Current Issues in Redress

Quarter 4 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 pension has typically increased for younger investors over the quarter, potentially by as much as 10%. This reflects that the impact of rising yields on government bonds will have been offset by high levels of current inflation and increases to expected future inflation.

For investors who have already reached retirement age, the value placed on the defined benefit pension is likely to have fallen by around 8% due to rising yields on government bonds. Redress for these investors is typically not highly sensitive to short term inflation so there is a more muted offsetting effect compared to younger investors.

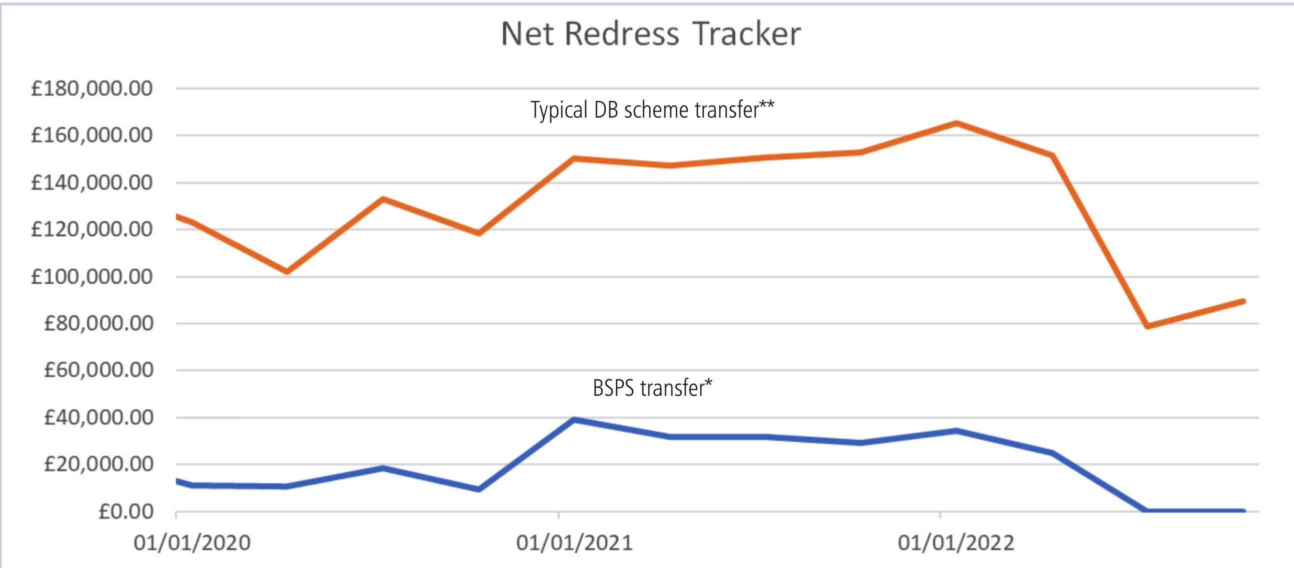
Indicative change in the value placed on defined benefit (DB) pension*

8% fall to 10% increase depending on age of Investor

Change in the FTSE UK Private Investors Income Total Return Index

1%

Depending on age and benefit structure



**Modelling is based on an example BSPS 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.*

*** Modelling is based on an example individual born in 1967 and allows for the estimated redress applying for a comparable BSPS member to be adjusted to remove scheme specific features of the BSPS, in particular, the changes in BSPS benefit structure implemented on transition to the BSPS2.*

FCA consultation on calculating redress for non-compliant pension transfer advice

On 2 August, the FCA published consultation document CP22/15 setting out proposed changes to their guidance for calculating redress in relation to DB transfer. The consultation ended on 27 September and OAC expect new guidance to be released in the first half of 2023.

The key changes proposed are a consolidation of the redress guidance into the FCA Handbook, and for the mechanism for paying redress to be altered such that as much as possible is paid as top up to the defined contribution pension. In practice the latter will be restricted by Annual Allowance and Lifetime Allowance considerations.

Although some changes are proposed to the way in which redress assumptions are set, these are not expected to materially affect the magnitude of redress when considered over a book of business.

Transitional arrangements for new redress guidance

The FCA have confirmed that consumers should be given the option to defer receiving their compensation offer whilst the review of redress guidance is ongoing. This means that advising firms will need to confirm with investors whether they would like their calculation performed under the existing redress guidance FG17/9 before commissioning the redress calculation.

The FCA have issued a suite of Frequently Asked Questions Defined benefit pension transfers redress calculations | FCA to help consumers understand the implications of the new guidance and decide whether or not to delay the settlement of their case.

For more information on CP22/15 please see our Alerts and our response to the consultation, both of which are available on our website.

State Pension (SERPS) adjustments

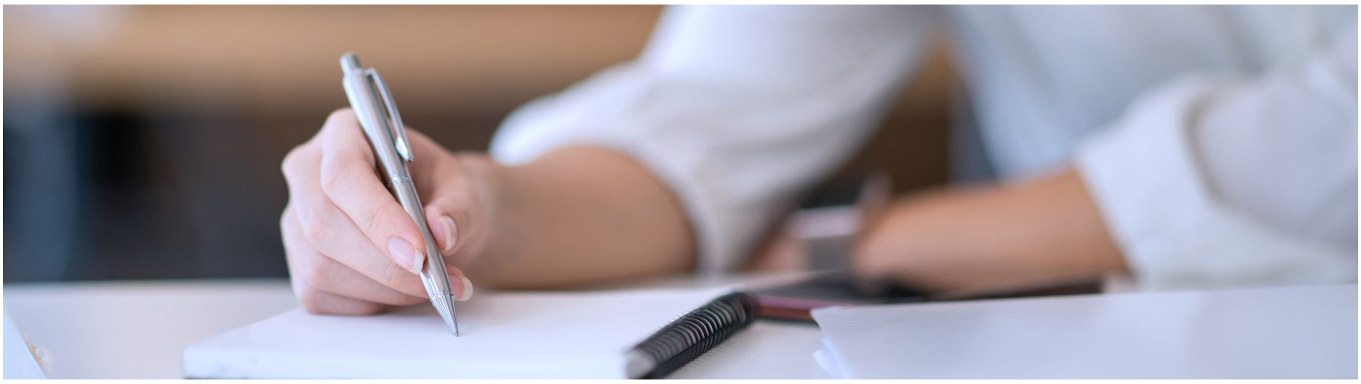
OAC have noted in the past the importance of making allowance for the 2016 changes to the state pension when determining SERPS adjustments in transfer loss assessments. This issue is specifically flagged in CP22/15 with the FCA confirming that the treatment of SERPS adjustments should be in line with OAC's current approach.

In particular:

- For transfers out effected after April 2016, no SERPS adjustment should be allowed for in the loss assessment.

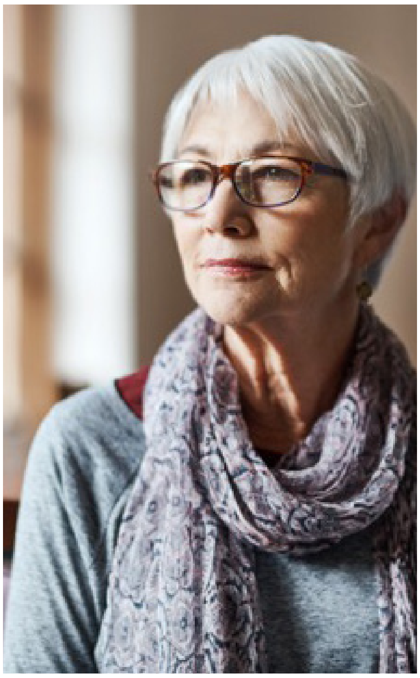
- When the investor reaches State Pension Age after April 2016, consideration should be given to the changes to the State Pension implemented at that time, meaning that the SERPS adjustment will normally be minimal for this cohort.

OAC note that decisions taken by the Financial Ombudsman often refer to SERPS adjustments and typically allow extra time before the accrual of interest for data gathering in relation to the State Pension. It will be interesting to see whether all future decisions will continue to incorporate this wording given the clarification now offered in CP22/15.



What is a SERPS adjustment?

SERPS stands for the “State Earnings Related Pension Scheme”. It was a portion of the State Pension which was abolished as part of the reform of the State Pension in April 2016. It was possible for defined benefit Pension Schemes to “contract out” of SERPS – and schemes that did this prior to 1997 were then required to pay a guaranteed minimum pension (GMP) in relation to contracted out service prior to April 1997.



The way that SERPS was calculated was complicated but importantly was, in some circumstances, affected by the GMP that the investor accrued in the defined benefit Scheme. The mechanics of the interaction of the state pension with the occupational scheme pension are complicated, but in simple terms, an investor might receive a higher state pension as a result of transferring out.

If this is the case, the value of the increase in the SERPS pension that arose as a result of the transfer out should be treated as a gain in the transfer redress calculation, thus reducing overall redress.

High inflation

The Institute and Faculty of Actuaries issued a Risk Alert on the impact of high inflation on actuarial practice. This includes the redress calculations we perform.

The Alert highlights that there are unusual challenges in allowing for inflation at a level not seen during most people’s working lifetimes and we have reviewed how we approach our calculations to ensure that the methodologies we use are appropriate.

FCA considering a review of drawdown strategies

The FCA has confirmed that it has begun to move away from defined benefit pension supervision and is at the “evidence-gathering stage” of a potential review of pension drawdown and decumulation strategies.

For more information

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