Current Issues in Redress
Summer 2021

Update to Redress Guidance FG17/9

On 3 March 2021, the FCA announced that it would be issuing updated guidance on how to calculate redress for unsuitable Defined Benefit transfers. The updated guidance was published on 26 March 2021.

The amendment to the guidance introduces a change to the Consumer Prices Index (CPI) assumption. Until March 2021, FG17/9 required the CPI assumption to be 1% pa lower than the Retail Prices Index (RPI). The updated guidance allows for the difference between RPI and CPI to be reduced from the previous level of 1% pa. The new RPI-CPI differential is term dependent, with RPI and CPI being assumed to converge from 2030.

This change reflects the Government's announcement on 25 November 2020 that RPI will be harmonised from 2030 with CPIH (the Consumer Prices Index including owner occupiers' housing costs). Uncertainty over the future of RPI has previously been flagged by OAC as a potential risk to the appropriateness of the inflation assumptions in FG17/9.

The revised CPI assumption has been backdated, meaning that firms will need to revisit cases calculated after 1 January 2021 and establish whether the compensation was understated. If compensation is assessed to be too low then a top up payment will need to be provided to the consumer.

Overall, the impact of the guidance means that future redress payments will be higher, with the greatest impact being felt where investors are younger and where increases are linked to CPI once the pension is in payment. As the New British Steel Pension Scheme (BSPS2) offers CPI linked benefits in deferment and payment, redress for members of this scheme could increase materially under the updated guidance.

Similarly, redress for former members of public sector pension schemes could increase substantially. As the assumptions specified in FG17/9 are used when calculating redress for unsuitable advice in relation to FSAVCs, the updated guidance will also result in a material increase in compensation for public sector "Added Years" FSAVC loss calculations.

GMP equalisation

The most recent of the various judgements regarding the Lloyds Banking Group GMP equalisation issue relates to the treatment of individuals who have transferred out of the scheme. As with the other Lloyds hearings, the conclusion reached will apply equally to transfers out of other contracted-out Defined Benefit schemes.

The judge ruled that transfer values paid after 17 May 1990 should have reflected GMP equalisation. As such, where non equalised transfer values were paid, the ceding scheme retains a liability to provide a top up payment to the member.

At first sight this would appear to remove the requirement for redress calculations to reflect GMP equalisation – in other words, redress would be calculated on the basis that the scheme benefits would not be equalised, and the ceding scheme would pay the investor the difference in value between equalised and non-equalised benefits. Even if the ceding scheme has not proactively calculated a top-up payment for the investor– for example because they do not consider they have adequate data to do so - the investor could approach the scheme and rightfully request that they fulfil their legal obligation to top-up.

However, it is important to note that the ceding scheme is only obliged to pay the difference between the transfer value paid and that which would have been paid if it had reflected equalised benefits. This is not necessarily the same as the value that would be placed on the difference between equalised and non-equalised benefits under FG17/9. As such, consideration needs to be given as to whether redress should make allowance for GMP equalisation, particularly where the transfer out was some time ago.

Similarly, the judge concluded that in the case of non-statutory transfers, which include those paid within 12 months of retirement age, that there is no residual liability with the ceding scheme. As such, it will be necessary to consider GMP equalisation carefully in these cases.

Freezing of the LTA

In the March Budget, the Chancellor froze the Lifetime Allowance (LTA) at its current level of £1,073,100 for 5 years until 2025/2026. The LTA caps the maximum pension value that the investor can take before incurring the LTA tax charge. The freeze on the LTA clearly has an adverse effect on the financial circumstances of "high earners" with this generating some debate in the pensions industry. However, it also has less well documented implications for transfer loss assessment.

When advising high earners on pension transfers from defined benefits to personal pensions the adviser must take account of the impact of the transfer on the investor's LTA position. A defined pension is valued at 20 times the annual pension for LTA purposes. However, in recent years the value placed on defined benefit pension when they are transferred to a personal pension could be 30 (or more) times the annual pension. As a result, transferring out could push the investor over the LTA, or could mean that they are exposed to a substantially higher LTA tax charge than they otherwise would have been.

This raises questions as to how the potential LTA tax charge should be reflected in the redress calculation with judgement required as to how best to make allowance for it. Clients may need to determine the most appropriate approach for dealing with the LTA on a case by case basis.

The impact of the freezing of the LTA on an investor's tax position could also be considered when determining the appropriate redress for high earners who are being compensated for unsuitable advice relating to FSAVCs. Again, this requires judgement given the complexity and subjectivity of making allowance for LTA tax charges in these calculations.

Transfer value guidance from the FCA

Following consultation, the FCA published finalised guidance FG21/3 on 30 March, which aims to help firms give suitable advice on Defined Benefit transfers. The guidance is comprehensive and detailed although it largely reflects existing rules and legislation. It incorporates practical examples of good and poor practice. The guidance also encourages the use of its Defined Benefit Advice Assessment Tool, this being the FCA's preferred starting point for suitability reviews of historic transfer advice.

Given the difficulty in demonstrating suitable Defined Benefit transfer advice, it is unsurprising that (according to a report from Aegon and NextWealth, published on 22 March), 36% of firms who currently offer this service expect to significantly reduce the volume of such advice and that 9% expect to leave the market altogether. Whilst it is important that the FCA take steps to ensure high quality advice, the number of IFAs exiting the sector remains a concern for the financial services industry given the ongoing high demand for Defined Benefit transfer advice.

Unwinding of 2015 public sector pension scheme changes

Following consultation, the Government has confirmed that the deferred choice underpin approach will be adopted for rectifying the age discrimination associated with the 2015 public sector pension scheme changes. However, different arrangements will apply to the judicial pension scheme, with judges taking part in an "options exercise" in 2022.

Where the magnitude of redress is affected by the post 2015 benefit structure, it will be necessary to establish whether the legacy or reformed arrangement will be more generous. In some cases, this may require the use of subjective assumptions - in particular around the likely level of future salary growth – and expert help may be needed in setting such assumptions.

Other issues to watch out for:

- **Claims Manager Fees**
  In January 2021, the FCA published proposals to introduce a price cap on the fees that Claims Management Companies (CMCs) charge their customers. The caps would restrict the charges to 15%-30% of the redress received by the investor, with the higher cap applying where redress is over £50,000. This is a substantial drop from the current charges imposed by some CMCs which can, according to the FCA be more than 40% of the redress. The consultation on the proposals closed on 21 April 2021 with a policy statement due in the Autumn.
- **Consultation on pensions freedoms**
  The Work & Pensions Select Committee has commenced a call for evidence in relation to Pension Freedoms. This will inform their inquiry into the extent to which investors are "prepared and protected" as they start to draw on their pension savings.

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