

Current Issues in Redress

Winter 2020

Winter 2020



GMP Equalisation

In October 2018, the High Court ruled that pension schemes were required to equalise benefits to reflect differences in GMP between males and females. Guidance from HMRC on the tax treatment of GMP equalisation was issued earlier this year and many Trustees are currently taking preliminary steps to implement GMP equalisation.

There were, however, various points which were not covered by the original High Court judgement. One such area of uncertainty is whether Trustees are required to revisit historic transfers from their schemes and, if necessary, provide top up payments to reflect equalised GMP. A High Court hearing was held to address this specific point during May, with conclusions now expected to be announced in Q4 2020.

This is an important consideration for transfer loss assessment as it determines whether the transferring scheme is liable for the GMP equalisation uplift, or whether the liability for GMP equalisation should be incorporated into the redress calculation.

For many people, GMP equalisation will have little impact on pension benefits. However, the impact of GMP equalisation depends on an investor's gender, service history, actual or assumed retirement age, and the benefit structure of their pension scheme. As such, some individuals could see a significant increase in their benefits as a result of GMP equalisation.

Redress is calculated as the difference between the value of lost defined benefits, and the value of the actual benefits arising from the transfer. This means that relatively small changes in defined benefits can materially impact the magnitude of redress. Therefore, if it is necessary to allow GMP equalisation in transfer loss assessment, redress for some cases may increase significantly. Clients should be mindful of the risk of increases to transfer redress in future, for certain categories of member.

Irrespective of the position reached in relation to transfers out, GMP equalisation should be reflected in opt out and non-joiner redress calculations.

Fair treatment of vulnerable customers

Following the consultation in July, finalised guidance relating to the treatment of vulnerable customers is expected later this year. The FCA's 2020 Financial Lives survey suggests that around 46% of adults in the UK display characteristics of vulnerability, and the Competition and Markets Authority has identified supporting vulnerable consumers as an essential part of their role.

The guidance, which applies to all financial products and services, is intended to improve outcomes for vulnerable customers such that they are as good as for other consumers. The guidance sets out practical steps that firms should take in order to embed fair treatment into their culture and processes, with implications on communications, product design and customer service. Many of these practical suggestions will be relevant for complaint handling as well as day to day operations.

The FCA is expecting material changes in practice on the back of the guidance. In order to protect themselves for future complaints, firms are encouraged to proactively take appropriate action, bearing in mind also that there is likely to have been an increase in the prevalence of vulnerability as a result of Covid-19.

Defined Benefit (DB) Pension Transfer Advice

The FCA has continued to focus on defined benefit (DB) pension transfer in recent months: releasing in June a package of measures designed to improve standards in advice in June; contacting 7,700 individuals who transferred out of the British Steel Pension Scheme; and carrying out a new round of data gathering from firms authorised to advise on DB transfer with feedback letters being issued in the late summer.

The FCA is clearly concerned about the risk to the consumer of DB transfer, exacerbated both by an asymmetry of information (with many individuals not fully understanding the fundamental change in risk arising on transfer to a defined contribution arrangement), and increased demand for access to funds. The latter is an ongoing issue given the impact that Covid-19 has had on many people's financial circumstances, not aided by the recent ruling on state pension age for women. It is therefore seeking to raise awareness of the risks associated with defined benefit transfer amongst both advisors and consumers.

The steps taken by the FCA will likely lead to an increase in complaints relating to historic transfers. Firms may find it helpful to review their existing book to understand their potential exposure. Further difficulty arises for firms in relation to the cost and access to professional indemnity (PI) insurance for transfer advice. PI insurers are likely to be more wary about taking on risk, and may introduce greater exclusions, increase costs or refuse cover. This, combined with the removal of contingent charging, which became effective on 1 October, is expected to lead to a number of firms exiting the DB transfer advice market.

A fall in supply of transfer advice would have repercussions for the pensions industry as a whole. Many UK pensions scheme sponsors are keen to offer their members an "at retirement" transfer option as part of liability management – and the flexibility to restructure retirement income is a key aspect of pensions freedoms. With consumers required to take advice before transferring out, a reduction in availability of advice may result in worse outcomes for both schemes and members.

Potential unwinding of 2015 public sector pension scheme changes (McCloud and Sargeant cases)

In July 2019 a ministerial statement was issued confirming that the discrimination identified in the McCloud hearing would be addressed for all public sector pension schemes. From a redress perspective, the main implications of the judgment are for opt out and non-joiner cases where the investor would not have been eligible for full transitional protection, or where an investor transitioned to the reformed scheme, left service and subsequently transferred out.

A consultation on how the discrimination could be rectified ran from July until October 2020 with the Government now analysing feedback. For most public sector schemes, two possible approaches have been put forward to correct age discrimination during a "remedy period" running from 1 April 2015 to 31 March 2022 (or early cessation of active service):

- Immediate choice whereby assessment of whether an individual would be better off in the legacy (Final Salary) or reformed (Career Average) arrangement would take place as soon as possible after March 2022, or earlier retirement.
- Deferred choice underpin in which there would be an underpin on benefits calculated at retirement whereby members would get the higher of the benefits accrued in their legacy or reformed arrangement.

In some cases the most beneficial arrangement will be easily identified (ie the immediate choice decision would align with the deferred choice underpin). This would mean that either of the proposed approaches would be relatively simple to reflect in loss assessment, both the legacy and reformed benefits being well understood. However, in some cases the position may need more thought and the assumptions adopted for the analysis (particularly salary growth) could introduce additional subjectivity. Furthermore, it may be some time before the proposals are finalised and legislation enacted to implement them, and there may therefore be a period of uncertainty during which a sensible approach to redress calculations will be needed.

Other issues to watch out for:

- **Potential changes to RPI** - FG17/9 specifies that redress calculations should reflect market derived RPI and an assumed RPI-CPI gap of 1% pa. Given the potential harmonisation of RPI with CPIH it may be appropriate to reconsider this methodology. In particular, once there is greater clarity over the future of RPI, clients may (depending on the outcome) consider adopting a more generous approach to setting the CPI assumption. The consultation on the reform to the RPI methodology closed on 21 August. The Government is now reviewing the feedback and it is expected that a response to the consultation will be issued in the Autumn.
- **Changes to pensions tax** - With ongoing debate over the way in which the economic impact of the pandemic might be mitigated, speculation about the future of pensions tax has again become a talking point. The most likely changes would be a reduction to higher rate tax relief and the removal of tax relief on the pensions commencement lump sum. The latter would have a potentially beneficial impact on the magnitude of redress, on the assumption that people will still draw cash benefits. However, if the longer term impact of the change was a reduction in the take up of cash commutation, and an improvement in terms offered by schemes, then this could lead to an increase in redress for private schemes in particular.

For more information

Sarah Abraham

Head of Redress Solutions

020 7278 9500

sarah.abraham@oacplc.com



Progress with confidence

OAC PLC, 141-142 Fenchurch Street, London, EC3M 6BL, United Kingdom
Registered in England | Company no. 4663795