
> *[...]*
>
> *Do you have a recognised medical condition? Are you a smoker?*
>
> *If so, you may be able to buy an annuity that pays more because of this. These options are known as an 'enhanced' or 'impaired' annuity.*

1.11. In September 2011, the ABI announced its intention to introduce a mandatory Code of Conduct on Retirement Choices (the 'ABI Code'). A consultation document and draft version of the ABI Code was published in December 2011 and the final version of the ABI Code was published in March 2012. It came into force in March 2013. The aim of the ABI Code was to reduce the proportion of people who "do not shop around for an annuity when they reach retirement and, as a result, may be missing out on a higher income, potentially losing thousands of pounds over the course of their retirement."

1.12. The ABI Code applied "in addition to any legislative or regulatory requirements that may also be relevant." It codified and extended existing industry standards of good practice. The ABI Code applied "wherever an ABI member is communicating directly with a new or existing customer who can buy a lifetime annuity."

1.13. The ABI Code is a mixture of general principles and obligations and specific rules about communications and the sales process. In terms of general principles and obligations, the ABI Code states that:

i) *"The primary purpose of all customer communications is to help the customer understand the decisions he or she must make, and to support him or her through the retirement process";*

ii) *"The provider must highlight the possibility of joint, escalating and enhanced annuities"*; and

iii) "The provider must encourage the customer to gather comparative quotations from different providers. In order to do this, the provider must clearly explain how this can be done, provide all the information needed and must not sell any product by relying on the customer's inertia or ignorance."

1.14. In terms of specific rules, the ABI Code:

i) Introduced or added to requirements for members' written communications which:

(1) Required greater contact with customers in the years prior to their anticipated retirement;

(2) Added to the required content of wake-up packs and follow-up packs;

(3) Gave greater prominence and clarity to the customer's options, including to shop around or seek an Enhanced Annuity.

ii) Prohibited members' wake-up packs and follow-up packs from:

(1) Allowing a customer to purchase an annuity from the provider without first contacting that provider;

(2) Including an annuity application form unless specifically requested by the customer.

iii) Required any unrequested quotations included in members' wake-up packs or follow-up packs:

(1) To "clearly and prominently state that the customer may be able to obtain a higher rate by shopping around"; and

(2) To include a prominent reference to the option of seeking an Enhanced Annuity if no enhanced rate is included with the quote.

iv) Introduced a mandatory process that providers had to complete before being able to complete any sale. This process included:

(1) Obtaining responses from the customer (orally, digitally or in writing) to 5 key questions, one of which was whether "they have any lifestyle or medical conditions that may mean they are eligible for an enhanced annuity";

(2) Explaining any risks that arise from the customer's responses to these questions;

(3) Highlighting to the customer the benefits of shopping around;

(4) Sending the customer a 'personalised illustration' based on their responses;

(5) Allowing the customer to make an annuity purchase.

ANNEX D

REGULATORY GUIDANCE

1. During the Relevant Period, the Authority made several interventions emphasising or clarifying aspects of the regulatory regime, as did the Pensions Regulator, which has some analogous responsibilities.

THE AUTHORITY

2. The Authority's Financial Risk Outlook 2008 included the following warning:

The decline in traditional retirement savings and competition from alternative suppliers such as fund supermarkets and wrap providers, and other alternative methods of providing a retirement income, pose a threat to the levels of new and existing business for life insurers. This is a particular challenge for firms with shrinking with-profits funds, where pressures to reduce costs may affect standards of customer service. Insurers seeking alternative sources of new business, while continuing to manage their existing business, need to ensure they do so in a way that treats their existing customers fairly.

3. In 2008 the Authority published a statement titled 'Results of the FSA's thematic work on Open Market Options under maturing personal pension and stakeholder pension schemes'. In the statement, the FSA listed examples of poor practice related to Enhanced Annuities and the Open Market Option that it had uncovered as part of its research:

i) Not explaining the advantages of exercising the OMO.

Several firms stopped short of actually explaining that exercising an OMO can result in a higher pension. Other firms explained the OMO as where 'you can get another firm to pay the pension' which in itself does not suggest any advantage to the customer. To comply with our rules, and with Principles 6 and 7, firms' literature should include a clear message that exercising the open market option might result in a higher pension and is therefore worth investigating. The wording firms use should also have regard to the realistic possibility of whether their customer base is likely to be able to shop around, for example most firms impose minimum fund sizes for taking OMO business of say £10,000 or £20,000.

Very few firms mentioned the advantages of shopping around for customers with health problems, who could be better off buying an annuity from providers offering impaired life or enhanced rate annuities.

ii) *Prominence of information.*

Generally, the OMO itself was given sufficient prominence in firms' material, but in some cases it was hardly mentioned or left until late in the wake up letter, with the main focus on the firm's own annuity products. Care needs to be exercised to ensure that the OMO is given proper prominence and that there is an appropriate balance between the information provided on the OMO and on the firm's own annuity products.

iii) *Mixing up the best type of annuity with the best rate.*

Too many companies blurred these issues into one, to make statements such as 'no one insurance company can provide all different types of annuity and there is no best type that suits all'. Another firm said 'there is no such thing as the best rate'. Both these statements are misleading. There are different types of annuity and while no one type will suit all, once a policyholder has decided on the right 'type' for them, there are different rates available. Firms' literature should make it clear that policyholders have the option of shopping around and that by doing so they could get a better rate.

4. It also listed examples of best practice, including:

   i) *Option of buying an annuity from the existing provider or shopping around using the OMO for a higher income, making it clear that other firms may offer better annuity rates.*

5. In February 2014, the Authority published a review called "Pension Annuities: A review of consumer behaviour." Its purpose was to review the available literature on consumer behaviour and outcomes in relation to annuities. It was mostly based on consumer research from before the ABI Code. The review fed into the Authority's subsequent thematic report. Although not always the case, the review suggested that in many cases not shopping around was problematic and was leading to poor outcomes for customers.

6. In February 2014, the Authority published the report of a thematic review - "TR14/2: Thematic Review of Annuities". The review estimated "that overall 80%

of those purchasing an annuity from their existing pension provider would benefit from shopping around and switching." It also raised a concern that "[c]onsumer inertia plays a significant role and some providers may be benefitting from this through the expected profitability of the annuities they sell to their existing customers."

7. The review also signalled that the Authority intended to conduct further work in the area of annuity sales practices, both in terms of how the market itself operates, and what information firms provide to their existing customers. It stated:

We would be concerned if insurers used sales techniques that were designed to retain customers by putting them off shopping around. The supervisory element of the market study will look in detail at a sample of pension providers' selling practices, including any retention strategies they may have, which will consider whether the best interests of customers are appropriately prioritised within these strategies.

OTHER GUIDANCE

8. The Pensions Regulator regulates work-based schemes, so its guidance did not apply to Relevant Sales. However, the issues it deals with are analogous and it is therefore illustrative of what was regarded as good practice for dealing with customers approaching retirement.

9. In October 2009, the Pensions Regulator released a substantial report on the provision of information to customers approaching retirement who are part of a trust-based pension scheme. It identified examples of good practice that included:

(1) *"Explaining the OMO in a clear, fair and positive manner, making clear the potential benefits of investigating the OMO";* and

(2) *"Simple health lifestyle screening questions that may lead to full questionnaire".*

10. In November 2010, the Pensions Regulator released its own informational brochure for work-based scheme members. This, like the Authority's factsheet, dealt with the Open Market Option clearly and prominently. It included the following advice:

It is particularly important to shop around:

• to find out if the annuity offered by your scheme is competitive;

• if you are in poor health as this may mean you can get a higher annuity; and

• if your lifestyle may qualify you for a higher annuity, for example, if you smoke or do a particular type of job.

11. It also stated:

Even if you have been very happy with your pension scheme up to now, consider the open-market option to check that it is offering the best deal for you when you come to retire. Remember, if you do nothing, you may not get the best annuity