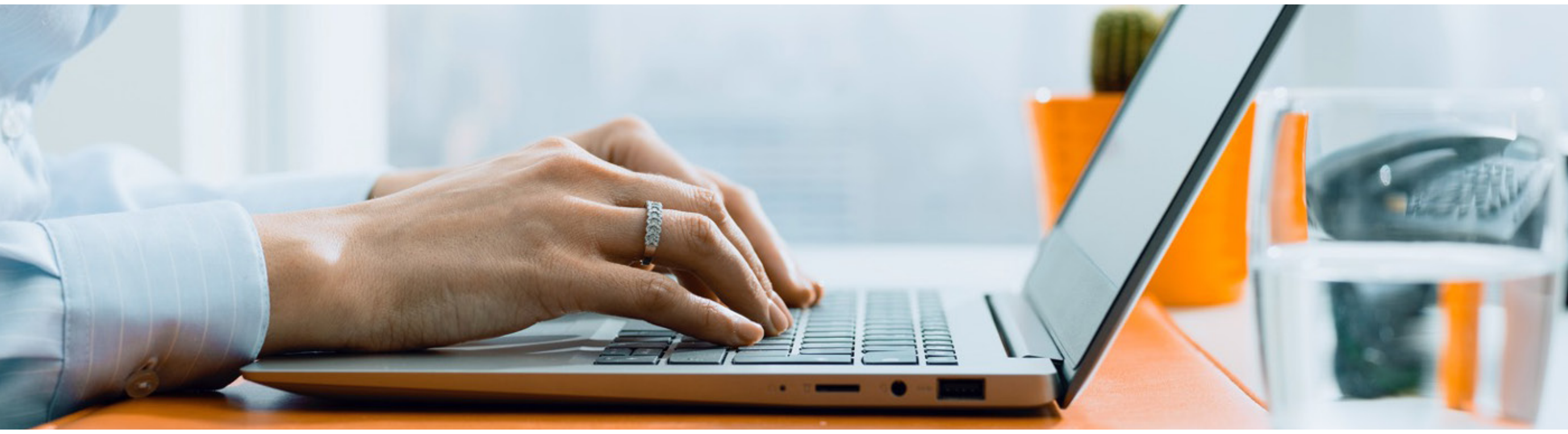
Current Issues in Redress

Quarter 3 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 not only 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 significantly since April 2022, particularly for younger Investors. This reflects rising yields on government bonds and a small reduction in expected future inflation. It is likely that in most cases redress will have fallen substantially 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*. This shows the marked fall in redress since April 2022.

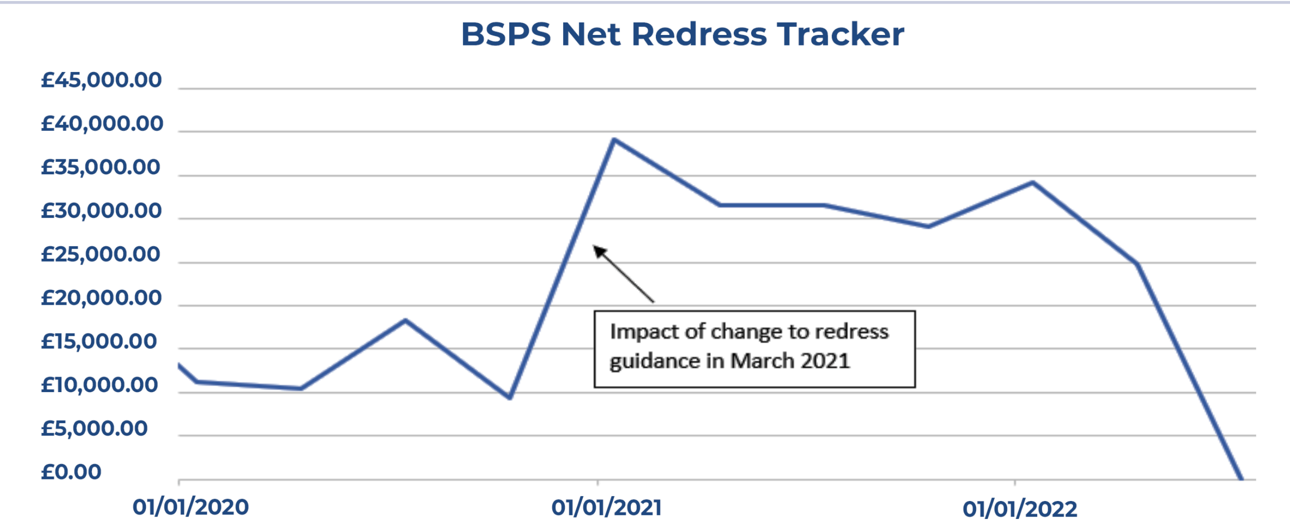
Indicative change in the value placed on defined benefit (DB) pension

7%-30%*

Change in the FTSE UK Private Investors Income Total Return Index

4%

**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

The consultation period on the British Steel Consumer Redress Scheme ended on 30 June and the FCA invited 300 advice firms to a roundtable in late June to gather opinions on the scheme. The exact form of the Redress Scheme is expected to be detailed in autumn or winter 2022, and from a redress perspective the plans are expected to reflect the outcome of the FCA's review of redress guidance FG17/9 scheduled for the summer.

For more of OAC's insight into the consumer redress scheme see Sarah Abraham's article in FT Adviser: **Implications of the British Steel consumer redress scheme - FTAdviser.com**

Fiscal Drag

"Fiscal drag" is where income grows faster than the increases in tax bands, thus increasing tax revenues without increasing tax rates. We can see this in the UK where, according to the Institute for Fiscal Studies, fewer than 4% of the adult population were higher-rate taxpayers in 1990 but almost 9% were higher-rate taxpayers by 2020.

Expected high pay rises in the medium term, reflecting high inflation, could exacerbate this trend unless income tax bands increase in line.

Redress (when paid as a lump sum) is reduced to reflect the expected tax rate of the individual during retirement. So more retirees in, or expected to be in, the 40% band means lower redress payments. In individual cases, it's worth reviewing the assumption that the individual will be a nil or basic rate tax payer, or whether a higher rate is more appropriate.

Lifetime Allowance

Fiscal drag is also an issue for the Lifetime Allowance.

The current intention is that the LTA will remain at its current level until 2026 and is then generally expected to increase in line with Consumer Price Index inflation. Thus, more individuals are likely to be caught by the LTA, with redress for affected cases increased to compensate.

Discretionary Pension Increases

The benefit structure of most private sector occupational pension schemes is such that caps apply on defined benefit pensions when inflation rises above a certain level, typically 5% pa or 2.5% pa. These caps generally have the largest impact for pensions in payment because of the way that they are applied.

With price inflation reaching record highs, some groups are calling for schemes to grant discretionary pension increases to prevent pensioners from being disproportionately affected by the cost of living.

Most scheme rules do include provisions for such increases. However, unless the sponsoring employer is explicitly funding discretionary increases via their regular contributions it is not generally possible to apply them unless doing so would not impact on the security of members' benefits.

From a redress perspective understanding whether discretionary pension increases will be granted is important. This is because if the transfer out had not occurred the investor would have received the discretionary increase. The value of the lost pension increase should therefore be redressed alongside the value of guaranteed pension increases.

A view is therefore needed on whether discretionary increases may been paid in the future. It might be possible to obtain from the occupational scheme the Trustees' policy on discretionary increases but this may not be practical in all scenarios (not least because the occupational scheme may not be willing to share its proposed treatment until it is implemented). Therefore, judgement is needed as to whether a discretionary increase could be granted. This might include consideration of the funding position of the scheme and the precedent for paying such increases. This process could, for some cases, lead to increases in the time taken to provide redress and the cost of calculating the redress.

Restrictions on claims managers with connections to advising firms

The FCA issued policy statement PS22/6 on 7 June, setting out restrictions on claims management companies (CMCs) which take effect on 7 July. The rules prevent CMCs from activity in relation to claims or potential claims against the Financial Services Compensation Scheme under certain circumstances, where the CMC has connections to the claim. The statement follows from last year's consultation on such "phoenixing". The FCA have established that around 7% of regulated CMCs have connections to advising firms.

FSCS commentary on the future of financial services compensation

In May, the Financial Services Compensation Scheme (FSCS) issued a paper entitled "The balancing act of compensation - Data and insight from FSCS to support discussion on the future of financial services compensation in the UK". Within the paper, the FSCS call for a review of the compensation cap for claims settled by them to be raised for claims relating to pensions advice, noting the current discrepancy with the cap applied by the Financial Ombudsman Service of £375,000 from 1 April 2022. It flags the potential for investors to have suffered significant losses in relation to pension transfers – particularly where the funds were invested in high-risk asset classes which may have suffered significant losses.

The paper also sets out the FSCS's concerns about the activities of non-regulated funds and unauthorised introducers as well as touching on the funding framework for the FSCS acknowledging industry concerns about how the levy is set for different classes of firm.

For more information

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