

SDA Response to CP22/15 - Calculating redress for non-compliant pension transfer advice

Q1: Do you agree that we should consolidate the pension transfer redress methodology as a new appendix in the Dispute Resolution: Complaints sourcebook covering pension transfer redress cases within the current scope of Finalised Guidance 17/9? If not, what alternative approach would you propose?

Yes, this is a reasonable approach to take.

Q2: Do you agree with our decision not to retain the Securities and Investments Board/Personal Investment Authority provisions specified in Table 1? If not, why do you think we should retain them?

The final entry in Table 1 states that all DB schemes provide index-linked increases; however, this is not true in the case of any service accrued pre-April 1997. There are still schemes that do not give any guaranteed increases in payment to this tranche of service but do still award discretionary increases. Therefore, we suggest that either the SIB/PIA provision is included, or else an alternative approach is introduced.

Q3: Do you agree with our proposal that firms should continue to calculate redress as the difference between the estimated value of the benefits given up in the defined benefit scheme and the current value of the consumer's defined contribution pension and pay that redress as a lump sum? If not, what alternative approach would you propose?

Yes we do.

Q4: Do you agree with the high-level description of the steps that we propose firms should take to calculate redress and with our proposal to no longer specify separate approaches for actual and prospective loss cases? If not, what alternative approach would you propose?

Yes we do.

Q5: Do you agree with our proposal that all valuations of benefits must be undertaken on a same date basis, referred to as the 'valuation date'?

Yes we do.

Q6: Do you agree with our proposal that firms should issue calculations within three months of the valuation date? If not, what timeframe would you propose for issuing calculations to consumers and why?

A 3-month window between Valuation Date and Issue date seems quite long; however some further clarification regarding the Calculation Date would be useful. If a firm begins its calculations on the 26th Jan for example but these aren't completed until the 15th Feb due to delays in obtaining some further information, does this mean that the Valuation Date needs to be changed to 1st Feb or would it stay at 1st Jan? And then what if the calculations aren't checked/signed-off until 3rd March? It would appear as if the Valuation Date would not need updating, unless an error was found in the calculations, and then they would need to be re-worked at 1st March. Is that correct?

Q7: Do you agree with our proposals for actuarial oversight of redress calculations? If not, what alternative approach would you propose?

Yes we do.

Q8: Do you agree with the information we have proposed that firms obtain to calculate redress? If not, what alternative approach would you propose?

Generally yes, but we think that asking about the consumer's expected retirement date would also be useful, especially for those who have carried on working past their NRA.

If a consumer's original DC fund has been transferred elsewhere, should attempts be made to get the fund value from the current provider, or could a notional fund value be used? And if the current charges being incurred are greater than those from the original DC investment, and the advice to churn funds came from a different advisor, should the DC charges be limited to those that would have been expected to apply in the original DC investment?

Q9: Do you agree with our proposed approach to requesting information from consumers, including what should happen if consumers do not respond to reasonable requests? If not, what alternative approach would you propose?

What happens if the consumer doesn't reply to an information request and so their case is calculated using appropriate assumptions, but then the consumer disputes those assumptions and subsequently provides the information that was originally requested (which may lead to higher redress). Does the firm have an obligation to recalculate or can they stand by the original offer on the basis that the client didn't respond within the required timeframe? The specific wording of the guidance will be important.

Q10: Do you agree that compensation should include losses outside the redress calculation methodology? If not, why not?

Yes we do.

Q11: Do you agree with our proposed approach to keeping the methodology under review? If not, do you have any other suggestions for how we could ensure the methodology and individual assumptions remain appropriate?

Yes we do.

Q12: Do you agree with our proposal that firms should update the economic assumptions they use for redress calculations no less frequently than the last working day of each month? If not, what frequency and timeframes would you propose for updating the economic assumptions and why?

We are unsure whether the move to monthly assumptions will prove beneficial, as often the time required to complete and check a set of calculations could take several weeks (due to a lack of info and/or staffing resources), which means firms run the risk of having to update their calculations to a new valuation date mid-calculation. See our response to Q6 above. Quarterly updates have generally worked well in the past.

Q13: Do you agree with our proposal to retain the 'UK instantaneous implied inflation forward curve (gilts)' for deriving retail price index inflation and our proposed changes to improve consistency of redress calculations? If not, which alternative approach would you propose?

Yes we do.

Q14: Do you agree with our proposed approach to setting an inflation risk premium? If not, what alternative approach would you propose?

Yes we do.

Q15: Do you agree with our proposal to introduce a formula-based approach to calculating the future differential between the retail price index and the consumer price index? If not, which alternative approach would you propose?

Yes we do.

Q16: Do you agree with our proposal to introduce an earnings inflation assumption? If so, do you agree it should be set at +1.0% above the consumer price index? If not, what alternative approach would you propose?

Yes we do, and that {CPI + 1.0%} is a reasonable assumption. We did wonder whether having a different assumption for public/private sector employees could be justified, given the restrictions that were introduced on public sector wage increases, but overall applying the same assumption for everyone is a sensible approach.

Q17: Do you agree with our proposed approach to pre-retirement pension increases? If not, what alternative approach would you propose?

Yes we do.

Q18: Do you agree with our approach to pension increases in payment, including the use of the Black-Scholes model? If not, what alternative approach would you propose?

Yes we do, and whilst the use of a Black-Scholes model does increase the complexity of the calculation this shouldn't be beyond most actuarial firms.

Q19: Do you agree that we should continue to retain the existing pre-retirement discount rate assumption consistent with a 50% return on equity? If not, what alternative approach would you propose?

Yes we do.

Q20: Do you agree with the proposed formula for calculating the pre-retirement discount rate? If not, what alternative approach would you propose?

Yes we do.

Q21: Do you agree with the proposed changes to the dividend yield, GDP growth and inflation elements used in the pre-retirement discount rate formula? If not, what alternative approach would you propose?

Yes we do.

Q22: Do you agree with our proposal not to make an allowance for lifestyling within the pre-retirement discount rate? If not, how do you think we should allow for lifestyling?

Yes we do.

Q23: Do you agree with our assessment that we do not need to specify an alternative pre-retirement discount rate for use where the consumer's investments are unlikely to achieve the proposed rate? If not, what alternative approach would you propose?

Yes we do.

Q24: Do you agree with our proposal to continue calculating the post-retirement discount rate by using the Bank of England gilt curve to derive gilt yields at the consumer's retirement date? If not, what alternative approach would you propose?

Yes we do.

Q25: Do you agree with our proposal to apply a 0.6% deduction to the post-retirement discount rate to allow for the margins built into annuity pricing? If not, what alternative approach would you propose?

Given that the implied adjustment varies according to whether the annuity is an increasing one or level, and the fact that nearly all scheme DB benefits would have had some form of guaranteed increase, we think that a flat-rate adjustment may be too simplistic. It could be worth stipulating a table with adjustments for 0%, 3% and 5% escalation, and then the actual adjustment is worked out by interpolation based on the actual scheme increase rate.

Q26: Do you agree that where a consumer has already retired, the consumer's term to retirement for annuitisation purposes will be zero and the post-retirement discount rate will be based only on the consumer's discounted mean term at the valuation date? If not, what alternative approach would you propose?

Yes we do, but could the table be extended to take into account ages 80 and 85 for the avoidance of doubt when extrapolating to later ages for those already retired?

Q27: Do you agree with our approach for allowing for the pension commencement lump sum? If not, what alternative approach would you propose?

On the whole yes, but we have noted that when carrying out Actual Loss FSAVC cases involving Public Sector schemes (ie. Those that pay an additional lump sum on retirement), the majority of members have elected to take additional TFC via commutation, in addition to their 3/80ths lump sum. Therefore, we question whether making no allowance for commutation in cases where schemes provide a separate lump sum at retirement is appropriate? Could this form part of the information gathering from the consumer?

Q28: Do you agree with our proposal to update the post retirement mortality basis with the PxA16 mortality tables? If not, what alternative basis would you suggest?

Yes we do.

Q29: Do you agree with our proposal that firms should allow for pre-retirement mortality? If not, what alternative approach would you suggest?

Yes we do.

Q30: Do you agree that we should move from a single assumption based on a constant probability of a consumer being married or in a civil partnership to a probability table based on term to retirement and current marital or civil partnership status? If not, what alternative approach would you propose?

Yes we do.

Q31: Do you agree that the approach to the spouse's age difference assumption remains appropriate? If not, what alternative approach would you propose?

Yes we do.

Q32: Do you agree with our proposal to introduce a 'rebuttable presumption' to ensure that firms make appropriate assumptions about when the consumer would have retired in their defined benefit scheme? If not, what alternative approach would you propose?

Yes we do, although as noted in our response to Q8 this is something that could be asked of the consumer directly, especially if they have continued working beyond their normal retirement age.

Q33: Do you agree with our proposal to allow for a reasonable level of product charges of 0.75% and ongoing adviser charges of 0.5%? If not, what alternative approach would you propose?

No we don't. We believe that more consideration should be given to the actual charges that are being incurred, especially if these are a (lower) fixed rate monthly fee rather than a percentage of FUM. Furthermore, we don't agree with allowing for ongoing adviser charges if the consumer currently isn't paying this.

Q34: Do you agree that redress should allow for initial advice charges when consumers are not currently in an advice arrangement or where their ongoing advice charges are above the reasonable level? If not, what alternative approach would you propose?

No, we don't believe that initial advice charges should necessarily be allowed for if the consumer is not already in an advice arrangement eg. if the consumer expresses a preference for the redress to be paid in cash. And instead of automatically increasing the redress amount in respect of initial advice charges, the firm could instead offer to pay for reasonable costs of advice if the consumer so wishes.

Q35: Do you agree with the proposed initial advice charge of 2.4% if a consumer needs to find a new adviser, with a minimum charge of £1,000 and maximum charge of £3,000? If not, what alternative approach would you propose?

No, because there's a danger that some consumers will just treat the additional sum as a cash bonus rather than seek advice. Instead, firms should offer to pay any initial advisor costs up to a reasonable maximum (which could be £3,000).

Q36: Do you agree with the default early and late retirement factors we have proposed? If not, what alternative approach would you propose?

Yes we do.

Q37: Do you agree with our approach to cash enhancement payments? If not, what alternative approach would you propose?

Yes we do.

Q38: Do you agree with our approach to valuing illiquid assets? If not, please suggest an alternative approach and the rationale for your suggestion. Are there any other circumstances when it is difficult to obtain defined contribution fund values?

Yes we do.

Q39: Do you agree with our approach to valuing liquid assets where an up-to-date defined contribution fund value is not available? If not, please suggest an alternative approach and the rationale for your suggestion. Are there any other circumstances when it is difficult to get DC valuations?

Yes we do. With regards to obtaining defined contribution fund values what should happen with regards to churned fund values (see our response to Q8)? Can we use notional fund values (ie. units held at date of transfer multiplied by current unit price, less an allowance for charges) rather than obtaining fund values from whichever firm now holds the original DC investment?

Q40: Do you agree with our clarification that a State Earnings Related Pension Scheme adjustment to the redress calculation is no longer needed for transfers occurring after 6 April 2016? If not, why not?

Yes we do, but we would appreciate some clearer guidance on how to calculate the SERPS adjustment for pre-April 2016 transfers/opt-outs. For example, while the DWP can give an indication on an individual's actual State Pension calculation, how should a firm determine what the notional State Pension would be if the transfer/opt-out hadn't occurred?

Q41: Do you agree that we should not propose a specific approach to Guaranteed Minimum Pension (GMP) equalisation? If not, how do you think GMP equalisation should be taken into account when undertaking redress calculations? Please consider materiality and consistency across the industry.

No, we think that a specific approach should be considered. One option is to calculate what the GMP amount at leaving would have been (and resulting Excess), had the individual been the opposite sex, and to then base the calculations on whichever method gives the higher revalued pension amount at retirement.

Q42: Do you agree that past payments should be increased from date of payment to the valuation date in line with Bank of England Base Rate over the period? If not, what alternative approach would you propose?

Given the very low levels of Base Rate over the past 10+ years it is likely that the amount of interest being added to past payments will be fairly immaterial. Given that investment returns over the same period have been significantly greater (as seen by the proposed index for FSAVC cases) we propose that a higher rate is used, to better reflect the spending power of those payments eg. rolling-up past payments at CPI.

Q43: Do you agree with our proposal that where a DB scheme has entered the Pension Protection Fund (PPF), redress should be calculated on the basis of the PPF benefits unless the firm knows that the scheme is shortly going to be secured outside of the PPF, resulting in members receiving higher benefits? If not, what alternative approach would you propose?

Yes we do.

Q44: Do you agree with our proposals to adopt the FTSE UK Private Growth Total Return Index for returns post 1 January 2005? If not, please could you indicate what alternative benchmark index should be used.

Yes we do.

Q45: Do you agree that firms should pay as much of the redress as possible directly into the consumer's defined contribution pension by augmentation? Do you also agree that payment should only be by cash lump sum where augmentation is likely to mean consumers incur a tax charge or where the consumer specifically requests that redress is provided in this way? If not, how do you think redress should be provided to consumers and why?

Yes we agree that augmentation should be into the consumer's DC pension where possible, and that payment in the form of a cash lump sum should only be made for tax reasons or if specifically requested (for appropriate reasons).

Q46: Do you agree with the factors that are likely to be relevant in judging whether augmentation would result in a consumer exceeding their annual or lifetime allowance? If not, which factors do you think are likely to be relevant?

Yes we do.

Q47: Do you agree with our proposal on how firms should allow for tax and means-tested state benefit entitlements on lump sum augmentation of redress payments? If not, what alternative approach would you propose?

Yes we do.

Q48: Do you agree with our proposal on how firms should allow for tax and means-tested state benefit entitlements on cash lump sum redress payments? If not, what alternative approach would you propose?

Yes we do. And presumably if someone is expected to be a higher-rate taxpayer in retirement the notional tax deduction should be at a higher rate?

Q49: Do you agree with our proposal that calculations should be valid for three months from date of issue to the consumer? If not, what alternative timeframe would you propose?

Yes we do, but note our response to Q6.

Q50: Do you agree that redress payments should be increased between the valuation date and the payment date using, as appropriate, the pre-retirement or post-retirement discount rate to compensate consumers for foregone investment returns? If not, what alternative approach would you propose?

Yes we do, although we note there is a discrepancy between this method and the proposed use of Bank Base Rates for rolling-up past payments (see our response to Q42).

Q51: Do you agree with the proposed content of the calculation explanation? If not, what information do you think consumers should be given to help them understand their calculation?

Yes we do, although there is a balance to be found between giving the consumer enough information to be able to understand the offer and overloading them with too much superfluous information. We would argue that stating what the level of future investment returns being assumed, along with details of assumed product charges compared to actual product charges, could be confusing for consumers.

Q52: Do you agree with the proposed wording for the warning when consumers receive redress as a cash lump sum? If not, what wording do you suggest would be more impactful for consumers?

Yes we do.

Q53: Do you agree that consumers should be encouraged to read their explanations carefully and that firms should be required to and set out clearly the process the consumer should follow if they have any questions, wish to challenge any of the information used in the calculation, or make a complaint?

Yes we do.

Q54: Do you agree that, subject to the differences set out in Chapter 8, the same redress calculation methodology should be used for British Steel cases as all other cases? If not, what alternative approach would you propose?

Yes we do.

Q55: Do you agree with our proposal to follow our general approach on the method of payment of redress for BSPS consumers? If not, what alternative approach would you propose?

Yes we do.

Q56: Do you agree that where the Pension Protection Fund is used as the comparator scheme, consumers should be redressed based on the upcoming Pension Insurance Corporation benefits when available? If not, what alternative approach would you propose?

Yes we do.

Q57: Do you agree that where consumers made an active selection of either the new British Steel Pension Scheme (BSPS2) or the Pension Protection Fund at the time of the transfer, the redress calculation should be based on the benefits of the selected scheme? If not, what alternative approach would you propose?

Yes we do.

Q58: Do you agree that where there is no evidence of consumers making an active selection of either the new British Steel Pension Scheme (BSPS2) or the Pension Protection Fund at the time of the transfer, firms should calculate what the redress would be for both and pay the higher amount to the consumer? If not, what alternative approach would you propose?

Yes, we believe this would be the fairest option.

Q59: Do you agree that where consumers have not made an active selection, firms should consider information from the time of the transfer advice to see if there is any evidence that demonstrates the consumer would have been more likely than not to have chosen one of the two schemes? If so, what evidence do you consider could help firms demonstrate this?

No, on the basis that it is unlikely that definitive evidence will be available to demonstrate which of the two options they would have chosen and brings an element of subjectivity which may mean that some consumers are treated differently to others.

Q60: Do you agree that if the firm cannot demonstrate with evidence which scheme the consumer would have chosen, the calculation should be based on the scheme that provides the higher redress to the consumer?

Yes we do.

Q61: Do you agree that where further information is needed for a redress calculation, firms should obtain the consumer's consent to request this from a third party?

Yes we do.

Q62: Do you agree that the calculation methodology for British Steel cases should use the same assumptions as the general approach? If not, what alternative approach would you propose?

Yes we do, although we again question the need to pay for initial advisor charges on the redress amount (as per our response to Q34).

Q63: Do you agree with the proposed redress calculation methodology for the British Steel redress scheme? If not, what alternative approach would you propose?

Yes we do.

Q64: Do you agree with our proposals for adjusting the redress payment to take account of the consumer's tax position and accumulated interest between the valuation date and payment date? If not, what alternative approach would you propose?

Yes we do.

Q65: Do you agree with our proposals for issuing redress determinations to consumers? If not, what alternative approach would you propose?

Yes we do.

Q66: Do you agree with our proposals for paying redress to consumers? If not, what alternative approach would you propose?

Yes we do.

Q67: Do you have any other comments on the stages of the process that firms must follow to calculate redress under the proposed British Steel redress scheme?

No we don't.

Q68: Do you agree that the calculator should significantly reduce or eliminate the need for actuarial input? If not, why not?

Yes we do, although this does come with a risk that consumers may lose out if the calculator is not used correctly or requires manual adjustment for 'non-standard' cases. Firms without actuarial input may just accept the results of the calculator without sense-checking or carrying out reasonableness tests.

Q69: Do you agree that the use of the calculator should be limited to firms, the Financial Services Compensation Scheme and the Financial Ombudsman?

Yes we do.

Q70: Do you agree that the use of the calculator should be mandatory? If not, why not?

Yes we do.

Q71: Is your firm interested in taking part in testing the redress calculator for the proposed British Steel redress scheme?

Yes, we would be very interested in testing the redress calculator. Our firm has been carrying out pension/FSAVC loss calculations for over 20 years now and has a deep understanding of what is required.

Q72: Do you have any other proposals on how to make redress calculations for the proposed British Steel redress scheme more consistent?

No we don't.

Q73: Do you have any other comments on the development of the calculator?

No we don't.

Q74: Do you agree with our estimates of the costs and benefits of our proposals?

On the whole, yes we do. But we agree that the need to schedule calculations in the first half of the month in order to try and avoid unnecessary assumption updates mid-calculation could be inconvenient for some firms.