Update to Redress Guidance FG17/9

March 2021

The assumptions used to calculate redress for unsuitable defined benefit transfers are set out in the FCA guidance document FG17/9. FG17/9 was issued in October 2017 following a consultation period earlier in 2017.

On 3 March 2021, the FCA announced that it would be updating FG17/9 in mid-March, without a consultation period. It also confirmed that any change to the guidance would be backdated to 25 November 2020 meaning that some completed calculations would need to be revisited.

The updated guidance was issued on 26 March 2021.

What's changed in the update to FG17/9 and what is the relevance of 25 November 2020?

The update to the guidance introduces a change to the CPI assumption. This is an important assumption for redress calculations because many defined benefit pensions increase in line with CPI and therefore the value placed on the lost pension will reflect future expectations of CPI.

Until March 2021, FG17/9 required the CPI assumption to be 1% pa lower than RPI.

However, on 25 November 2020, the Government confirmed its intention for the Retail Price Index (RPI) to be harmonised from 2030 with CPIH (the Consumer Prices Index including owner occupiers' housing costs).

This announcement followed a period of uncertainty about the future of RPI, commencing in September 2019 when Sajid Javid wrote to the Chair of the UK Statistics Authority to confirm that a consultation would be held on the timing for the harmonisation of the two indices.

How will the updated guidance affect the magnitude of redress?

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 allowed to converge from 2030.

For example, if an investor is aged 51 and is nine years away from retirement at age 60, the CPI assumption used until retirement age will remain 1% pa lower than RPI, reflecting that they will reach retirement before 2030. However, the post retirement CPI assumption will be the same as the post retirement RPI assumption.

Overall this means that compensation 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.

Which completed calculations will need to be revisited?

The new guidance is backdated to 25 November 2020, although in practice, calculations tend to be done with an effective date at a quarter end so the new guidance will generally apply only for calculations that were completed with an effective calculation date of 1 January 2021.

All defined benefit loss calculations carried out after 1 January 2021 will therefore need to be reviewed, and loss recalculated where there is exposure to the post 2030 CPI assumption. In practice, as Guaranteed Minimum Pension accrued after 5 April 1988 generally receives increases in payment in line with CPI (albeit capped at 3% pa), it is expected that a top up redress offer will be needed in many instances, even if this top up is relatively small compared to the original redress.

What next for redress guidance?

FG17/9 was due to be reviewed in 2021 and it seems reasonable to expect that this formal review process will be completed, despite the "quick fix" to the CPI assumption.

It is worth nothing that the FCA's approach of adopting a smaller RPI-CPI from 2030 differential implicitly assumes that market implied RPI correctly reflects expectations of RPI from that date. In other words, the FCA have taken the view that CPI should increase, rather than RPI reducing. This is favourable to the investor but could be considered unfair to firms who are liable to pay compensation.

In this context, it is relevant to note that there was no step fall in market implied RPI on the back of the 25 November announcement. This could be because the move to CPIH had already been reflected in markets (30 year RPI swaps had fallen by around 0.5% since September 2019) but it could also suggest that market implied RPI is not a good indicator for future RPI. Indeed, projected RPI over the period 2030 - 2035 remains relatively high at around 3.7% pa adding weight to the argument that market implied RPI is overstated. It is to be hoped that this might be given consideration in the formal review of FG17/9.

For more information

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