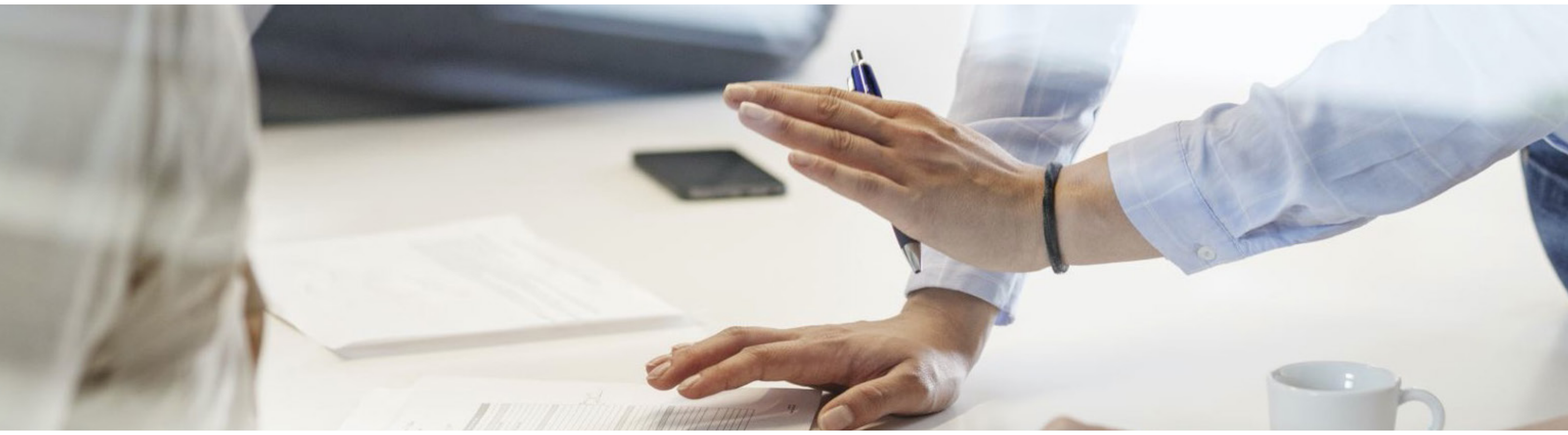
Current Issues in Redress

Quarter 2 2022



Market update

Redress in relation to unsuitable defined benefit transfer is calculated as the difference between the current value of the proceeds of the transfer and the cost of providing the relinquished defined benefit pension. Movements in redress are therefore very dependent upon the performance of the personal pension but are also affected by the value placed on the defined benefit pension.

The value placed on defined benefit pensions has fallen over the quarter, particularly for older Investors. Depending on asset performance, this is likely to mean that redress has fallen over the quarter.

The graph below shows how redress for a typical British Steel member with an assumed pension of £10,000 pa might have developed over time* if the funds were invested in the FTSE UK Private Investors Income Total Return Index.

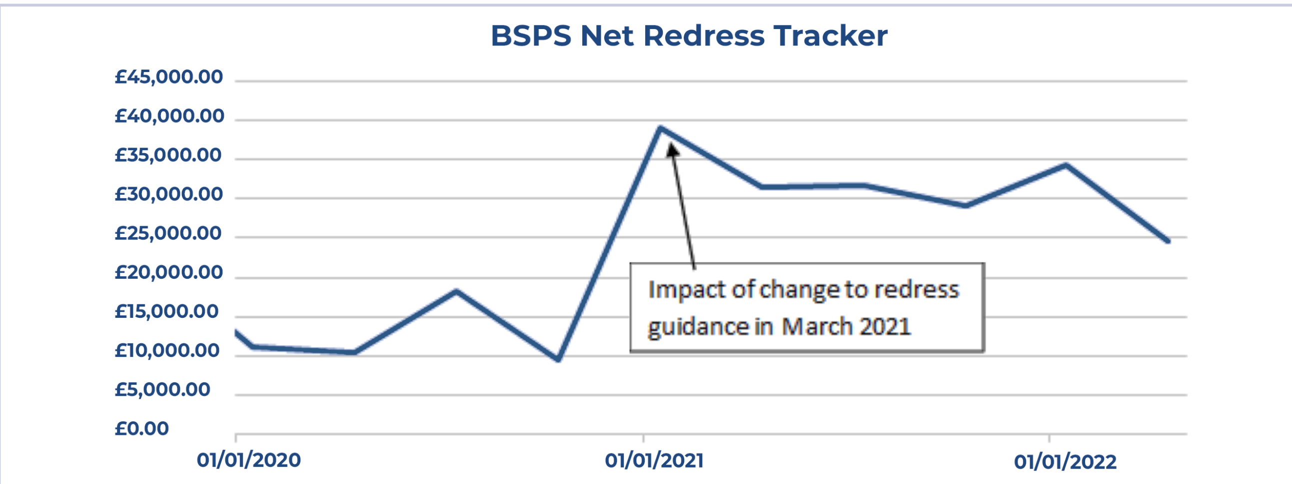
Indicative change in the value placed on defined benefit (DB) pension

2%-9%*

Change in the FTSE UK Private Investors Income Total Return Index

2%

Depending on age and benefit structure



**Modelling is based on an example member born in 1967 with pension of £10,000 at date of transfer in January 2018, for whom 50% of pension was accrued prior to April 1997. Net redress is assumed to be 16% of the transfer value implemented as set out in the FCA document CP22/6.*

British Steel Consumer Redress Scheme

On 31 March 2022, the FCA published proposals for a consumer redress scheme for individuals who were advised to transfer out of the British Steel Pension Scheme (BSPS). The consultation period will run to 30 June 2022.

The FCA anticipate that the redress scheme will be implemented by early 2023 and that compensation payments will be paid from late 2023 onwards.

The proposals allow for the scheme to cover individuals who transferred out between 26 May 2016 and 29 March 2018. This is a longer period than was anticipated when the FCA initially announced their plans to consult on the redress scheme – and importantly it now covers transfer values paid on the less generous terms which were available from the British Steel Pension Scheme prior to March 2017.

Analysis by OAC suggests that losses for transfer values paid from the BSPS in late 2016 / early 2017 are around twice the losses incurred where the transfer was implemented later in 2017. This means that the wider window for advice that is now proposed could result in a substantial step up in the redress paid under the scheme – both because more individuals will fall within its remit, and because the average redress for those individuals will be relatively high. Under the FCA's proposals, complaints to the Financial Ombudsman Service (FOS) made before the implementation of the redress scheme will be processed outside of the scheme.

The FCA also propose that where advice was given by a firm that is now insolvent, the redress will be calculated by the Financial Services Compensation Scheme (FSCS) using the methodology prescribed in the redress scheme rules.

The FCA indicate that compensation payments calculated under the redress scheme will be determined in line with the revised version of redress guidance FG17/9, on which the FCA will consult during July 2022. This may mean that factors that impact materially on BSPS calculations (in particular the CPI inflation assumption, and the way in which early retirement is reflected in redress calculations) are given extra attention during the review process.

The FCA are looking into the possibility of developing a calculator which can be used by firms to calculate redress. This would have benefits in terms of consistency of approach – particularly given the complex benefit structure of the BSPS - and would expedite the redress calculation process.

Asset retention requirement for firms which advised British Steel Pension Scheme members

On 25 April 2022 the FCA issued their Policy Statement PS22/4 which outlines restrictions on the use of funds by firms who have provided transfer advice in relation to the British Steel Pension Scheme.

The intention of the rules are to ensure that advising firms are able to meet their liabilities under the consumer redress scheme.

For firms that are in scope, a Financial Resilience Assessment calculation will need to be carried out before transactions which are not deemed to be "in the ordinary course of business" are enacted.

The assessment assumes that 46% of transfers effected were based on unsuitable advice and an average redress payment of 16% of the transfer value effected.

Change to redress guidance FG17/9

The FCA have published revised pre and post retirement Consumer Prince Index (CPI) assumptions. These are required to ensure that the CPI assumptions adopted in redress calculations are consistent with the harmonisation of RPI and CPIH (the Consumer Prices Index include owner occupied housing costs) from 2030.

It is worth noting that the revised version of the guidance includes a new clause specifying that when calculating redress, consideration should be given to relevant determinations made by FOS. It is unclear to what extent firms are required to investigate previous FOS decisions and how directly any decisions are expected to be extrapolated into redress methodology given that the circumstances of any one case will be unique.

Spring Statement

On 23 March 2022 the Chancellor of the Exchequer presented his Spring Statement. As part of this he announced a proposed reduction in the basic rate of income tax from 20% to 19% from 2024.

Where redress is paid by means of a lump sum payment to the investor, an adjustment is made to the compensation payment to reflect the presumed tax which would be incurred on payments out of their pension plan.

A reduction in basic rate tax would, all other things being equal, lead to a small increase in redress for cases where the investor is assumed to be a basic rate tax payer.

As the proposal has not been legally implemented OAC consider that making allowance for the lower tax rate would be premature at the current time. However, it will be interesting to see how this develops – and in particular whether FOS start to reflect the proposal in their determinations.

FCA Pensions Advice Checker

On 21 April 2022 the FCA issued an updated version of their pensions transfer advice checker, which provides consumers with a series of questions to assess whether they may wish to make a complaint about the advice they have received.

Claims Manager Fees

Rules came into effect on 1 March 2022, limiting the amount of fees that Claims Management Companies (CMCs) can charge their customers. The caps restrict the charges to 15%-30% of the redress received by the investor. The maximum fee that can now be incurred is £10,000. CMCs will also be required to disclose key information to consumers before entering a contract, such as how fees will be calculated and that they are able to make a complaint directly to FOS or the FSCS without incurring fees.

What does a high inflation environment mean for redress calculations?

Increases to the cost of living are hitting the headlines at the moment, with inflation at its highest rate for 30 years.

With pension scheme benefits usually linked to inflation, what does this mean for redress? Will higher inflation mean an increase in the value placed on defined benefit pensions and thus an increase in redress?

In general, as can be seen from the market update chart, the effect is not as marked as one might expect with redress actually having decreased slightly in many cases over the last 12 months.

There are two key, interlinked reasons for this:

1. Redress considers long-term inflation – e.g. over the next 20-30 years or so. Inflation is currently spiking, but market forecasts suggest this is a relatively short-term effect, with inflation falling back to lower levels in the medium to long term.

2. Pension increases are capped in most occupational pension schemes, typically at 5% per annum. So even short-term spikes taking inflation above 5% won't be fully reflected in pension increases.

A key caveat to this is the effect of an inflationary environment on asset values. "Real" investments might be expected to keep pace with inflation, but fixed interest investments could suffer.

For more information

Sarah Abraham

Head of Redress Solutions

020 7278 9500

sarah.abraham@oacplc.com